HALLADOR PETROLEUM CO
Form 10-Q
November 13, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2008

or

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

Commission File Number 0-14731

Hallador Petroleum Company
(Exact Name of Registrant as Specified in Its Charter)

Colorado (State or Other Jurisdiction of Incorporation or Organization)	84-1014610 (I.R.S. Employer Identification No.)
1660 Lincoln St., #2700, Denver, Colorado (Address of Principal Executive Offices)	80264-2701 (Zip Code)

(303) 839-5504 fax: (303) 832-3013
(Registrant's Telephone Number, Including Area Code)

Indicate by checkmark 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 þ No o

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 "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o	Smaller reporting company þ
(Do not check if a 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 o No þ

Shares outstanding as of November 12, 2008: 22,446,028

Part 1 - Financial Information
Item 1. Financial Statements

Consolidated Balance Sheet
(in thousands, except share data)

ASSETS	September 30, 2008	December 31, 2007*
Current assets:		
Cash and cash equivalents	$ 14,316	$ 6,978
Cash – restricted	2,248	1,800
Accounts receivable	6,075	2,361
Coal inventory	203	92
Other	1,664	861
Total current assets	24,506	12,092
Coal properties, at cost	87,232	64,685
Less - accumulated depreciation, depletion, and amortization	(5,816)	(2,743)
	81,416	61,942
Investment in Savoy	11,615	11,893
Other assets	2,144	1,330
	$ 119,681	$ 87,257
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 5,337	$ 1,893
Accounts payable and accrued liabilities	8,122	5,550
Other	487	620
Total current liabilities	13,946	8,063
Long-term liabilities:		
Bank debt, net of current portion	30,686	33,464
Asset retirement obligations	676	646
Contract termination obligation	4,345	4,346
Interest rate swaps, at estimated fair value	1,124	1,181
Total long-term liabilities	36,831	39,637
Total liabilities	50,777	47,700
Minority interest	753	384
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $.10 par value, 10,000,000 shares authorized; none issued		
Common stock, $.01 par value, 100,000,000 shares authorized; 21,902,528 and 16,362,528 outstanding	219	163
Additional paid-in capital	67,568	44,990
Retained earnings (deficit)	364	(5,980)
Total stockholders' equity	68,151	39,173

		$	119,681	$ 87,257

*Derived from the Form 10-KSB.

See accompanying notes.

Consolidated Statement of Operations
(in thousands, except per share data)

	Nine months ended September 30,		Three months ended September 30,	
	2008	2007	2008	2007
Revenue:				
Coal sales	$ 41,688	$ 18,070	$ 17,726	$ 8,672
Gain on sale of oil and gas properties	494	1,824		1,824
Equity income (loss) – Savoy	(103)	203	(378)	132
Other	400	388	112	25
	42,479	20,485	17,460	10,653
Costs and expenses:				
Cost of coal sales	27,579	14,326	11,127	6,340
DD&A	3,213	1,670	1,282	712
G&A	2,270	3,624	902	2,583
Interest	2,227	2,721	851	1,484
	35,289	22,341	14,162	11,119
Income (loss) before minority interest	7,190	(1,856)	3,298	(466)
Minority interest	(846)	320	(365)	30
Net income (loss)	$ 6,344	$ (1,536)	$ 2,933	$ (436)
Net income (loss) per share-basic and diluted	$ .36	$ (.12)	$ .14	$ (.03)
Weighted average shares outstanding-basic and diluted	17,824	12,320	20,707	12,619

See accompanying notes.

Condensed Consolidated Statement of Cash Flows
(in thousands)

	Nine months ended September 30,	
	2008	2007
Operating activities:		
Cash provided by (used in) operating activities	$ 7,166	$ (1,483)
Investing activities:		
Acquisition of additional 20% interest in Sunrise	(11,771)	
Capital expenditures for coal properties	(10,852)	(12,094)
Sales of oil and gas properties	752	2,456
Other	(559)	131
Cash used in investing activities	(22,430)	(9,507)
Financing activities:		
Proceeds from bank debt	2,000	7,140
Payments of bank debt	(1,334)	
Proceeds from stock sale	21,983	
Capital contributions from Sunrise minority owners		800
Proceeds from exercise of stock options		460
Other	(47)	(136)
Cash provided by financing activities	22,602	8,264
Increase (decrease) in cash and cash equivalents	7,338	(2,726)
Cash and cash equivalents, beginning of period	6,978	7,206
Cash and cash equivalents, end of period	$ 14,316	$ 4,480
Cash paid for interest (net of amount capitalized - $176 and $230)	$ 2,308	$ 1,710
Change in accounts payable for coal properties	$ 994	$ 1,371
Acquisition of minority interest	$ 477	

See accompanying notes.

Statement of Stockholders' Equity
(in thousands, except share data)

	Common Stock	Additional Paid-In Capital	Retained Earnings (Deficit)	Total
Balance December 31, 2007	$ 163	$ 44,990	$ (5,980)	$ 39,173
July stock sale, net of issuance costs (5,500,000 shares)	55	21,928		21,983
Stock-based compensation	1	650		651
Net income			6,344	6,344
Balance September 30, 2008	$ 219	$ 67,568	$ 364	$ 68,151

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.

Our organization and business, the accounting policies we follow and other information, are contained in the notes to our financial statements filed as part of our 2007 Form 10-KSB. This quarterly report should be read in conjunction with that annual report.

The accompanying consolidated financial statements include the accounts of Hallador Petroleum Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated. We are engaged in the production of coal from a shallow underground mine located in western Indiana. We also own a 45% equity interest in Savoy Energy L.P., a private oil and gas company, which has operations primarily in Michigan.

As discussed in prior filings, we have entered into significant equity transactions with Yorktown and other entities that invest with Yorktown. Yorktown currently owns about 55% of our common stock and represents one of the five seats on our board.

2. Equity Investment in Savoy

We account for our interest in Savoy using the equity method of accounting. On October 5, 2007 we acquired an additional 13% in Savoy which brought our total interest to 45%.

Below (in thousands) are: (i) a condensed balance sheet at September 30, 2008, and (ii) a condensed statement of operations for the nine months ended September 30, 2008 and 2007.

Condensed Balance Sheet

Current assets	$ 13,525
PP&E	14,646
	$ 28,171
Total liabilities	$ 6,871
Partners' capital	21,300
	$ 28,171

Condensed Statement of Operations

	2008	2007
Revenue	$ 5,587	$ 4,099
Expenses	(5,078)	(3,207)
Net income	$ 509	$ 892

For 2008, the difference between the purchase price and our pro rata share of the equity of Savoy was amortized based on Savoy's units of production rate using proved developed oil and gas reserves. Such amounts for September 30, 2008 and 2007 were $332,000 and $82,000, respectively. For 2007 such amount was amortized using proved reserves.

3. Notes Payable

In late June 2007, our Indiana banks agreed to increase the Sunrise line of credit (LOC) from $30 million to $40 million. We are the guarantor of this LOC. The additional funds were used to purchase certain mining equipment, build a rail loop, and for working capital. As of September 30, 2008, we have drawn down $36 million; plus we have outstanding letters of credit for another $3 million. The current interest rate is LIBOR (3.2%) plus 3.55% or 6.75%. As discussed below, Sunrise entered into two interest rate swaps.

The LOC was converted to a seven year term note in July 2008. The note will mature in June 2015. The note requires monthly principal payments of $445,000 plus interest.

Aggregate maturities of debt are $1,334,000 for the last quarter of 2008, $5,337,000 in 2009, $5,337,000 in 2010, $5,337,000 in 2011, $5,337,000 in 2012, and $13,341,000 thereafter.

We have entered into two interest rate swap agreements swapping variable rates for fixed rates. The first swap agreement is relative to the $30 million LOC and matures on July 15, 2012. The second swap agreement relates to the additional $10 million that increased Sunrise's LOC to $40 million. This second swap agreement matures on December 28, 2011. The two swap agreements fix our interest rate at about 8.8%. At September 30, 2008, we recorded the estimated fair value of the two swaps as a $1.1 million liability.

Accounting rules require us to recognize all derivatives on the balance sheet at estimated fair value. Derivatives that are not hedges must be adjusted to estimated fair value through results of operations. We have no derivatives designated as hedges.

We are in negotiations with a bank group to increase our credit facility by $30 million in order to fund additional mine expansion. We expect to finalize the new loan agreement by the end of November 2008.

4. Fair Value Measurements

We adopted SFAS No. 157, “Fair Value Measurements,” effective January 1, 2008 for financial assets and liabilities measured on a recurring basis. SFAS No. 157 applies to all financial assets and liabilities that are being measured and reported on a fair value basis. In February 2008, the FASB issued FSP No. 157-2, which delayed the effective date of SFAS No. 157 by one year for nonfinancial assets and liabilities except those that are recognized and recorded in the financial statements at fair value on a recurring basis. As defined in SFAS No. 157, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). SFAS No. 157 requires disclosure that establishes a framework for measuring fair value and expands disclosure about fair value measurements.

The statement requires fair value measurements be classified and disclosed in one of the following categories:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities. We consider active markets as those in which transactions for the assets or liabilities occur in sufficient frequency and volume to provide pricing information on an ongoing basis. We have no Level 1 instruments.

Level 2: Quoted prices in markets that are not active, or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability. We have no Level 2 instruments.

Level 3: Measured based on prices or valuation models that require inputs that are both significant to the fair value measurement and less observable from objective sources (i.e., supported by little or no market activity). Our Level 3 instruments are comprised of interest rate swaps. Although we utilize third party broker quotes to assess the reasonableness of our prices and valuation, we do not have sufficient corroborating market evidence to support classifying these liabilities as Level 2.

At December 31, 2007, March 31, 2008, June 30, 2008 and September 30, 2008, the estimated fair value of our interest rate swaps were a liability of $1.2 million, $2.1 million, $1.1 million and $1.1 million, respectively. The difference for the respective periods is reflected in our results of operations.

5. Commitments and Contingencies

Based on contracts in place as of November 2008, during the period October 1, 2008 through December 31, 2013 we are committed to deliver 14.3 million tons of coal at prices averaging about $42 per ton.

6. Advances to Sunrise

In order to expand coal production at the Carlisle mine, additional capital is necessary to purchase mining equipment. During the nine months ended September 30, 2008 we advanced Sunrise $6.2 million and, subsequently, have advanced an additional $1.8 million. We are currently receiving monthly interest at 6% on the $8 million. The advances and interest are eliminated in consolidation.

7. Restricted Stock Units

Effective April 8, 2008, the Board approved the Hallador Petroleum Company 2008 Restricted Stock Unit Plan. On July 7, 2008 the Plan was amended to increase the authorized issuance of restricted stock units (RSUs) from 450,000 units to 1,350,000 units.

On May 6, 2008, we awarded to certain Sunrise employees and owners a total of 180,000 RSUs which vest on April 1, 2011. The RSUs were valued at $4.25 per share based on the closing price on that date. On May 14, 2008, we accelerated vesting on 50,000 shares and recognized an expense of about $212,000. Additionally, we recognized another $40,000 in service cost for the remaining 115,000 RSUs during the three months ended September 30, 2008.

On July 7, 2008, we awarded to certain of our and Sunrise's key employees 820,000 RSUs, all of which vest on July 7, 2011. Of the 820,000 RSUs awarded, Victor P. Stabio, our CEO received 450,000 units and Brent Bilsland, Sunrise's President, received 300,000 units. These RSUs were valued at $3.55 per share based on the closing price on that date. During October 2008, we accelerated vesting on 815,000 RSUs, of which 450,000 were issued to Victor Stabio and 300,000 were issued to Brent Bilsland, and the remaining 65,000 were issued to others. Our stock was selling in the $2.75 to $2.85 range on the dates of acceleration. During the fourth quarter 2008, we will recognize an expense of about $2.3 million for these RSUs.

Vesting occurs at the end of three years of employment. Upon vesting, each RSU entitles the recipient to receive one share of common stock. If the RSU recipient’s employment with us or Sunrise ceases for any reason prior to vesting, the RSUs will be cancelled and the recipient will no longer have any right to receive any shares of common stock. Due to employee resignations during the third quarter, 15,000 RSUs were forfeited back to the Plan.

As of November 12, 2008, we have 365,000 RSUs available for future issuance and there are 165,000 RSUs outstanding which have not vested.

8. Sales of Common Stock and Purchase of Additional Interests in Sunrise

On July 21, 2008, we sold 5.5 million shares of our common stock for $22 million ($4 per share) in a private placement transaction to existing shareholders. On July 24, 2008 we purchased an additional 20% interest in Sunrise from certain of its existing members for $11.8 million, bringing our ownership in Sunrise to 80%. The purchase price was allocated to coal properties.

Prior to the purchase of the additional 20% interest, we consolidated 100% of the Sunrise operations with a 13% minority interest. Subsequent to the purchase, we are now using an 8% minority interest. Once we receive our $22.9 million funding commitment (as previously discussed in prior filings), plus interest of 10%, the minority interest will change to 20%.

9. Income Taxes

At December 31, 2007 we had NOLs of about $8.8 million. The NOLs will expire in 2026. The second quarter 2008 is the first time we have shown a profit since our involvement with Sunrise. Accordingly, until management is

satisfied that we will be profitable on a continuing basis, we will not recognize any tax benefits resulting from our NOLs.

ITEM 2. MD&A.

THE FOLLOWING DISCUSSION UPDATES THE MD&A SECTION OF OUR 2007 FORM 10-KSB AND SHOULD BE READ IN CONJUNCTION THERETO.

Outlook

If prices and mine conditions continue as they were in the third quarter we expect fourth quarter earnings and cash flows to exceed the third quarter.

Sales of Common Stock and Purchase of Additional Interests in Sunrise

On July 21, 2008, we sold 5.5 million shares of our common stock for $22 million ($4 per share) in a private placement transaction to existing shareholders. On July 24, 2008 we purchased an additional 20% interest in Sunrise from certain of its existing members for $11.8 million, bringing our ownership in Sunrise to 80%. The remainder of the proceeds will be used for mine expansion.

Mine Expansion

Due to the recent increases in coal prices, we made the decision to expand the mine from its current capacity of 1.8 million tons per year to 3 million tons per year. This expansion will involve the purchase of additional mine equipment, the construction of another wash plant, and the hiring of about 130 new employees. We expect the expansion to be completed during the first half of 2010.

Funding for the expansion will come from a combination of (i) advances to Sunrises, (ii) additional bank borrowings, and (iii) cash from operations. We anticipate the cost of the expansion to be about $45 million.

We have committed to advance Sunrise up to $13 million for the mine expansion of which $8 million has been advanced to date. We are charging Sunrise interest at 6%. The advances and interest are eliminated in consolidation.

Negotiations are ongoing with our bank group to provide the remaining funds for the mine expansion.

In July 2008 we amended one of our three coal contracts so that we will have a market for the aforementioned production of 3 million (MM) tons per year in 2010. Our current average sales price is about $31 per ton and we expect our average price to rise to $43 per ton in 2010. We expect 2008 production to be 1.9 MM tons with an average price of $36.50; 2009 production to be 2.4 MM tons with an average price of $43; and 2010 production to be 3 MM tons with an average price of $43.

Gain on Sale of Unproved Lease Acreage

In late October 2008, we sold our interest in 10,000 acres in southeast Wyoming for about $2 million and will recognize a gain of about $1.3 million. Upon the favorable outcome of a pending lawsuit regarding the title to certain acreage we could receive an additional $450,000. The purchaser is now bearing the cost of the litigation. Assuming an unfavorable outcome, there is no loss to us other than we would not receive the additional $450,000. We retained a 2% overriding royalty interest (ORRI) on the 10,000 acres we sold plus an additional 2% ORRI on an adjacent 10,000 acres which resulted from an arrangement we had with one of our partners in this prospect.

As a result of this sale, we have minimal unproved acreage in our inventory. Since entering the joint venture with Sunrise in June 2006, we have sold about $10 million of oil and gas properties to support the development of the Carlisle mine. We will continue to evaluate possible oil and gas lease plays in the Rocky Mountain region.

Liquidity and Capital Resources

We have no off-balance sheet arrangements.

Results of Operations

Year to Date

Coal sales began in February 2007. For the nine months ended September 30, 2007 we sold 617,000 tons at an average price of $29.30/ton. For the nine months ended September 30, 2008 we sold 1,355,000 tons at an average price of about $30.75/ton.

In early July 2007 we sold our interest in the San Juan properties for $2.3 million. We recognized a gain of about $1.8 million. During the first quarter 2008, we sold some unproved oil and gas properties and recognized a gain of $494,000.

Savoy's income declined due to a higher dry hole costs and seismic expenses. In addition, we had amortization expense of $332,000 in 2008 compared to $82,000 in 2007. This increase was due to the additional 13% interest in Savoy we acquired in October 2007. The difference between the purchase price and our pro rata share of the equity in Savoy is amortized based on Savoy's units of production rate. Due to declining oil and gas prices, Savoy's fourth quarter revenues will decline.

Cost of sales increased due to a substantial increase in the tons of coal sold. On a per ton basis, they dropped by about $3 per ton due to increases in mining efficiencies.

The increase in DD&A was due to nine months of coal sales in 2008 compared to eight months in 2007. In addition, our coal properties have increased. There were no significant changes in our coal reserves.

During July and August 2007, the Board allowed Mr. Stabio's and Mr. Bisland's restricted stock awards to vest. We took a charge of about $1.8 million for these vested shares. During 2008 we incurred higher stock compensation expense of about $300,000.

Included in interest expense for 2007 was $165,000 related to the fair value of our interest rate swap and $260,000 for accretion of the contract termination obligation. We ceased amortizing such obligation on December 31, 2007.

The change in minority interest was due to Sunrise having a profit in 2008 compared to a loss in 2007.

Quarter to Date

Coal sales began in February 2007. For the three months ended September 30, 2007 we sold 304,000 tons at an average price of about $28.50/ton. For the three months ended September 30, 2008 we sold 530,000 tons at an average price of about $33.45/ton.

See above for a discussion of the change in our equity in Savoy's income or loss.

Cost of coal sales on a per ton basis stayed about the same for both periods.

See above for a discussion in the change in DD&A.

See above for a discussion in the change in G&A.

Included in interest expense for 2007 was $295,000 related to the fair value of our interest rate swap and $130,000 for accretion of the contract termination obligation. We ceased amortizing such obligation on December 31, 2007.

New Accounting Pronouncements

Other than SFAS 160, none of the recent FASB pronouncements had, or will have any material effect on us. In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements, an amendment of Accounting Research Bulletin No. 51. This statement requires an entity to separately disclose non-controlling interests as a separate component of equity in the balance sheet and clearly identify on the face of the income statement net income related to non-controlling interests. This statement is effective for financial statements issued for fiscal years beginning after December 15, 2008. The adoption of this statement will change how we present

our consolidation with Sunrise.

ITEM 4(T). 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 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 of the effectiveness of the design and operation of our disclosure controls and procedures. Based upon that evaluation, our CEO, who is also our CFO, concluded that our disclosure controls and procedures are effective for the purposes discussed above.

There has been no change in our internal control over financial reporting during the quarter ended September 30, 2008 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II—OTHER INFORMATION

ITEM 6.	EXHIBITS
(a)	10.1 -- 331 -- SOX 302 Certification 32 -- SOX 906 Certification ----------

SIGNATURE

In accordance with the requirements of the Exchange Act, the Registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

HALLADOR PETROLEUM COMPANY

Dated: November 12, 2008

By: /S/ VICTOR P. STABIO
CEO and CFO
Signing on behalf of registrant and
as principal financial officer.

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