

National Coal Corp. ([NCOC](#))—Q3 2009 Earnings Call Transcript

November 5, 2009 4:30 pm ET

Christine Pietryla

Good afternoon, everyone. This is Christine Pietryla. Thanks for joining us. I just want to read a few comments and then I'm going to turn it over to our speakers today. Today, we're going to hear from President & CEO, Dan Roling, our CFO, Mike Castle, and our COO, Bill Snodgrass. Their statements are going to be followed by a question-and-answer period.

Before I begin, I want to remind everyone that we will be discussing forward-looking information on this call. Examples of forward-looking statements include anticipated benefits of capital improvements and new mines and an anticipated strengthening or weakening within the coal market.

Forward-looking statements should not be read as a guarantee of future performance or results and are based on information currently available. Forward-looking statements made on this call are based on management's good faith, belief that at this time with respect to future events and/or subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed and/or suggested by the forward looking statements.

These conditions are more fully described in our company's filings with the Securities and Exchange Commission, including our most recently filed annual report on Form 10-K and our quarterly reports on Form 10-Q, which should be read in conjunction with the information presented in this call.

Further, we will also be referring to non-GAAP financial measures, which are reconciled in both our third quarter, 10-Q and earnings release. Both of these are located on our Web site.

With that, I'm going to introduce Dan Roling, National Corp's President and CEO.

Daniel Roling

Thank you, Christine, and good afternoon. Thank you for your participation on this call. To begin I will just point out that Mike Castle, our Chief Financial Officer is going to specifically address our financial results.

So I would like to start by discussing the steps we're taking to improve shareholder value in the midst of challenging market and economic conditions as well as to provide some guidance on our production, pricing and overall health of the company, which I believe continues to show modest improvement in a very tough economic and coal market.

First, the continued uncertainty for the outlook of our economy is causing stress on business. However, with that said, I can say that our business has stabilized since mid-summer. Even though we are not seeing any upturn in demand we can also state that we have not experienced any further deterioration.

Our outlook for the next year is one of cautious optimism. Electricity demand has declined two consecutive periods in 2008 and 2009 for the first time in well over 60 years. The significance is that 93% of coal consumed in the United States, is consumed generating electricity.

Coal stockpiles are high by recent measures and need to be reduced to more normal levels. I believe that our customers need to see an increase in demand for their product, electricity and lower coal inventory levels, before they will return to the market as buyers. We anticipate this sometime in the second half of 2010.

Political uncertainty surrounding the future use of coal is also an issue. The one that is very long-term in nature. For the foreseeable future the ability of the United States to switch away from coal is limited. Accordingly, I believe that coal consumption will continue to increase over time along with economic activity.

Regarding the outlook for our production targets for our 2010 and 2011, we believe that we have the capacity to produce between 1.5 million tons and 1.8 million tons a coal. For 2010 and '11 our production will be scaled to meet demand, but clearly limited by our capacity. Prices have retreated from record highs reached last year to levels that may not support current production levels. Much less justify reinvestment in the industry.

Demand for coal is weak, but steady at present. The near-term outlook is somewhat less positive reflecting no growth in year-on-year electricity generation that some strength seems to be present from the steel industry from meteorological coal. The offset to these concerns is the realization that supply is not assured.

Production in Appalachian regions has declined about 100 million tons in the last decade and has shown no real ability to recover even with the record high prices realized last year. This might be the challenge facing National Coal as well as the coal industry in general that we have to be able to meet demand from our customers and are in the cost to capital on our invested capital.

Historically, the industry and National Coal have not done this. Thus it is my objective to drive our company into profitability and then to earn its cost to capital. In order to achieve this it is vital that we do not foster or believe that increased production at any price is acceptable.

Accordingly, until it becomes clear that the outlook for coal demand and its relative prices become more positive, our decision has been to scale back production. We are, however, continuing to work on obtaining additional permits so that we can be well-positioned to benefit in the next upside to coal.

During the third quarter we continued to focus on controlling costs in a weak market, which unfortunately caused us to address a new balance in our production schedule to meet the

demands of our customers. We are continuing to work on this and believe that we will achieve the proper balance during the fourth quarter.

Our coal sales have increased during the third quarter. They increased 5.9% to 286,000 tons from 270,000 tons and for the nine months they increased 3.3% to 855,000 tons from 827,000 tons.

Looking forward, we have locked in about 900,000 tons for 2010 at an average price of \$79.56. And for 2011, we have also locked in 900,000 tons at an average price of \$76.47. Uncommitted tons for 2010 are between 500,000 tons and 600,000 tons and for 2011, 800,000 tons to 900,000 tons.

With that I will turn it over to Mike Castle, our Chief Financial Officer for his review of our financial results.

Mike Castle

Thank you, Dave. First, I will review the third quarter and year-to-date 2009 results for our ongoing Tennessee operations, briefly discuss certain noteworthy changes in our balance sheet and overall liquidity, then I will go over to 2009 third quarter and year-to-date results of National Coal of Alabama and the impact on our financial statements and discontinued operations

The third quarter 2009 as compared to the second quarter 2009 first. We sold approximately 286,000 tons in the third quarter 2009 at an average sales price of \$75, for total sales revenue of \$21.5 million compared to 291,000 tons sold at an average sales price of \$74.81 per tons sold, for total sales revenue of \$21.7 million in the second quarter of 2009.

This change in our per tons sales price is consistent from prior quarter coal sales based on new coal supply agreements that we negotiated began shipping earlier in the year. The sales tons were down by a very small number due to the 1/September scheduled trade that was moved into the first week of October.

Our cost of sales is \$20 million at an average cost per ton sold is \$69.92 during the third quarter 2009, compared to \$19.3 million at an average cost per ton sold of \$66.34 in the second quarter 2009. This slight increase in cost per tons driven by approximately 14% reduction in tons produced, which internally due to a couple of factors.

We have vacations for the underground mines in July. And second, we cut back to one section line from a two section line in one of our underground mines. Third, we have (inaudible) mine in late September and increase (inaudible) all of our mines had an impact.

The year-to-date 2009 versus year-to-date 2008 during the nine months ended September 30, 2009, we sold 855,000 tons at an average sales price of \$72.89 for total sales revenue of \$62.3 million. This is compared with 828,000 tons sold at an average sales price of \$59.34 per ton for total sales revenue of \$49.1 million in the same period 2008.

It represents an increase of 23% on our average sales price per ton with an increase of about 27% of total revenues from coal sales. This increase is due again primarily to new negotiated coal supply agreements that we began shipping earlier in the year.

Our cost of sales was \$58.3 million at an average cost per ton sold was \$68.19 during the nine months ended September 30, 2009, compared to \$48.7 million at an average cost per ton sold of \$58.89 in the same period 2008, which is an increase of approximately 16% on our average cost per ton sold.

Production from our Tennessee mines was down 81,000 tons for the nine months ended September 2009 from the same period 2008, primarily due to the transitioning from higher costs mine, the lower costs mine in 2009. And our ability to purchase coal for third quarter in recent months were as at option was simply not available in 2008.

We purchased approximately 238,000 tons coal during the nine months ended September 30, 2009 at an average price per ton of \$62.78, compared to purchasing 25,257 tons in the same period 2008 at an average price per ton of \$47.26. That is an increase of \$15.52 per ton.

The third quarter 2009 as compared to the third quarter 2008, in the third quarter 2009 again we sold approximately 286,000 tons at an average sales price of \$75 for total sales revenue of \$21.5 million compared to 271,000 tons sold at an average sales price of \$65.08, for total sales revenue of \$17.6 million in the third quarter of 2008.

That represents an increase of 15% on our average sales price per ton with an increase of about 22% in total revenue from coal sales. Again, this increase is the direct result of a couple of new coal supply agreements that we began shipping during the early part of 2009.

Our cost of sales was \$20 million at an average cost per ton sold is \$69.92 during third quarter 2009, compared to \$16.5 million at an average cost per ton sold is \$60.84 in the third quarter of '08, which is an increase of approximately 15% on our average cost per ton sold. This increase was primarily due to an increase in per ton purchase coal costs offset by reduction in price of fuel costs.

We purchased and sold 87,000 tons of coal at an average price of \$59.80 during Q3 2009 compared to 8500 tons at an average price of \$48 during the same period in 2008.

Now going to the balance sheet, and the statement of cash flows, at September 30, 2009, we had available liquidity of \$10.1 million consisting of \$6 million available under our short-term revolving credit facility. And cash and cash equivalents of approximately \$4.1 million. This is an increase of \$5 million on June 30th 2009 and approximately \$6 million on December 31, 2008.

We generated cash of continuing operations of \$2.9 million during the nine months ended September 30, 2009 as compared to cash used in operations of \$6.2 million during the same period in 2008.

It should be noted we put in place a revolving credit facility in April 2009 which provide additional liquidity, for National Coal Corporation, our Tennessee operations.

At September 30, 2009, the outstanding balance on that credit facility is \$4 million and we also paid an additional \$500,000 on October 6, 2009. Currently, we are in discussions to obtain consent from holders of two-thirds of our 10.5% notes due December 2010 to extend this debt facility to coincide with the due date of our 10.5% notes.

Last, the results of National Coal of Alabama, during the third quarter 2009, our discontinued operations sold 46,000 tons at an average sales price of \$79.41 for a total sales revenue of \$3.7 million. On August 3, 2009, the holders of our 12% notes due 2012 foreclosed on the outstanding capital stock of National Coal of Alabama.

As a result, we recorded a gain on disposal of discontinued operations for the three months and nine months ended September 30, 2009 of approximately \$23.5 million and a loss of discontinued operations of \$19.7 million which included \$19.8 million charge from (inaudible) payment, resulting in net income from discontinued operations of \$3.8 million.

Dan, I will turn it back over to you if you want to add anything and then we can open it up to questions.

Daniel Roling

Thank you, Mike. The comments that I would add a very brief but the outlook for coal in my opinion is tied heavenly to the economic activity which is heavily tight, which will result in increases in demand per electricity should economic recovery continue.

The political climate in Washington today is very tough for any mining company and the outlook for coal again is one of the constant discussion. However, we believe that the U.S. is, I won't say dependent, but U.S. does use coal extensively and the outlook for coal and its need in the U.S. will continue for a number of years to come. However, because of the political climate in Washington at present, the ability or willingness of companies to reinvest in this sector, in this country, has been very limited.

Reinvestment in coal, I believe, will lead to lack of reinvestment in coal, will lead to much higher prices as supply and demand, which clearly saw demand exceed supply in 2008 as the demand comes back we will see once again demand exceed supply with the inability of supply to catch up in the short run. Thus I think there is a very strong and bullish market ahead for coal, but not in the near foreseeable future. But it will come and demand for coal and prices will be reflecting that accordingly.

With that I will open it up for questions. Christine?

Question-and-Answer Session

George

Hi, Dan, hi, Mike. Maybe you could first let us know, Dan, what the conditions are at the mines right now? Any problem areas with operations?

Daniel Roling

I'm going to ask, Bill Snodgrass, our Chief Operating Officer to comment on that. He is in here. I think George [ph] wants to know what the current operating conditions are at the mines.

Bill Snodgrass

Operating conditions at present is real good. We're actually had some of our operations backed up a little bit, match up with the resilience. We don't have any unborn problems at present.

Mike Castle

Okay. And then kind of as a follow-up to that. I know, Dan, you had expressed earlier in the year that manpower availability was a problem. Is that situation getting any better?

Bill Snodgrass

Well, we actually have an excess of labor workforce right now. That's available. There's no need for.

George

Okay. And finally on the cost per tons number, going forward, next quarter, do you think that's going to remain relatively flat with conditions as they are or is there potential to improve on that a little bit?

Daniel Roling

I would say flat would be a very good comparison unless we have a very cold winter and gas prices would happen to go up significantly. I guess it's been somewhat disappointed. We've seen the price of natural gas move up from around \$3 to around \$5, but we've not seen any incremental demand a rise in the price of coal.

As far as costs, quarter-on-quarter, I would look for our costs to come down in the fourth quarter, as we scale back production in the fourth quarter to balance demand and supply, the costs are not as immediate as the pullback in production. So in the third quarter, we saw production come back about 14%, but costs only came back just about 5%. We would look for the fourth quarter to see costs come back more, as the lower costs from that reduced production in the third quarter flow through into the fourth quarter.

George

Okay. Thanks, guys. I appreciate it.

Daniel Roling

You're welcome, Mike.

Christine Pietryla

Next Al Shams

Al Shams

Yes, gentlemen, good afternoon. Sure, it's nice to see a positive cash flow number.

Daniel Roling

We are working hard on that, Al.

Al Shams

I know. I know. And as a shareholder I want the guys who are pick in up the coal and mining the coal, I mean the guys in the mines to know that as a shareholder I'm really appreciative of their hard efforts, because I know it's a team effort and not just the efforts of the few people. With that said, did we have about \$67 million worth of debt associated with Alabama?

Mike Castle

Did we?

Al Shams

Yes, did we?

Mike Castle

Yes, there was.

Al Shams

Okay. Okay. So obviously again that's gone with the seizure, taking the assets by the creditors. On the financial statements we have about \$1.3 million in restricted cash. Could you talk about that please?

Mike Castle

The restricted cash we have in our balance sheet are sets out to collateralize our reclamation bonds, and this in current made it's going to be free, within the next period of time, and we will be back into working capital. That's what definite. We've instituted a program to get about \$4.5 million of our restricted cash that had been tied up we gotten up freed up over the last couple months now.

Al Shams

Okay. I notice there was a big increase in payables, in accounts payables. It almost doubled, since, I guess, the previous quarter.

Mike Castle

Well, the biggest portion of that is because it's in purchase coal we've. We have some arrangements to buy coal from third parties. And it's inflating in our typical vendor and accounts payable number somewhat. And we have terms on with that and those terms are a little more relaxed and what normally they maybe. So that number has gone up somewhat because of that. We feel we have an outstanding relationship, one of the folks we had a business win, but we're trying to conserve our liquidity also.

Al Shams

Okay. It did seem like there was a corresponding increase in assets of some of your to offset that increase in payables. Have I missed something or is that correct?

Mike Castle

Well, there's probably not, but our inventories have been up over the last three months or four months. We've been carrying in the 30% to 40% more in inventory. So the amount be reflected in another pure number on the balance sheet, but that is cash on the ground, in my opinion.

Al Shams

Okay. And then lastly a question for you, Dan. Just kind of a business question. With these low natural gas prices, how much of the risk is natural gas to us on a short-term and medium-term basis?

Daniel Roling

I think we felt the impact already of the low natural gas prices. Our belief is that with gas in the \$4 to \$5 range that it's not as economic to compete with coal, clearly a \$4 it is below \$4. Above \$4 it's not. But I think natural gas has taken market share this year and I don't look forward to take any more market share, but with that said, I do not look for to give up that market share within the next two quarters to three quarters as most of that gas most likely was purchased

under some form of contractual arrangement which is longer-term than just the price. I would look for gas a big market share in the low-to-mid 20s, is probably a bit higher than that right now.

Remember, electricity demand was down almost 4% year-on-year in 2008, and it's down again almost 4% in 2009. This is the first time as far back as 1950 that electricity generation in United States declined two consecutive years. So I think when we see the economy recovery and demand for electricity recover it will have a two-fold impact.

One, industrial demand for electricity will be key as industrial demand picks up, industrial demand for electricity will increase, and those industries use a lot of natural gas themselves so the demand for natural gas from the industrial customers will be up, demand for electricity from industrial customers will be up, that means that the utilities will have to generate more electricity and more likely the non in my opinion that incremental kilowatt electricity will come from coal and as gas prices recover to the 5+ level they will back out their natural gas as non-competitive with coal.

Al Shams

And then lastly, Dan, are you in a position to give us any guidance for the next quarter or two? Do you think it will remain cash flow positive in the fourth quarter?

Dan Roling

I am really not in a position to do that. What I can say is we will continue to work as hard as we have been and we really do have an objective of being cash flow positive. So we will continue to work with that as our number one objective, but as far as being able to predict it at this point one of the main reasons for that is the trains, given our size, if a customer reschedules one or two trains, or if the rail road for whatever reason has a problem delivering a train, which both of those happen, one or two trains to us have a disproportional impact, and we are working hard to fix that. So with that said it's very difficult. If everything goes according to plan I could give you an answer. But I have learned a long time ago nothing goes according to plan in the coal space.

Al Shams

Right. Okay, well, thanks again for your hard work and again it's great to see a positive cash flow number.

Dan Roling

Thank you, Al.

Christine Pietryla

Now we will take a question from Seth Yeager.

Seth Yeager

Hi, Seth Yeager, Jefferies. Were there any customer deferrals during the quarter of any particular shipments?

Bill Snodgrass

We have one train stood up because of scheduling, but I would not call it a deferral.

Seth Yeager

What was the tonnage on that? And do you expect that come in the fourth quarter then?

Bill Snodgrass

Yes, actually we don't receive the train, and it was probably a 12,000 ton train.

Seth Yeager

Okay. And what was the actual, I guess, just base backing into the CapEx number, having some issues just based on the discontinued operations, what was the actual cash CapEx during the quarter?

Bill Snodgrass

On the discontinued ops?

Seth Yeager

No, no, for NCOC.

Bill Snodgrass

Give us one minute, we will com back to you on that.

Seth Yeager

No problem. And what is the good, I assume at this point you are in maintenance only mode? What is the good maintenance CapEx number with the current company?

Mike Castle

Probably 200,000 a month to 250,000 a month.

Daniel Roling

250,000 a month

Seth Yeager

Okay. And as you are looking into 2010, are you hedged all of some of your input costs and where do you see your input costs going on a year-over-year basis with the new size of the firm?

Daniel Roling

Well, we always work very hard on stabilizing our input costs as it relates to diesel, because we consume a fair amount of that. And we have locked in a diesel price for the majority of all our

needs, about 75%. So we're very comfortable with our diesel costs and they're probably a little lower than where they are in the marketplace today. So that, that we have locked in. Beyond that we've not locked in any other input costs.

Seth Yeager

Okay. All right, thank you. And I don't know I'll get that ...

Daniel Roling

We will get back to you the CapEx number, but it's going to be pretty minimal.

Seth Yeager

Okay. That's what I m assume. Thank you.

Christine Pietryla

If there're any more questions please let us know now so we can get them answered.

Mike Castle

The CapEx for the quarter was \$1.1 million

Daniel Roling

All right. With that I'd like to thank everyone for participating in the call. Again, we can be reached directly at 865-690-6900 or e-mail through our Web site. We will continue to work hard and try and show improved results going forward. Thank you, and we look forward to talking with you.

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