

National Coal Corp. (NCOC) -- Q2 2009 Earnings Call Transcript

August 10, 2009 10:00 am ET

Christine Pietryla

Good afternoon, everyone. Thank you for joining us our second quarter 2009 results conference call. I am Christine Pietryla, the Public Relations and IR contact. Today, we are going to hear from our President and CEO, Dan Roling, as well as our CFO, Michael Castle.

As always, their statements will be followed by a question-and-answer period. Before we begin, I want to remind everyone that we'll be discussing forward-looking information on this call. Examples of forward-looking statements include anticipated benefits of capital improvements and new mines as well as 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 at the 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 all of the 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 10-Q and earnings release. All of these materials are located on our website.

With that, I'll introduce Dan Roling, National Coal's President and CEO Daniel Roling.

Daniel Roling

Thank you, Christine. And welcome everyone to National Coal Corp's second quarter 2009 investor conference call. Release went out about one hour ago and the information contained therein I think is very complete and thorough. We have out in our consolidated results and then the results of pro forma and consolidating statements so investors have a chance to understand National Coal Corp on a going forward basis.

The reason for that is during this current quarter, the third quarter we had our National Coal of Alabama operations were disposed National Coal of Alabama had a very serious decline in volume relative to expectations. Relative to contracted tonnage and as a result of those lower tones about 35% in the quarter versus expectations, National Coal was unable to meet its financing commitments to its lender.

And therefore the lender exercised its legal option and foreclosed on the assets on August 3rd, so on August 3rd National Coal of Alabama is no longer a part of National Coal Corp. National Coal Corp basically is the Tennessee assets which we believe had a bright future, we have a lot of strategic assets and opportunity in Tennessee and has been in the area that we have been focused on for growth, when we look at Tennessee for the quarter, it actually came in inline with our budget and our expectations or our revised budget and our revised expectations but the volume were not nearly as weak as they were in Alabama.

Also in reviewing the quarter and first half results I do want to go back and remind everyone that during the first half of this year we closed or idled approximately four mines actually three mines and mined out of one permitted increment of another major mine. We did open two new mines as result of those endeavors as you all know the closing of a mine is a very expensive process and the last tons taken out of the mine normally are your most expensive tons taken out, so a higher cost associated with those mines were fully reflected in the first quarter. This second quarter reflected the start up of the new mines those new mines did not get up to capacity until mid way through the second quarter, so the outlook for national coal I believe continues to improve as we anticipate better volumes for the second half of this year better pricing for the second half of this year and a lot you will continue to be a function of economic activity. Electricity generation which is the single largest source of demand for coal is down about 4% year to date but the industrial side is down 10% and that has had a very meaningful impact on us.

At this point in time I am going to charter the call over to Mike Castle, our CFO to go through the financial results of the company, Mike.

Michael Castle

Thank you, Dan. On a consolidated basis I will briefly discuss the second quarter 2009 results as compared to the previous quarter and as compared to the same period in 2008. And for our discontinued operations on a stand-alone basis I will discuss the second quarter 2009 results as compared to the first quarter 2009. The second quarter 2009 results as compared to the same period in 2008 and then briefly highlight the year-to-date 2009 compared to the same period of 2008. And finally I will discuss certain noteworthy changes since December 2008 in our balance sheet in our overall liquidity. And first on a consolidated basis in second quarter of 2009 as compared to the first quarter 2009, we saw approximately 457,000 tons in the second quarter at an average sales price to \$75.15 for total sales revenue of \$34.04 million compared to 469,000 tons sold at an average sales price, the \$72.68 for total sales revenues of \$34.1 million in the first quarter of 2009. That represents an increase of 3.4% on our average sales price per ton with an increase of about 18.6% in total revenues from coal sales. This increase can be largely attributable to an increase in sales price on new coal supply agreements that we began shipping in the second quarter of 2009. Our cost of sales was \$30.8 million and an average cost for ton sold is \$67.36 right in the second quarter of 2009 compared to \$31.5 million at an average cost per ton sold in \$67.13 in the first quarter 2009. This slide in increase is directly attributable to the increases we experienced in our Alabama operation primarily in May or June.

Our loss from operations during the three months ended June 30, 2009 decreased \$2.4 million or 54% as compared to the first quarter 2009. We should continue to see reductions in our loss from

operations if we are able to maintain normalized production of sales going forward it continues go soft at our Tennessee operations. On a consolidated basis, the second quarter 2009 is compared to the same quarter 2008. As previously stated we sold 457,000 tons at an average price of \$75.15 for total sales revenue at \$34.4 million in the second quarter as compared to 472,000 tons at an average sales price to \$64.32 for total sales revenues at \$30.4 million in the second quarter 2008, that represents an increase of 16.8% on our average sales price per ton with an increase of about 13% in total revenues from coal sales.

Our cost of sales was again \$30.8 million and average cost per ton sold is \$67.36 in the second quarter compared to 29.2 million at an average cost per ton sold \$61.73 in the same quarter 2008, which is an increase of approximately 9.1%. Our loss from operations during the three months ended June 30 decreased about \$2.1 million of 50.4% compared to the same three-month period in 2008.

Now I will go through a little bit of a second quarter 2009 compared to the first quarter 2009 for our Tennessee operations on a stand alone basis. And in the second quarter 2009 we start with approximately 291,000 tons in Tennessee at an average sales price of \$74.81 for total coal sales revenue of \$21.7 million compared to 278,000 tons sold at an average sales price of \$68.71 per ton for total sales revenues of \$19.1 million in the first quarter of 2009. It represents an increase of nearly 9% on our average sales price per ton with an increase of about 13.7% in total revenues from coal sales. Again this increase is a direct result of a couple new coal supply agreements that we began shipping the later part of the first quarter.

Our total cost of sales was \$19.3 million at an average cost per ton sold \$66.34 during the second quarter of 2009 compared to \$19 million at an average cost per ton sold at \$68.31 in the first quarter of 2009 which is a decrease of nearly \$2 per ton at approximately 3%. This is a direct result of closing less productive mines in Q1 and transitioning the one new mine and adding another section in the second quarter and another mine. Both of these lowered out personnel costs and assuming normalized production levels we've expect this trend to continue. And comparing to Tennessee, second quarter 2009 to the second quarter 2008 again as previously outlined, we sold 291,000 tons at an average sales price of \$74.81. The total sales revenue is \$21.7 million in 2009, this compared to 253,000 tons sold at an average sales price of \$61.42 per ton for total sales revenue is \$15.5 million in 2008. That represents an increase of 21% on our average sales price per ton with an increase of about 40% in total revenues from coal sales.

Our cost of sales was \$19.3 million at an average cost per ton sold of \$66.34 during the second quarter '09 compared to \$13.9 million at an average cost per ton sold at \$54.89 in the same quarter 2008. The increase in cost of sales during the second quarter 2009 compared to the same period in 2008 can plainly be attributed to an increase in purchased coal cost. We've purchased approximately 80,000 tons of coal during the quarter ended June 30, 2009 at an average price per ton of \$63 compared to purchases of 10,000 tons in the same period in 2008 at an average price per ton of just over \$48.

Our purchased coal has historically been used to supplement lower than expected production during the transition in the new mines are going down period such as vacation. And this is something we will continue only if we are able to purchase third party coals in attractive prices.

Now going to the balance sheet and the statement of cash flows, briefly, on a consolidated basis we generated cash from operations of \$2.5 million during the six months ended June 30, 2009 as compared to cash used in operation of \$5.8 million during the same period of 2008. At June 30, 2009 we had cash and cash equivalents and roughly \$900,000 decrease of approximately \$3.7 million from December 31, 2008.

Our Tennessee operations generated cash from operations of \$600,000 during the six months ended June 30, 2009 compared to cash flows used in operations at \$8.5 million in 2008 same period. At June 30, 2009 our Tennessee operations held roughly \$600,000 of cash and cash equivalents, a decrease of approximately \$3.3 million from December 31. It should be noted; we put in place a revolving facility in early April 2009, which provides additional liquidity for National Coal Corporation of Tennessee operations.

At June 30, 2009 the outstanding balance on that credit facility was \$4 million with \$6 million remaining available at June 30.

Dan, I'll turn it back over to you if you want to add anything.

Daniel Roling

Just a few more comments on the outlook, clearly there seems to be few indications that the outlook for coal is starting to improve in our comments that the demand for metallurgical coal in the international market is picking up. There has been some comments about domestic steel industry recovery; clearly we have not seen any improvement at this point over demand for steam coal. Our utility customers our industrial customers basically have not asked for any make-up tonnage yet on the other hand at least in Tennessee which is where our focus is now. We have not seen any deterioration from the levels we've seen in the second quarter. So I guess looking forward our view is that we have bottomed from a demand standpoint, we are not seeing any improvement at the present time. But there are indications that improvements are out there, its just they have not yet materialized for us. But the deterioration has ended and we believe at this time that we're at the bottom.

With that I would like to open it up for questions. [Brett] let me think you're first on the queue.

Question-and-Answer Session

Unidentified Analyst

Couple of questions here. Can you guys describe going forward for the second half of 2009 and for 2010, what is the percentage of coal you've got sold out of Tennessee and at what price?

Daniel Roling

Yes, give me (inaudible) what percent if we got sold a 100% cause as we said in the press release we do not intend to send, sale any on the spot market and we basically at \$74.45 per ton, we are looking at selling about 617,000 tons.

Unidentified Analyst

And then how about for 2010?

Daniel Roling

2010 we have about 800 and 80,000 tons committed at an average price of almost \$79.56. We, at this point in time have available for sale next year about 500,000 tons.

Unidentified Analyst

So are you going to answer into some forward purchase contracts or what are you going to do address the additional tons?

Daniel Roling

We will continue to monitor the market, we'll continue to have ongoing discussions with current and potential customers and we will look for an improvement in the market before we commit. At current prices, it will be very difficult for us to commit to selling any coal.

Unidentified Analyst

And in addition to that because you've got more commitments than you've got production capacity in 2010, what are you looking out for your Tennessee operations CapEx for the balance of this year and for 2010?

Daniel Roling

The balance of this year we're looking at \$1.5 million to \$2 million.

Unidentified Analyst

Yes it's roughly \$1.5 million.

Daniel Roling

And for next year we have not put out a number yet. We are in the process of reviewing what it will be given the new structure of the company. But it will be minimal unless the market improves significantly; if it does we do have some opportunities at opening some new mines and some permits that we have talked about in the past so the opportunity is there but not in this market.

Unidentified Analyst

And then lastly and I'll get back in queue. With respect to the Tennessee, Alabama situation at what point do you think that gets resolved? Are there any cash or tax related charges or benefits that we've come out of closing that part of your transaction?

Daniel Roling

Well let me say it is fully resolved as of August 3. The lender has taken legal ownership of the assets and we are no longer involved with it.

Michael Castle

And to answer your question on the tax side there is no tax implications at this time. However, at the end of the year there will be some net operating loss carry forwards that we'll accrue to the Alabama operation. And I don't know what that number is Brett but we'll make it available. Michael Gaugler?

Michael Gaugler

Two questions Dan. First, do you anticipate purchasing any tons in the second half '09 or can you basically produce what you need?

Daniel Roling

We will be opportunistic is we can purchase coal in the second half that would be advantageous to us; we will look to do that. If not we'll have to produce the coal ourselves.

Michael Gaugler

And second item. On the cost of sales line. I am wondering now with Alabama gone, where you anticipate cost per tons will be? And where they will be trending over the next couple of quarters?

Michael Castle

Our cost per ton has been trending down in Tennessee. We continue to expect that and it's going to get, its down in the low 60s, it has been trending in that area and that's where we anticipate that it will maintain its going lower. Al Shams?

Al Shams

Just a few brief questions Dan. Number one, I'm assuming we're going to have to take the charge in the third quarter with respect to the Alabama operations as...

Daniel Roling

It will actually be a slight positive.

Al Shams

I think we won't have any write-offs or anything of that nature?

Daniel Roling

We have recap.

Michael Castle

No we were not having write-offs as a matter of fact we'll probably pick-up in an excess of \$4 million on equity.

Al Shams

Well maybe equity side of our balance sheet looks a little weak but I understand the cash flow numbers and the operating side and the fact that Alabama is out, we should improve those number going forward, but just to be sure the closing of the Alabama operations is not going to trigger any kind of covenant against the other operations or anything of that nature?

Dan Roling

No, let me make sure you understand, they weren't closed. The operations are still active as far as we know. They were foreclosed on and the lender took possession on August 3rd. No, we don't expect any other implications from [corp] and definitely there were no cross collateralization or any recourse to any of the other entities.

Al Shams

Okay. Dan, could you speak a little bit about the near-term supply/demand factors for coal and where coal may end up being two or three years down the road in terms of supply and demand? I mean we know that a lot of small mines are closing or consolidating, and no new miners are entering the workforce, just that whole kind of intermediate term picture.

Dan Roling

Sure, I will be happy to and again this is my view, but as we look at the industry right now. Not only have we seen a number of small and intermediate sized coal companies close, we have seen a few of them actually declare and go into bankruptcy. In addition to that, a number of the very large mining companies have closed very major operations bigger than we are as a company. So there has been significant closures. According to one consultant study and what you read in the coal press, almost 100 million tons of capacity on an annualized basis has been closed year-to-date. With that said there are some views out there that another 25 million to 50 million tons on an annualized basis may close or needs to close to bring the market into balance.

My view is that a number of these properties that have been closed are being closed on a permanent basis never to be reopened again. Some are idle if we had to break that down I would say 25 million to 30 million tons are permanent closures and that would leave 75 to 100 plus of idle facilities that will come back on.

With demand growing in the long term at about 2% a year, we need about 20 million tons of new capacity every year just to stay even. So clearly with demand off this year we don't need it. With demand having been off last year, we did not need it, but most likely as we go into 2010, demand will come back and not only will we use the inventories but we will most likely be short on a supply and demand basis. Now recently that shortfall has been made up with imports.

Yes, we have seen our exports go up last year, they have come down dramatically this year, but if exports recover next year and some believe there will be a mild recovery in exports, we will need an increase in imports to make up for the shortfall. As we look out two to three years, it's my view that demand will clearly exceed supply and we will see a significant rationing of supply based upon price because supply will not be there to meet demand for two reasons.

One we just went over the closure and permanent closure of capacity and two all the issues surrounding permitting in the industry. It is becoming much more difficult to get permits, the permitting time I would say for small and medium-sized mines are two to three years, the EPA under the new administrator just came out with a memo coordinating all permitting between EPA, Fish and Wildlife and the Army Corp of Engineer. So effectively what that is doing is putting another layer of bureaucracy on permitting to be issued. Permits are used to be able to be issued at regional levels. Now I have to go to Washington for a final review that is another layer of bureaucracy that was not there. There continue to be movements to slowdown the ability to mine and open new mines.

So I don't know if it is two years out or five years, but clearly in my opinion the US will not be able to produce the coal needed to meet its demand in the future.

Al Shams

Okay and with the changes in the operations in Alabama, the lender taking that back, you feel good about the ability to navigate the financial orders until we get to better days

Dan Roling

Yes I do but I am making one very large assumption that the very rough turbulent waters that the financial markets have been through are starting to calm and that we will see a more stable financial market which will allow not only our customers, but our vendors and ourselves to do what you normally would do in financial markets, be that revolving lines of credit for our customers and our vendors, for ourselves and any other financing that might be needed and I am not implying financing is needed on our end, but clearly as you all know our high yield debt which we have outstanding at \$42 million is due December of 2010. So sometime over the next year we will be looking to refinance part or all of that debt, but yes I see us able to navigate these markets assuming some stability in the market here.

Al Shams

Okay. Well, with respect to the credit markets, they couldn't get much worse than we've been through in the last six months, so I think the outlook is more positive than negative.

Dan Roling

Well thank you for your interest. I believe there are no more questions and we will give it a second in case somebody wants to pop in, but otherwise let me thank you all for dialing in for participating in our conference and we look forward to having another one of these calls in three months and as we have said in the first quarter we thought that the second quarter performance would be better. We believe it has been better and we believe the third quarter performance will show further improvement. We are seeing improved volumes in Tennessee. As Mike said our cost continued to trend down and clearly as is in the press release, our selling price per unit continues to trend upward. So with a better economy ahead, we are looking for a much better performance by our company going forward. Thank you all very much.