

HALLADOR ENERGY CO  
Form 10-Q  
November 06, 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  
<sup>x</sup>1934

For the quarterly period ended: September 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 COAL KEEPS YOUR LIGHTS ON”  
LIGHTS  
ON”  
**HALLADOR ENERGY COMPANY**

([www.halladorenergy.com](http://www.halladorenergy.com))

Colorado

84-1014610

(State

of (IRS Employer Identification No.)  
incorporation)

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

(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 November 5, 2015, we had 29,059,000 shares outstanding.

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

(in thousands)

	September 30, 2015	December 31, 2014
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 19,503	\$ 13,469
Marketable securities	1,427	1,656
Accounts receivable	26,124	27,297
Income tax receivable	4,835	5,791
Coal inventory	10,704	19,722
Parts and supply inventory	12,982	14,919
Other	1,467	1,555
Total current assets	77,042	84,409
Coal properties, at cost:		
Land and mineral rights	115,963	116,025
Buildings and equipment	346,493	323,758
Mine development	590,201	564,218
Less - accumulated DD&A	(138,949 )	(106,608 )
	451,252	457,610
Investment in Savoy	13,787	13,896
Investment in Sunrise Energy	4,845	4,821
Other assets (Note 5)	16,472	18,849
	\$ 563,398	\$ 579,585
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Current portion bank debt	\$ 26,250	\$ 21,875
Accounts payable and accrued liabilities	28,922	28,105
Total current liabilities	55,172	49,980
Long-term liabilities:		
Bank debt	239,783	284,470
Deferred income taxes	46,883	41,581
Asset retirement obligations	12,103	12,074
Other	2,110	1,605
Total long-term liabilities	300,879	339,730
Total liabilities	356,051	389,710
Commitments and contingencies		
Stockholders' equity:		

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Preferred stock, \$.10 par value, 10,000 shares authorized; none issued		
Common stock, \$.01 par value, 100,000 shares authorized; 29,058 and 28,962, shares outstanding, respectively	290	289
Additional paid-in capital	92,123	90,218
Retained earnings	114,995	99,003
Accumulated other comprehensive income (loss)	(61	) 365
Total stockholders' equity	207,347	189,875
	\$ 563,398	\$ 579,585

See accompanying notes.

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**Consolidated Statement of Comprehensive Income (Loss)**

(in thousands, except per share data)

	<b>Nine Months Ended September 30,</b>		<b>Three Months Ended September 30,</b>	
	2015	2014	2015	2014
Revenue:				
Coal sales	\$273,728	\$133,910	\$81,332	\$64,764
Equity income (loss) - Savoy	(110 )	5,731	(93 )	1,217
Equity income - Sunrise Energy	24	191	21	104
Other	1,625	717	753	237
	275,267	140,549	82,013	66,322
Costs and expenses:				
Operating costs and expenses	191,427	101,689	56,995 <sup>(1)</sup>	52,588
DD&A	32,756	17,131	10,648	6,979
Coal exploration costs	1,581	1,907	381	716
SG&A	9,427	7,220	3,003	2,511
Interest <sup>(2)</sup>	13,955	2,687	5,176	1,825
Vectren deal costs		8,912		8,912
	249,146	139,546	76,203	73,531
Income (loss) before income taxes	26,121	1,003	5,810	(7,209 )
Less income taxes:				
Current	1,231	4,244	680	(157 )
Deferred	5,302	(4,067 )	(14 )	(1,284 )
	6,533	177	666	(1,441 )
Net income (loss) <sup>(3)</sup>	\$19,588	\$826	\$5,144	\$(5,768 )
Net income (loss) per share: (Note 7)				
Basic and diluted	\$0.65	\$0.03	\$0.17	\$(0.20 )
Weighted average shares outstanding:				
Basic and diluted	29,011	28,766	29,044	28,772

(1) Oaktown's operating costs for the 3<sup>d</sup> quarter 2015 were \$28.13/ton.

(2)

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Included in interest expense is the change in the estimated fair value of our interest rate swaps. For the nine and three months ended September 30, 2015 such amounts were \$1,858 and \$1,251, respectively.

- (3) There is no material difference between net income (loss) and comprehensive income (loss).

See accompanying notes.

**Consolidated Condensed Statement of Cash Flows**

For the nine months ended September 30,

(in thousands)

	2015	2014
Operating activities:		
Cash provided by operating activities	\$76,573	\$20,730
Investing activities:		
Capital expenditures for coal properties	(27,109)	(14,326 )
Vectren Fuels acquisition		(319,762)
Other	478	
Cash (used in) investing activities	(26,631)	(334,088)
Financing activities:		
Dividends	(3,596 )	(3,593 )
Bank borrowings		350,000
Payments on bank debt	(40,312)	(20,375 )
Other		(6,884 )
Cash (used in) provided by financing activities	(43,908)	319,148
Increase in cash and cash equivalents	6,034	5,790
Cash and cash equivalents, beginning of period	13,469	16,228
Cash and cash equivalents, end of period	\$19,503	\$22,018

See accompanying notes.

**Consolidated Statement of Stockholders' Equity**

(in thousands)

	Shares	Common Stock	Additional Paid-in Capital	Retained Earnings	AOCI(L)*	Total
Balance, January 1, 2015	28,962	\$ 289	\$ 90,218	\$ 99,003	\$ 365	\$ 189,875
Stock-based compensation			2,362			2,362
Stock issued on vesting of RSUs	127	1				1
Taxes paid on RSU vesting	(45 )		(543 )			(543 )
Dividends				(3,596 )		(3,596 )
Net income				19,588		19,588
Other	14		86		(426 )	(340 )
Balance, September 30, 2015	29,058	\$ 290	\$ 92,123	\$ 114,995	\$ (61 )	\$ 207,347

\*Accumulated Other Comprehensive Income (Loss)

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 nine months ended September 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 August 2014 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 September 30, 2015 was \$266 million (term-\$146, revolver-\$120). The maximum that we could borrow at September 30, 2015 was \$311 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 (20 bps at September 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 September 30, 2015 was 2.58X. The leverage ratio is currently 3.50X. 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 term loan swap steps down in unison with the term loan payment and the revolver swap steps down 10% each quarter commencing March 31, 2016. At September 30, 2015, these two interest rate swaps had an estimated fair value current liability of \$2.5 million included in accounts payable and accrued liabilities.

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% (2015), 15% (2016), 15% (2017), 20% (2018), and 20% (2019) 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 September 30, and a condensed statement of operations for the nine months ended September 30, 2015 and 2014.

Condensed Balance Sheet

	2015
Current assets	\$ 11,709
Oil and gas properties, net	26,522
	\$38,231
Total liabilities	\$5,152
Partners' capital	33,079
	\$38,231

Condensed Statement of Operations

	2015	2014
Revenue	\$10,887	\$32,135
Expenses	(11,156)	(19,423)
Net income (loss)	\$(269 )	\$12,712

**(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 September 30, and a condensed statement of operations for the nine months ended September 30, 2015 and 2014.

**Condensed Balance Sheet**

	2015
Current assets	\$2,325
Oil and gas properties, net	8,131
	\$10,456
Total liabilities	\$777
Members' capital	9,679
	\$10,456

**Condensed Statement of Operations**

	2015	2014
Revenue	\$1,773	\$2,328
Expenses	(1,725)	(1,945)
Net income	\$48	\$383

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

	September 30, 2015	December 31, 2014
Long-term assets:		
Advance coal royalties	\$ 6,506	\$ 5,496
Deferred financing costs, net	5,461	6,507
Marketable equity securities available for sale, at fair value (restricted)*	1,723	2,249
Other	2,782	4,597
	\$ 16,472	\$ 18,849

\*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 12 mining units spread out over 20 miles. The historical cost of such equipment is approximately \$250 million.

**(7) Net Income (Loss) per Share**

We compute net income (loss) per share using the two-class method, which is an allocation formula that determines net income (loss) 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 (loss) allocated to common shareholders for the nine and three months ended September 30, 2015 and 2014 (in thousands):

<b>Nine months ended</b>		<b>Three months ended</b>	
<b>September 30,</b>		<b>September 30,</b>	
2015	2014	2015	2014

Numerator:

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Net income (loss)	\$ 19,588	\$ 826	\$ 5,144	\$ (5,768 )
Less earnings allocated to RSUs	(595 )	(23 )	(155 )	
Net income (loss) allocated to common shareholders	\$ 18,993	\$ 803	\$ 4,989	\$ (5,768 )

**(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 \$177 million at September 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 natgas 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 reduce our estimate of the future net cash flows attributable to the Carlisle Mine, it 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 September 30, 2015, and the related consolidated condensed statement of comprehensive income for the nine and three month periods ended September 30, 2015 and 2014, the consolidated condensed statement of cash flows for the nine month periods ended September 30, 2015 and 2014, and the consolidated condensed statement of stockholders' equity for the nine month period ended September 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

November 6, 2015

Denver, Colorado

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## 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 natgas 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.

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 two 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 natgas. Most of our customers were surprised by these conditions and purchased too much coal for 2015. In an effort to assist our customers to 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 has been increased and production at our Carlisle mine was decreased. For the next couple of years, we expect Oaktown to represent more than 90% of our production.

Consequently, a large number of employees were transferred from Carlisle to Oaktown. Unfortunately, in late July, a reduction in force was made of 175 employees.

The table below shows our contracted tons. Some of our contracts contain language that allow our customers to increase or decrease tonnages throughout the year. The table represents the minimum and maximum tonnages we could deliver under existing contracts. In some cases, our customers are required to purchase their additional tonnage needs from us. We fully anticipate making additional sales.

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

Year	Minimum Tons To Be Sold			Maximum Tons To Be Sold			Average Estimated Prices
	Priced Tons	(Unpriced) Tons	Total Tons	Priced Tons	(Unpriced) Tons	Total Tons	
2015	1,528		1,528	1,528		1,528	\$ 45.29
2016 <sup>(1)</sup>	5,568		5,568	6,424		6,424	43.34
2017 <sup>(2)</sup>	3,070	389	3,459	4,620	581	5,201	42.67

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2018	2,685	1,199	3,884	4,410	1,791	6,201	41.67
2019	2,575	2,009	4,584	3,450	3,001	6,451	42.15
2020	2,350	2,009	4,359	3,200	3,001	6,201	43.77
2021		2,009	2,009		3,001	3,001	
2022		2,009	2,009		3,001	3,001	
2023		1,620	1,620		2,420	2,420	
2024		810	810		1,210	1,210	
	17,776	12,054	29,830	23,632	18,006	41,638	

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(1)For 2016, we estimate we will sell 6.5 million tons.

(2)For 2017, we estimate we will sell 7.5 million tons.

Committed unpriced tons are firm commitments, 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. As set forth in the table above, we have 12-18 million tons committed but unpriced through 2024.

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 \$177 million at September 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 natgas 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 reduce our estimate of the future net cash flows attributable to the Carlisle Mine, it 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  
**Annual**

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	Capacity	Proven	Probable	Total
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

\*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, located near Carlisle, Indiana in Sullivan County became operational in January 2007. The coal is accessed with a slope to a depth of 340'. The coal is mined out of 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' deep box cut and a 2,200' slope on a 14% grade, reaching coal in excess of 375' 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' deep box cut and a 2,600' slope on a 14% grade, reaching coal in excess of 400' 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' to over 9'. The mine's wash plant has a capacity of 1,800 tons per hour. 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 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 Rates Used in Reserve Estimates**

	Mine recovery		Wash plant recovery*	
Carlisle	53	%	81	%
Bulldog	45	%	77	%
Oaktown 1	49	%	81	%
Oaktown 2	49	%	81	%

\* Does not include out-of-seam material extracted during the mining process.

**Liquidity and Capital Resources**

Our maintenance capex budget for the 4<sup>th</sup> quarter of 2015 is \$4.5 million. Cash from operations should fund these expenditures.

We have no material off-balance sheet arrangements.

**Capital Expenditures (capex)**

Capex for the first nine months of 2015 was \$27 million allocated as follows (in thousands):

Carlisle & Oaktown - maintenance capex (approximately \$3.79/ton)	\$21,824
Other projects	5,285
Capex per the Consolidated Condensed Statement of Cash Flows	\$27,109

We expect maintenance capex/ton for the remainder of 2015 to be around \$3/ton.

**Results of Operations**

In the third quarter, we made progress in lowering our cash costs going forward. Oaktown's cash costs for the 3<sup>d</sup> quarter were \$28.13/ton. Over the course of 4<sup>th</sup> quarter 2015 and 1<sup>st</sup> quarter 2016 our mining plan will lead us to higher recovery coal. Thus, we are still targeting \$27/ton cash costs in 2016. Going forward we expect our SG&A to be \$12 million annually and costs associated with Prosperity and Carlisle to be \$7.5 million annually.

Beginning August 29, 2014, the tables below include the mines acquired from Vectren.

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

	<b>4<sup>th</sup> 2014</b>	<b>1<sup>st</sup> 2015</b>	<b>2<sup>nd</sup> 2015</b>	<b>3<sup>rd</sup> 2015</b>	<b>T4Qs</b>
Tons sold	2,275	2,146	2,078	1,791	8,290
Coal sales	\$99,992	\$97,073	\$95,323	\$81,332	\$373,720
Average price/ton	43.95	45.23	45.87	45.41	45.08
Wash plant recovery in %	67	67	69	69	
Operating costs	\$67,367	\$66,152	\$68,280	\$56,995	\$258,794
Average cost/ton	29.61	30.83	32.86	31.82	31.22
Margin	32,625	30,921	27,043	24,337	114,926
Margin/ton	14.34	14.40	13.01	13.59	13.86
Capex	11,509	8,250	14,789	4,070	38,618
Maintenance capex	11,162	6,685	13,323	1,816	32,986
Maintenance capex/ton	4.91	3.12	6.41	1.01	3.98

	<b>4<sup>th</sup> 2013</b>	<b>1<sup>st</sup> 2014</b>	<b>2<sup>nd</sup> 2014</b>	<b>3<sup>rd</sup> 2014</b>	<b>T4Qs</b>
Tons sold	757	776	847	1,500	3,880
Coal sales	\$34,307	\$33,016	\$36,130	\$64,764	\$168,217
Average price/ton	45.32	42.55	42.66	43.18	43.35
Wash plant recovery in %	63	66	68	64	
Operating costs	\$24,202	\$23,005	\$26,096	\$52,588	\$125,891
Average cost/ton	31.97	29.65	30.81	35.06	32.44
Margin	10,105	10,011	10,034	12,176	42,326
Margin/ton	13.35	12.90	11.85	8.12	10.91
Capex	7,834	2,936	6,190	5,200	22,160
Maintenance capex	2,721	2,650	3,974	4,756	14,101
Maintenance capex/ton	3.59	3.41	4.69	3.17	3.63

#### **First Nine Months 2015 vs. 2014**

For the first nine months of 2015, we sold 6,015,000 tons at an average price of \$45.51/ton. For the first nine months of 2014, we sold 3,123,000 tons at an average price of \$42.88/ton. The higher average price for the first nine months of 2015 is due to the mix of our various contracts. As previously discussed, we expect prices for the last quarter of 2015 to average \$45.29.

Operating costs and expenses averaged \$31.82/ton in 2015 compared to \$32.56 in 2014.

SG&A increased due to purchasing Vectren Fuels. SG&A as a percentage of coal revenue decreased from 5.4% to 3.4% and SG&A per ton of coal sold decreased from \$2.31 to \$1.57. Included in SG&A are non-cash charges related to RSU amortization of \$1.8 million for 2015 and \$1.6 million for 2014.

**Third Quarter 2015 vs. 2014**

For the third quarter of 2015, we sold 1,791,000 tons at an average price of \$45.41/ton. For the third quarter of 2014, we sold 1,500,000 tons at an average price of \$43.18/ton.

Operating costs and expenses averaged \$31.82/ton in 2015 compared to \$35.06 in 2014.

As mentioned above, SG&A increased due to purchasing Vectren Fuels. SG&A as a percentage of coal revenue decreased from 3.9% to 3.7% and SG&A per ton of coal sold for 2015 and 2014 were approximately the same at \$1.67. Included in SG&A are non-cash charges related to RSU amortization of \$586,000 for 2015 and \$488,000 for 2014.

**Net Income (Loss) per Share**

	<b>4<sup>th</sup> 2014</b>	<b>1<sup>st</sup> 2015</b>	<b>2<sup>nd</sup> 2015</b>	<b>3<sup>rd</sup> 2015</b>
Basic and diluted	\$ .33	\$ .25	\$ .23	\$ .17

	<b>4<sup>th</sup> 2013</b>	<b>1<sup>st</sup> 2014</b>	<b>2<sup>nd</sup> 2014</b>	<b>3<sup>rd</sup> 2014</b>
Basic and diluted	\$ .16	\$ .12	\$ .10	\$ (.20 )

**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 4.5%. The low ETR for 2014 was due primarily to the reduction in the Indiana state income tax rate. For 2015, we estimate our ETR to be circa 25%.

**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