

HALLADOR ENERGY CO  
Form 10-Q  
August 07, 2015

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D. C. 20549**

**FORM 10-Q**

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended: June 30, 2015

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number: 001-3473

“COAL KEEPS YOUR LIGHTS ON” “COAL KEEPS YOUR LIGHTS ON”

**HALLADOR ENERGY COMPANY**  
**(www.halladorenergy.com)**

Colorado 84-1014610

(State of incorporation) (IRS Employer Identification No.)

1660 Lincoln Street, Suite 2700, Denver, Colorado 80264-2701

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(Address of principal executive offices)

(Zip Code)

Issuer's telephone number: 303.839.5504

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☒

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "larger accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

☐ Large accelerated filer

☒ Accelerated filer

☐ Non-accelerated filer (do not check if a small reporting company)

☐ Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

As of August 5, 2015 we had 29,044,000 shares outstanding.

**PART I - FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****Consolidated Balance Sheet**

(in thousands)

|   | <b>June 30,<br/>2015</b> | <b>December<br/>31,<br/>2014</b> |
|---|--------------------------|----------------------------------|
| <b>ASSETS</b>                               |                          |                                  |
| Current assets:                             |                          |                                  |
| Cash and cash equivalents                   | \$ 16,489                | \$ 13,469                        |
| Marketable securities                       | 1,645                    | 1,656                            |
| Accounts receivable                         | 25,642                   | 27,297                           |
| Income tax receivable                       | 6,936                    | 5,791                            |
| Coal inventory                              | 15,952                   | 19,722                           |
| Parts and supply inventory                  | 14,008                   | 14,919                           |
| Other                                       | 1,315                    | 1,555                            |
| Total current assets                        | 81,987                   | 84,409                           |
| Coal properties, at cost:                   |                          |                                  |
| Land and mineral rights                     | 115,963                  | 116,025                          |
| Buildings and equipment                     | 344,442                  | 323,758                          |
| Mine development                            | 125,591                  | 124,435                          |
|   | 585,996                  | 564,218                          |
| Less - accumulated DD&A                     | (128,363)                | (106,608)                        |
|   | 457,633                  | 457,610                          |
| Investment in Savoy                         | 13,880                   | 13,896                           |
| Investment in Sunrise Energy                | 4,824                    | 4,821                            |
| Other assets (Note 5)                       | 17,304                   | 18,849                           |
|   | \$ 575,628               | \$ 579,585                       |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b> |                          |                                  |
| Current liabilities:                        |                          |                                  |
| Current portion bank debt                   | \$ 26,250                | \$ 21,875                        |
| Accounts payable and accrued liabilities    | 28,056                   | 28,105                           |
| Total current liabilities                   | 54,306                   | 49,980                           |
| Long-term liabilities:                      |                          |                                  |
| Bank debt                                   | 251,345                  | 284,470                          |
| Deferred income taxes                       | 46,897                   | 41,581                           |
| Asset retirement obligations                | 11,979                   | 12,074                           |
| Other                                       | 8,329                    | 1,605                            |
| Total long-term liabilities                 | 318,550                  | 339,730                          |
| Total liabilities                           | 372,856                  | 389,710                          |

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Commitments and contingencies

Stockholders' equity:

Preferred stock, \$.10 par value, 10,000 shares authorized; none issued

Common stock, \$.01 par value, 100,000 shares authorized; 29,044 and 28,962, shares outstanding, respectively

Additional paid-in capital

Retained earnings

Accumulated other comprehensive income

Total stockholders' equity

|           |           |
|-----------|-----------|
| 290       | 289       |
| 91,268    | 90,218    |
| 111,049   | 99,003    |
| 165       | 365       |
| 202,772   | 189,875   |
| \$575,628 | \$579,585 |

See accompanying notes.

**Consolidated Statement of Comprehensive Income**

(in thousands, except per share data)

|                                       | <b>Six Months Ended</b> |             | <b>Three Months Ended</b> |             |
|---------------------------------------|-------------------------|-------------|---------------------------|-------------|
|                                       | <b>June 30,</b>         |             | <b>June 30,</b>           |             |
|                                       | <b>2015</b>             | <b>2014</b> | <b>2015</b>               | <b>2014</b> |
| Revenue:                              |                         |             |                           |             |
| Coal sales                            | \$192,396               | \$69,146    | \$95,323                  | \$36,130    |
| Equity income (loss) – Savoy          | (17 )                   | 4,514       | (153 )                    | 2,135       |
| Equity income (loss) - Sunrise Energy | 3                       | 87          | (37 )                     | (2 )        |
| Other                                 | 872                     | 480         | 120                       | 197         |
|                                       | 193,254                 | 74,227      | 95,253                    | 38,460      |
| Costs and expenses:                   |                         |             |                           |             |
| Operating costs and expenses          | 134,432                 | 49,101      | 68,280                    | 26,096      |
| DD&A                                  | 22,108                  | 10,152      | 10,770                    | 5,193       |
| Coal exploration costs                | 1,200                   | 1,191       | 492                       | 526         |
| SG&A                                  | 6,424                   | 4,709       | 3,080                     | 2,738       |
| Interest                              | 8,779                   | 862         | 3,323                     | 397         |
|                                       | 172,943                 | 66,015      | 85,945                    | 34,950      |
| Income before income taxes            | 20,311                  | 8,212       | 9,308                     | 3,510       |
| Less income taxes:                    |                         |             |                           |             |
| Current                               | 551                     | 4,401       | (865 )                    | 3,169       |
| Deferred                              | 5,316                   | (2,783 )    | 3,320                     | (2,727 )    |
|                                       | 5,867                   | 1,618       | 2,455                     | 442         |
| Net income <sup>(1)</sup>             | \$14,444                | \$6,594     | \$6,853                   | \$3,068     |
| Net income per share: (Note 7)        |                         |             |                           |             |
| Basic and diluted                     | \$0.48                  | \$0.22      | \$0.23                    | \$0.10      |
| Weighted average shares outstanding:  |                         |             |                           |             |
| Basic and diluted                     | 28,993                  | 28,763      | 29,024                    | 28,770      |

<sup>(1)</sup> There is no material difference between net income and comprehensive income.

See accompanying notes.



**Consolidated Condensed Statement of Cash Flows**

For the six months ended June 30,

(in thousands)

|  | <b>2015</b> | <b>2014</b> |
|--|-------------|-------------|
| Operating activities:                          |             |             |
| Cash provided by operating activities          | \$57,810    | \$16,437    |
| Investing activities:                          |             |             |
| Capital expenditures for coal properties       | (23,039)    | (9,126 )    |
| Other  | (603 )      |             |
| Cash used in investing activities              | (23,642)    | (9,126 )    |
| Financing activities:                          |             |             |
| Dividends                                      | (2,398 )    | (2,394 )    |
| Payments on bank debt                          | (28,750)    |             |
| Other  |             | (120 )      |
| Cash used in financing activities              | (31,148)    | (2,514 )    |
| Increase in cash and cash equivalents          | 3,020       | 4,797       |
| Cash and cash equivalents, beginning of period | 13,469      | 16,228      |
| Cash and cash equivalents, end of period       | \$16,489    | \$21,025    |

See accompanying notes.

**.Consolidated Statement of Stockholders' Equity**

(in thousands)

|                                 | <b>Shares</b> | <b>Common<br/>Stock</b> | <b>Additional<br/>Paid-in<br/>Capital</b> | <b>Retained<br/>Earnings</b> | <b>AOCI*</b> | <b>Total</b> |
|---------------------------------|---------------|-------------------------|---|------------------------------|--------------|--------------|
| Balance, January 1, 2015        | 28,962        | \$ 289                  | \$ 90,218                                 | \$ 99,003                    | \$ 365       | \$ 189,875   |
| Stock-based compensation        |               |                         | 1,623                                     |                              |              | 1,623        |
| Stock issued on vesting of RSUs | 127           | 1                       |   |                              |              | 1            |
| Taxes paid on RSU vesting       | (45 )         |                         | (543 )                                    |                              |              | (543 )       |
| Dividends                       |               |                         |   | (2,398 )                     |              | (2,398 )     |
| Net income                      |               |                         |   | 14,444                       |              | 14,444       |
| Other                           |               |                         | (30 )                                     |                              | (200 )       | (230 )       |
| Balance, June 30, 2015          | 29,044        | \$ 290                  | \$ 91,268                                 | \$ 111,049                   | \$ 165       | \$ 202,772   |

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\*Accumulated Other Comprehensive Income

See accompanying notes.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### (1) General Business

The interim financial data is unaudited; however, in our opinion, it includes all adjustments, consisting only of normal recurring adjustments necessary for a fair statement of the results for the interim periods. The financial statements included herein have been prepared pursuant to the SEC's rules and regulations; accordingly, certain information and footnote disclosures normally included in GAAP financial statements have been condensed or omitted.

The results of operations and cash flows for the six months ended June 30, 2015 are not necessarily indicative of the results to be expected for future quarters or for the year ending December 31, 2015. To maintain consistency and comparability, certain 2014 amounts have been reclassified to conform to the 2015 presentation.

Our organization and business, the accounting policies we follow and other information, are contained in the notes to our consolidated financial statements filed as part of our 2014 Form 10-K. This quarterly report should be read in conjunction with such 10-K.

The consolidated financial statements include the accounts of Hallador Energy Company and its wholly owned subsidiary Sunrise Coal, LLC (Sunrise) and Sunrise's wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated. We are engaged in the production of steam coal from mines located in western Indiana. We own a 40% equity interest in Savoy Energy, L.P., a private oil and gas company, which has operations in Michigan and a 50% interest in Sunrise Energy, LLC, a private entity engaged in shale and coalbed methane operations in the same vicinity as the Carlisle Mine.

### (2) Bank Debt

To finance the Vectren Fuels acquisition, we entered into a credit agreement with PNC Bank as administrative agent for a group of several other banks. The credit agreement allows for a \$250 million revolver and a \$175 million term loan. Our debt at June 30, 2015 was \$278 million (term-\$153, revolver-\$125). The maximum that we could borrow at June 30, 2015 was \$303 million due to the covenants. The credit facility is collateralized by substantially all of Sunrise's assets and we are the guarantor. Bank fees and other costs incurred in connection with this new facility were about \$6.8 million, which were deferred and are being amortized over five years.

All borrowings under the credit agreement bear interest at LIBOR (19 bps at June 30, 2015) plus 2.25% if the leverage ratio (debt/EBITDA) is less than 1X; LIBOR plus 2.5% if the leverage ratio is over 1X but less than 1.5X; LIBOR plus 2.75% if the ratio is over 1.5X but less than 2X; LIBOR plus 3% if the ratio is over 2X but less than 2.5X and at LIBOR plus 3.5% if the leverage ratio is over 2.5X. The computed ratio at June 30, 2015 was 2.76X. The maximum leverage ratio is currently 3.00X. We entered into swap agreements to fix the LIBOR component of the interest rate to achieve an effective fixed rate of no greater than 5% on 100% (\$175 million) of the term loan and on \$100 million of the revolver. The revolver swaps step down 10% each quarter commencing March 31, 2016. At June 30, 2015, these two interest rate swaps had an estimated net fair value liability of \$1.266 million consisting of a long-term asset of \$.812 million and a current liability of \$2.078 million. Such amounts are included in other long-term assets and accounts payable and accrued liabilities, respectively.

The credit agreement also imposes certain other customary restrictions and covenants as well as certain milestones we must meet in order to draw down the full amount. Any non-tax cash distributions from Savoy are required to be applied toward the debt. The term loan requires quarterly payments with annual amortization at 10%, 15%, 15%, 20%, and 20% with a balloon at maturity.

The credit agreement matures on August 29, 2019, but we have the right to prepay the loan at any time without penalty.

**(3) Investment in Savoy**

We currently own a 40% interest in Savoy Energy, L.P., a private company engaged in the oil and gas business primarily in the state of Michigan. Savoy uses the successful efforts method of accounting. Our 45% ownership was decreased to 40% on October 1, 2014 due to the exercise of options by Savoy's management. We account for our interest using the equity method of accounting.

Below (in thousands) to the 100% is a condensed balance sheet at June 30, and a condensed statement of operations for the six months ended June 30, 2015 and 2014.

**Condensed Balance Sheet**

|                             | <b>2015</b>     |
|-----------------------------|-----------------|
| Current assets              | \$ 12,397       |
| Oil and gas properties, net | 26,549          |
|                             | <b>\$38,946</b> |
| <br>Total liabilities       | <br>\$5,617     |
| Partners' capital           | 33,329          |
|                             | <b>\$38,946</b> |

**Condensed Statement of Operations**

|                   | <b>2015</b> | <b>2014</b> |
|-------------------|-------------|-------------|
| Revenue           | \$7,671     | \$24,493    |
| Expenses          | (7,712)     | (14,480)    |
| Net income (loss) | \$(41 )     | \$10,013    |

**(4) Investment in Sunrise Energy**

We own a 50% interest in Sunrise Energy, LLC, which owns gas reserves and gathering equipment with plans to develop and operate such reserves. Sunrise Energy also plans to develop and explore for coal-bed methane gas reserves on or near our underground coal reserves. They use the successful efforts method of accounting. We account for our interest using the equity method of accounting.

Below (in thousands) to the 100% is a condensed balance sheet at June 30, and a condensed statement of operations for the six months ended June 30, 2015 and 2014.

**Condensed Balance Sheet**

|                             | <b>2015</b>     |
|-----------------------------|-----------------|
| Current assets              | \$2,300         |
| Oil and gas properties, net | 8,105           |
|                             | <b>\$10,405</b> |
| <br>Total liabilities       | <br>\$769       |
| Members' capital            | 9,636           |
|                             | <b>\$10,405</b> |

**Condensed Statement of Operations**

|            | <b>2015</b> | <b>2014</b> |
|------------|-------------|-------------|
| Revenue    | \$1,167     | \$1,583     |
| Expenses   | (1,161)     | (1,409)     |
| Net income | \$6         | \$174       |

**(5) Other Long-Term Assets (in thousands)**

|  | <b>June<br/>30,<br/>2015</b> | <b>December<br/>31,<br/>2014</b> |
|--|------------------------------|----------------------------------|
| Long-term assets:  |                              |                                  |
| Advance coal royalties   | \$6,060                      | \$ 5,496                         |
| Deferred financing costs, net  | 5,810                        | 6,507                            |
| Marketable equity securities available for sale, at fair value (restricted)* | 1,960                        | 2,249                            |
| Other  | 3,474                        | 4,597                            |
|  | <b>\$17,304</b>              | <b>\$ 18,849</b>                 |

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\*Held by Sunrise Indemnity, Inc., our wholly owned captive insurance company.

**(6) Self Insurance**

In late August 2010, we decided to self-insure our underground mining equipment. Such equipment is allocated among 13 mining units spread out over 20 miles. The historical cost of such equipment is about \$250 million.

**(7) Net Income per Share**

We compute net income per share using the two-class method, which is an allocation formula that determines net income per share for common stock and participating securities, which for us are our outstanding RSUs. Outstanding RSUs have been excluded from the calculation of diluted weighted average shares outstanding because the impact would be anti-dilutive.

The following table sets forth the computation of net income per share for the six and three months ended June 30, 2015 and 2014 (in thousands):

| <b>Six Months<br/>Ended June 30,</b> |             | <b>Three Months<br/>Ended June 30,</b> |             |
|--------------------------------------|-------------|--|-------------|
| <b>2015</b>                          | <b>2014</b> | <b>2015</b>                            | <b>2014</b> |

Numerator:

|   |          |         |         |         |
|---|----------|---------|---------|---------|
| Net income                                  | \$14,444 | \$6,594 | \$6,853 | \$3,068 |
| Less earnings allocated to RSUs             | (443 )   | (263 )  | (208 )  | (125 )  |
| Net income allocated to common shareholders | \$14,001 | \$6,331 | \$6,645 | \$2,943 |

## **(8) Vectren Fuels Acquisition**

On August 29, 2014, we consummated the acquisition of all the common stock of Vectren Fuels, Inc. for \$311 million, which was accounted for as a business acquisition requiring measurement of acquired assets and assumed liabilities at their estimated fair value in applying purchase accounting. The estimated fair values are based on market participant assumptions.

**(9) Asset Realization**

The Carlisle assets had an aggregate carrying value of \$181 million at June 30, 2015. Considering the modifications to our coal contracts and the reduction in force as discussed in the MD&A section, we conducted review of those assets for recoverability, and determined that no impairment charge was necessary. In conducting such review, we assumed (i) that natural gas prices will start to increase in late 2016 (ii) Carlisle production will increase in 2017 and (iii) sometime in 2019, the Carlisle Mine will return to its normal production capacity of three million tons per year. If, in later quarters, we change our estimates for downward revisions to the future net cash flows attributable to the Carlisle Mine, this may result in future impairment of such assets and such charges could be significant.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders

Hallador Energy Company

Denver, Colorado

We have reviewed the accompanying consolidated condensed balance sheet of Hallador Energy Company and subsidiaries (the "Company") as of June 30, 2015, and the related consolidated condensed statement of comprehensive income for the six and three month periods ended June 30, 2015 and June 30, 2014, the consolidated condensed statement of cash flows for the six month periods ended June 30, 2015 and 2014, and the consolidated condensed statement of stockholders' equity for the six month period ended June 30, 2015. These financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying condensed consolidated interim financial information for it to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of the Company as of December 31, 2014, and the related consolidated statements of comprehensive income, cash flows, and stockholders' equity for the year then ended (not presented herein); and in our report dated March 5, 2015, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2014, is fairly stated, in all material respects, in relation to the balance sheet from which it has been derived.



/s/ EKS&H LLLP

August 7, 2015

Denver, Colorado

## ITEM 2. MD&A

**The following discussion updates the MD&A section of our 2014 Form 10-K and should be read in conjunction therewith.**

Our consolidated financial statements should be read in conjunction with this discussion.

### Overview

The largest portion of our business is devoted to coal mining in the state of Indiana through Sunrise Coal, LLC (a wholly owned subsidiary) serving the electric power generation industry. We also own a 40% equity interest in Savoy Energy, L.P., a private oil and gas exploration company with operations in Michigan, and a 50% interest in Sunrise Energy, LLC, a private natural gas exploration company with operations in Indiana. We account for our investments in Savoy and Sunrise Energy using the equity method.

On August 29, 2014, we consummated the acquisition of Vectren Fuels, Inc. (VFI). VFI, headquartered in Evansville, Indiana, owned three underground coal mines in southwestern Indiana, including the Oaktown 1 and Oaktown 2 mines in Oaktown, Indiana, and the Prosperity Mine located in Petersburg, Indiana. The Prosperity Mine was idled on August 29, 2014. The two underground mines located near Oaktown, Indiana are seven miles south of our Carlisle underground mine. Oaktown 2 is contiguous to our Carlisle mine and War Eagle reserve.

Oaktown 1, Oaktown 2, Carlisle and War Eagle are now one large underground mining complex representing 160 million tons of controlled reserves, with three portals, two wash plants and two rail facilities, located on the CSX railroad. We anticipate total capacity for the three mines to be roughly 11.3 million tons annually. Additionally, the capacity of our Ace in the Hole mine is .5 million tons annually. Thus, our total mining capacity is 11.8 million tons annually.

For 2015, over 80% of our coal sales are to customers with large scrubbed coal-fired power plants in the state of Indiana. Our mines and coal reserves are strategically located in close proximity to our primary customers, which reduces transportation costs and thus provides us with a competitive advantage with respect to those customers; our closest customer's plant is 13 miles away and the farthest Indiana customer is 200 miles away. We have access to our primary customers directly through either the CSX railroad (NYSE:CSX) or through the Indiana Rail Road (majority owned by the CSX) and via truck.

We see an increasing demand for coal produced in the Illinois Basin (ILB) in the future. Demand for coal produced in the ILB is expected to grow at a rate faster than overall U.S. coal demand due to ILB coal having higher heating content than Powder River Basin (PRB) and lower cost structure than Central Appalachia (CAPP) coal. Many utilities are scrubbing to meet emission requirements beyond just sulfur compliance, even utilities that burn exclusively PRB. Once scrubbed, those utilities are usually capable of burning ILB coal. It is this trend of new scrubber installations coupled with rising CAPP cost structure that is leading to increased switching from CAPP coal to ILB coal. Some fuel switching will also occur from PRB to ILB in newly scrubbed utilities located near ILB coal supply.

The majority of our coal is sold to investment grade customers who have scrubbed, “base load” power plants. Base load power plants are among the lowest cost producers of electricity and the first to dispatch in the power grid. Due to the large investments made to these plants, none of these plants are scheduled for retirement; thus, we expect to be supplying these plants for many years. It is not economical for the smaller, older, less efficient power plants to install scrubbers and other pollution control devices; accordingly, those type plants most likely will be retired in the coming years.

**Our Coal Contracts and Reduction in Force**

We sell coal to the following customers: Duke Energy Corporation (NYSE:DUK), Hoosier Energy, an electric cooperative, Indianapolis Power & Light Company (IPL), a wholly-owned subsidiary of The AES Corporation (NYSE:AES), Northern Indiana Public Service Co. (NIPSCO), a wholly-owned subsidiary of NiSource Inc. (NYSE:NI) and Vectren Corporation (NYSE:VVC). We also deliver coal to three Florida utilities. We believe these Florida sales are an indication of the trend of ILB coal replacing CAPP coal that has traditionally supplied the southeast markets.

2015 brought mild weather and a glut of low priced natural gas. Most of our customers were surprised by these conditions and purchased too much coal for 2015. In an effort to assist our customers balance their current needs and to secure long-term fuel supply, we agreed to modify several of our contracts.

To implement these modifications, production at our Oaktown Complex will be increased and production at our Carlisle Mine will be decreased. For the next couple of years, we expect Oaktown to represent more than 90% of our production.

Consequently, a large number of employees have been transferred from Carlisle to Oaktown. Unfortunately, a reduction in force of 175 employees was necessary.

Not all contract modifications are finalized, but we have verbal and written communications for the following future sales (in thousands except prices):

| <b>Period</b>       | <b>Priced<br/>Tons</b> | <b>Average<br/>Price/Ton</b> | <b>Committed<br/>Unpriced<br/>Tons</b> | <b>Total<br/>Tons</b> |
|---------------------|------------------------|------------------------------|--|-----------------------|
| 2015<br>(last half) | 3,282                  | \$ 44.57                     |  | 3,282                 |
| 2016                | 6,055                  | 43.12                        |  | 6,055 *               |
| 2017                | 3,700                  | 42.64                        | 480                                    | 4,180 **              |
| 2018                | 3,250                  | 41.69                        | 1,480                                  | 4,730                 |
| 2019                | 2,500                  | 42.30                        | 2,480                                  | 4,980                 |
| 2020                | 2,500                  | 43.96                        | 2,480                                  | 4,980                 |
| 2021                |                        |                              | 2,480                                  | 2,480                 |
| 2022                |                        |                              | 2,480                                  | 2,480                 |
| 2023                |                        |                              | 2,000                                  | 2,000                 |

|       |        |          |        |        |
|-------|--------|----------|--------|--------|
| 2024  |        |          | 1,000  | 1,000  |
| Total | 21,287 | \$ 43.04 | 14,880 | 36,167 |

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**\*For 2016, we estimate we will sell 7.0 million tons, of which, 87% (6.055 million tons) is committed and priced.**

**\*\* For 2017, we estimate we will sell 8.0 million tons, of which, 52% (4.180 million tons) is committed.**

As set forth in the table above, we have 14.88 million tons committed but unpriced through 2024. Roughly 1/3 of these tons reprice every year for a three-year period. Committed tons are a firm commitment, meaning we are required to ship and our customer is required to receive said tons through the duration of the contract. The contracts provide mechanisms for establishing a market-based price.

We expect to continue selling a significant portion of our coal under supply agreements with terms of one year or longer. Typically, customers enter into coal supply agreements to secure reliable sources of coal at predictable prices while we seek stable sources of revenue to support the investments required to open, expand and maintain, or improve productivity at the mines needed to supply these contracts. The terms of coal supply agreements result from competitive bidding and extensive negotiations with customers.

**Asset Realization**

The Carlisle assets had an aggregate carrying value of \$181 million at June 30, 2015. Considering the modifications to our coal contracts and the reduction in force as discussed in the MD&A section, we conducted a review of those assets for recoverability, and determined that no impairment charge was necessary. In conducting such review, we assumed (i) that natural gas prices will start to increase in late 2016 (ii) Carlisle production will increase in 2017 and (iii) sometime in 2019, the Carlisle Mine will return to its normal production capacity of three million tons per year. If, in later quarters, we change our estimates for downward revisions to the future net cash flows attributable to the Carlisle Mine, this may result in future impairment of such assets and such charges could be significant.

**Current Projects**

All of our underground coal reserves are high sulfur (4.5 - 6#) with a BTU content in the 11,200 -11,500 range. Our reserves have lower chlorine (<0.10%) than average ILB reserves of 0.22%. Much of the ILB's new production is located in Illinois and possesses chlorine content in excess of .30%. The relatively low chlorine content of our reserves is attractive to buyers given their desire to limit the corrosive effects of chlorine in their power plants.

As discussed below, the Ace surface mine is low sulfur (1.5#) with a BTU content of 11,400. We have no met coal reserves, only steam (thermal) coal reserves. Below is a discussion of our current projects preceded by a table of our coal reserves.

**Reserve Table - Controlled Tons (in millions):****2014 Year-End Reserves**

|                            | <b>Annual<br/>Capacity</b> | <b>Proven</b> | <b>Probable</b> | <b>Total</b> |
|----------------------------|----------------------------|---------------|-----------------|--------------|
| Carlisle (assigned)**      | 3.3                        | 43.7          | 9.5             | 53.2         |
| Ace in the Hole (assigned) | .5                         | 2.7           |                 | 2.7          |
| Oaktown 1* (assigned)      | 4.0                        | 30.3          | 14.1            | 44.4         |
| Oaktown 2* (assigned)      | 4.0                        | 47.6          | 15.3            | 62.9         |
| Bulldog (unassigned)       |                            | 19.6          | 16.2            | 35.8         |
| Total                      | 11.8                       | 143.9         | 55.1            | 199.0        |

|            |       |
|------------|-------|
| Assigned   | 163.2 |
| Unassigned | 35.8  |
|            | 199.0 |

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\*Oaktown 1 and 2 were acquired on August 29, 2014.

\*\* It is estimated that approximately 9 million tons of proven and probable Carlisle reserves will be mined from the Oaktown 2 portal in the future.

**Carlisle Mine (underground) – Assigned**

Our coal reserves at December 31, 2014 assigned to the Carlisle Mine were 53 million tons. The mine is located near the town of Carlisle, Indiana in Sullivan County and became operational in January 2007. The coal is accessed with a slope to a depth of 340'. The coal is mined in the Indiana Coal V seam which is highly volatile bituminous coal and is the most economical in Indiana. The Indiana V seam has been extensively mined by underground and surface methods in the general area. The coal thickness in the project area is 4' to 7'.

**Ace in the Hole Mine (Ace) (surface) – Assigned**

In November 2012, we purchased for \$6 million permitted fee coal reserves, coal leases and surface properties near Clay City, Indiana in Clay County. The Ace mine is 42 road miles northeast of the Carlisle Mine. We control 2.7 million tons of proven coal reserves of which we own .9 million tons in fee. We mine two primary seams of low sulfur coal, which make up 2.6 million of the 2.7 million tons controlled. Both of the primary seams are low sulfur (<2# SO<sub>2</sub>). Mine development began in late December 2012, and we began shipping coal in late August 2013. We truck low sulfur coal from Ace to Carlisle and/or Oaktown to blend with high sulfur coal. Many utilities in the southeastern U.S. have scrubbers with lower sulfur limits (4# SO<sub>2</sub>) which cannot accept the higher sulfur contents of the ILB (4.5# - 6# SO<sub>2</sub>). Blending high sulfur coal to a lower sulfur specification enables us to market our high sulfur coals to more customers. We also expect to ship low sulfur coal from Ace direct to unscrubbed customers that require low sulfur (1.5# SO<sub>2</sub>). We expect the maximum capacity of Ace to be 500,000 tons annually.

The Ace mine is a multi-seam open pit strip mine. The majority of the seams are sold raw, but some of the seams will be washed prior to sales depending on quality. To convert the tons sold raw the in-place tonnage is taken times a pit recovery of 94% based on seam thickness. To convert the tons sold washed the in-place tonnage is taken times a pit recovery based on seam thickness then reduced by the projected plant recovery of 72%.

**Oaktown 1 Mine (underground) – Assigned**

We have 44 million tons controlled and rated proved and probable of the Indiana coal V seam. All reserves are located in Knox County, Indiana. Access to the Oaktown 1 mine is via a 90-foot deep box cut and a 2,200-foot slope on a 14 percent grade, reaching coal in excess of 375 feet below the surface.

**Oaktown 2 Mine / War Eagle reserve (underground) – Assigned**

We have 63 million tons controlled and rated proved and probable of the Indiana coal V seam. All reserves are located in Knox County, Indiana and Lawrence County, Illinois. Access to the Oaktown 2 mine is via an 80-foot deep box cut and a 2,600-foot slope on a 14 percent grade, reaching coal in excess of 400 feet below the surface.

Our underground mines are room and pillar mines meaning that main airways and transportation entries are developed and maintained while remote-controlled continuous miners extract coal from so-called rooms by removing coal from the seam, leaving pillars to support the roof. Shuttle cars or similar transportation are used to transport coal to a conveyor belt for transport to the surface. The two Oaktown mines are separated by a sandstone channel. The coal



seam thickness ranges from 4 feet to over 9 feet. The mine's wash plant was originally sized to process 800 tons per hour and has been expanded to 1,600 tons per hour to accommodate the second mine. The two mines are connected to a railway equipped to handle 110 to 120 car unit trains. Coal is also transported via truck to customers.

**Bulldog Mine (underground) – Unassigned**

We have leased roughly 19,300 acres in Vermilion County, Illinois near the village of Allerton. Based on our reserve estimates we currently control 35.8 million tons of coal reserves. A considerable amount of our leased acres has yet to receive any exploratory drilling, thus we anticipate our controlled reserves to grow as we continue drilling. The permitting process was started in the summer of 2011, and we filed the formal permit with the state of Illinois and the appropriate Federal regulators during June 2012. In July 2014, we were notified by the Illinois Department of Natural Resources (ILDNR) that our permit had been deemed complete which starts the timeline for the ILDNR public review process. It is our estimation that our permit will be approved or denied in 2015.

Full-scale mine development will not commence until we have a sales commitment. We estimate the costs to develop this mine to be \$150 million at full capacity of three million tons annually.

Unassigned reserves represent coal reserves that would require new mineshafts, mining equipment, and plant facilities before operations could begin on the property. The primary reason for this distinction is to inform investors which coal reserves will require substantial capital expenditures before production can begin.

### **Mine and Wash Plant Recovery**

|           | <b>Mine<br/>recovery</b> | <b>Wash plant<br/>recovery</b> |
|-----------|--------------------------|--------------------------------|
| Carlisle  | 53 %                     | 81%                            |
| Bulldog   | 45 %                     | 77%                            |
| Oaktown 1 | 49 %                     | 81%                            |
| Oaktown 2 | 49 %                     | 81%                            |

### **Liquidity and Capital Resources**

Our maintenance capex budget for the last half of 2015 is \$6 million. Cash from operations should fund these expenditures.

We have no material off-balance sheet arrangements.

### **Capital Expenditures (capex)**

First half capex for 2015 was \$23 million allocated as follows (in thousands):

|  |         |
|--|---------|
| Carlisle - maintenance capex (approximately \$6/ton) | \$8,159 |
| Oaktown - maintenance capex (approximately \$4/ton)  | 11,849  |
| Other projects                                       | 3,031   |

Capex per the Consolidated Condensed Statement of Cash Flows \$23,039

We expect maintenance capex/ton for the remainder of 2015 to be around \$2/ton.

### **Results of Operations**

Considering our recent restructuring of the Carlisle Mine, we are working diligently to lower our costs to \$27/ton or less for the remainder of 2015. Additionally, we expect a 3<sup>rd</sup> quarter charge of \$500,000 for the reduction in force that took place in July. Going forward we expect our SG&A to be \$12 million annually and costs associated with Prosperity and Carlisle to be \$6 million annually.

The first table below includes the mines acquired from Vectren on August 29, 2014.

Quarterly coal sales and cost data (in thousands except for per ton data):

|                          | <b>3<sup>rd</sup><br/>2014</b> | <b>4<sup>th</sup> 2014</b> | <b>1<sup>st</sup> 2015</b> | <b>2<sup>nd</sup><br/>2015</b> | <b>T4Qs</b> |
|--------------------------|--------------------------------|----------------------------|----------------------------|--------------------------------|-------------|
| Tons sold                | 1,500                          | 2,275                      | 2,146                      | 2,078                          | 7,999       |
| Coal sales               | \$64,764                       | \$99,992                   | \$97,073                   | \$95,323                       | \$357,152   |
| Average price/ton        | 43.18                          | 43.95                      | 45.23                      | 45.87                          | 44.65       |
| Wash plant recovery in % | 64                             | 67                         | 67                         | 69                             |             |
| Operating costs          | \$52,957                       | \$67,367                   | \$66,152                   | \$68,280                       | \$254,756   |
| Average cost/ton         | 35.30                          | 29.61                      | 30.83                      | 32.86                          | 31.85       |
| Margin                   | 11,807                         | 32,625                     | 30,921                     | 27,043                         | 102,396     |
| Margin/ton               | 7.88                           | 14.34                      | 14.40                      | 13.01                          | 12.80       |
| Capex                    | 5,200                          | 11,509                     | 8,250                      | 14,789                         | 39,748      |
| Maintenance capex        | 4,756                          | 11,162                     | 6,685                      | 13,323                         | 35,926      |
| Maintenance capex/ton    | 3.17                           | 4.91                       | 3.12                       | 6.41                           | 4.49        |

|                          | <b>3<sup>rd</sup><br/>2013</b> | <b>4<sup>th</sup> 2013</b> | <b>1<sup>st</sup> 2014</b> | <b>2<sup>nd</sup><br/>2014</b> | <b>T4Qs</b> |
|--------------------------|--------------------------------|----------------------------|----------------------------|--------------------------------|-------------|
| Tons sold                | 817                            | 757                        | 776                        | 847                            | 3,197       |
| Coal sales               | \$34,985                       | \$34,307                   | \$33,016                   | \$36,130                       | \$138,438   |
| Average price/ton        | 42.82                          | 45.32                      | 42.55                      | 42.66                          | 43.30       |
| Wash plant recovery in % | 68                             | 63                         | 66                         | 68                             |             |
| Operating costs          | \$23,800                       | \$24,202                   | \$23,005                   | \$26,096                       | \$97,103    |
| Average cost/ton         | 29.13                          | 31.97                      | 29.65                      | 30.81                          | 30.37       |
| Margin                   | 11,185                         | 10,105                     | 10,011                     | 10,034                         | 41,335      |
| Margin/ton               | 13.69                          | 13.35                      | 12.90                      | 11.85                          | 12.93       |
| Capex                    | 8,780                          | 7,834                      | 2,936                      | 6,190                          | 25,740      |
| Maintenance capex        | 5,638                          | 2,721                      | 2,650                      | 3,974                          | 14,983      |
| Maintenance capex/ton    | 6.90                           | 3.59                       | 3.41                       | 4.69                           | 4.69        |

### **First Half 2015 vs. 2014**

For the first half of 2015, we sold 4,224,000 tons at an average price of \$45.55/ton. For the first half of 2014, we sold 1,623,000 tons at an average price of \$42.60/ton. The higher average price for the first half 2015 is due to the mix of our various contracts. As previously discussed, we expect prices for the last half of 2015 to average \$44.57.

Operating costs and expenses averaged \$31.83/ton in 2015 compared to \$30.25 in 2014.

SG&A increased due to purchasing Vectren Fuels. SG&A as a percentage of coal revenue decreased from 6.8% to 3.3% and SG&A per ton of coal sold decreased from \$2.90 to \$1.52. Included in SG&A are non-cash charges related to RSU amortization of \$1.2 million for 2015 and \$1.1 million for 2014.

## **Second Quarter 2015 vs. 2014**

For the second quarter of 2015, we sold 2,078,000 tons at an average price of \$45.87/ton. For the second quarter of 2014, we sold 847,000 tons at an average price of \$42.66/ton.

Operating costs and expenses averaged \$32.86/ton in 2015 compared to \$30.81 in 2014.

As mentioned above, SG&A increased due to purchasing Vectren Fuels. SG&A as a percentage of coal revenue decreased from 7.6% to 3.2% and SG&A per ton of coal sold decreased from \$3.23 to \$1.48. Included in SG&A are non-cash charges related to RSU amortization of \$586,000 for 2015 and \$614,000 for 2014.

## **Earnings per Share**

|                   | <b>3<sup>rd</sup><br/>2014</b> | <b>4<sup>th</sup><br/>2014</b> | <b>1<sup>st</sup><br/>2015</b> | <b>2<sup>nd</sup><br/>2015</b> |
|-------------------|--------------------------------|--------------------------------|--------------------------------|--------------------------------|
| Basic and diluted | \$ (.20 )                      | \$ .33                         | \$ .25                         | \$ .23                         |

|                   | <b>3<sup>rd</sup> 2013</b> | <b>4<sup>th</sup> 2013</b> | <b>1<sup>st</sup><br/>2014</b> | <b>2<sup>nd</sup><br/>2014</b> |
|-------------------|----------------------------|----------------------------|--------------------------------|--------------------------------|
| Basic and diluted | \$ .16                     | \$ .16                     | \$ .12                         | \$ .10                         |

## **MSHA Reimbursements**

Some of our legacy coal contracts allow us to pass on certain costs incurred resulting from changes in costs to comply with mandates issued by MSHA or other government agencies. We do not recognize any revenue until customers have notified us that they accept the charges.

We submitted our incurred costs for 2011 in October 2012 for \$3.7 million. \$2.1 million in reimbursements were recorded in the first quarter 2013 and \$1.6 million were recorded in the fourth quarter of 2013. Based on past experience, we expect to collect the 2012 costs in 2015. We submitted our incurred costs for 2012 in June 2015. We expect to receive over \$3 million; as stated above we do not record such reimbursements until they have been agreed to by our customers.

### **Income Taxes**

Our effective tax rate (ETR) for 2014 was 25%. For 2015, we estimate our ETR to be circa 28%.

### **40% Ownership in Savoy**

We currently own a 40% interest in Savoy Energy, L.P., a private company engaged in the oil and gas business primarily in the state of Michigan. Savoy uses the successful efforts method of accounting. Our 45% ownership was decreased to 40% on October 1, 2014 due to the exercise of options by Savoy's management. We account for our interest using the equity method of accounting.

Our share of Savoy's income dropped due to the precipitous drop in oil prices.

### **Critical Accounting Estimates**

See Note 9, "Asset Realization", to our consolidated financial statements for a discussion of estimates pertaining to our Carlisle mine.

Other estimates are of our coal reserves and our deferred tax assets and liability accounts. The reserve estimates are used in the DD&A calculation, in our impairment test if and when circumstances indicate the need for measurement, and in our internal cash flow projections. If these estimates turn out to be materially under or over-stated, our DD&A expense and impairment test may be affected. Furthermore, if our coal reserves are materially overstated, our liquidity and stock price could be adversely affected.

We account for business combinations using the purchase method of accounting. The purchase method requires us to determine the fair value of all acquired assets, including identifiable intangible assets and all assumed liabilities. The total cost of acquisitions is allocated to the underlying identifiable net assets, based on their respective estimated fair values. Determining the fair value of assets acquired and liabilities assumed requires management's judgment and the utilization of independent valuation experts, and often involves the use of significant estimates and assumptions, including assumptions with respect to future cash inflows and outflows, discount rates and asset lives, among other items. The fair value of our interest rate swaps is determined using a discounted future cash flow model based on the key assumption of anticipated future interest rates.

We have analyzed our filing positions in all of the federal and state jurisdictions where we are required to file income tax returns, as well as all open tax years in these jurisdictions. We identified our federal tax return and our Indiana state tax return as "major" tax jurisdictions. During 2012, the IRS completed an examination of our 2009 and 2010 federal tax returns and there were no significant adjustments. During 2012, the State of Indiana completed their examination of our 2008-2010 returns and no adjustments were proposed. We believe that our income tax filing positions and deductions will be sustained on audit and do not anticipate any adjustments that will result in a material change to our consolidated financial position.

### **Yorktown Distributions**

As previously disclosed, Yorktown Energy Partners and its affiliated partnerships (Yorktown) have made 10 distributions to their numerous partners totaling seven million shares since May 2011. In the past, these distributions were made soon after we filed our Form 10-Qs and Form 10-Ks. Currently, Yorktown owns 8.55 million shares of our stock representing about 29% of total shares outstanding. Yorktown last distributed shares in May 2015.

We have been informed by Yorktown that they have not made any determination as to the disposition of their remaining Hallador stock. While we do not know Yorktown's ultimate strategy to realize the value of their Hallador investment for their partners, we expect that over time such distributions will increase our liquidity and float.

If we are advised of another Yorktown distribution, we will timely report such on a Form 8-K.



**New Accounting Pronouncements**

None of the recent FASB pronouncements will have any material effect on us.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

We are not required to provide the information required by this item but it will be required in the Form 10-K.

## **ITEM 4. CONTROLS AND PROCEDURES**

### **Disclosure Controls**

We maintain a system of disclosure controls and procedures that are designed for the purposes of ensuring that information required to be disclosed in our SEC reports is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our CEO and CFO as appropriate to allow timely decisions regarding required disclosure.

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our CEO and CFO, of the effectiveness of the design and operation of our disclosure controls and procedures. Based upon that evaluation, our CEO and CFO concluded that our disclosure controls and procedures are effective for the purposes discussed above.

There have been no changes to our internal control over financial reporting during the quarter ended June 30, 2015 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II - OTHER INFORMATION**

### **ITEM 4. MINE SAFETY DISCLOSURE**

See Exhibit 95 to this Form 10-Q for a listing of our mine safety violations.

### **ITEM 6. EXHIBITS**

15 Letter Regarding Unaudited Interim Financial Information  
31 SOX 302 Certifications  
32 SOX 906 Certification  
95 Mine Safety Report  
101 Interactive Files

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**HALLADOR ENERGY COMPANY**

Date: August 7, 2015 /s/W. Anderson Bishop  
W. Anderson Bishop, CFO and CAO