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David Stetson, CEO, Alpha Metallurgical Resources, Addresses Bluefield Coal & Mining Show

David Stetson

"'Welcome to the Bluefield Coal & Mining Show, where so many exhibitors and vendors are set up to collaborate and offer their services, "said David Stetson, CEO, Alpha Natural Resources in presenting the Keynote Address to the Media and Exhibitor Breakfast, at the Bluefield Coal & Mining Show. "It's great to see so many people connected to the coal industry together at the same time," he said.

"I have been asked to share some remarks with you today about the coal industry – where we're currently sitting and what might be lying ahead and I'll do my best to shed some light on the situation through some anecdotal stories about how my company, Alpha, has managed over the last few years."

Alpha is the largest and most diverse metallurgical coal producer in the nation, accounting for nearly a quarter of total U.S. met coal production annually. "At Alpha, we believe in operating safely and ethically, and we encourage every employee to actively participate in our behavior-based safety program to continually improve our performance," he said.

The Alpha portfolio includes twenty-one mines, eight preparation plants, and control of over 725 million tons of reserves and resources. Additionally, Alpha are majority owners of Dominion Terminal Associates, commonly known as DTA, which is an export facility in Newport News, VA.

Last year, Alpha shipped coal to twenty-five countries, and generated over 2.25 billion dollars in coal revenues. None of this would be possible without the more than 3,500 employees who make up the Alpha team and dedicate themselves to safe production each and every day.

"One of my favorite quotes has been attributed to a number of different people, but it states that "you should only look back to see how far you've come." We have really taken this to heart at Alpha, as we've turned a number of corners in the last several years, but I think it's an instructive notion to kick things off for us this morning as well."

Stetson turned to the global perspective. The past few years have been tumultuous and full of change across every corner of the world and in all economic sectors. The coal industry is known for its often wild swings in volatility, but many other businesses have experienced sudden and severe ebbs and flows in the last two years.

The entire world was turned upside down with the pandemic, and we are still dealing with its residual effects in many aspects of our daily lives. This group in Bluefield is all too familiar with the supply chain challenges that have created havoc for consumers across the globe.

Whether it's Lysol wipes or toilet paper or baby formula, or now, affordable fuel for electricity, we have witnessed significant imbalances in supply and demand. Businesses imposed limits on the number of in-demand products that could be purchased at one time, and anxious customers were often faced with an inability to find the products they wanted or needed. At Alpha, the sourcing team has worked hard to overcome obstacles like these to keep the company running with the supplies

From a higher-level perspective, these challenges also highlighted the fragility of the global trade infrastructure and the need for analysis and improvements to strengthen those vital processes. Significant government spending in response to Covid has also had a deep impact on the economy. Depending on who you ask, there are many people who believe the current inflationary levels are directly linked to the deluge of government money that was poured into the marketplace. Some might argue that the Fed took a bit too long to respond to the early signs of inflation, but it's easy to play Monday morning quarterback.

It's far harder to stop a train that's barreling down the tracks. Regardless of how or why we got here, the inflationary pressures are real, and they have increased operational costs for coal companies. We are not alone in this, however. FactSet, a financial data and software company, analyzed the earnings calls from the first quarter of 2022 of 487 of the S&P 500 companies who hosted a call.

Of those, 417 companies—or 86% and the highest level in a decade— mentioned “inflation” as part of their remarks about Q1. Similarly, the mention of “supply chain” had hit record levels in the third quarter of 2021. Companies across all facets of the economy are grappling with these matters and looking for ways to mitigate their impacts on the business.

Another word on the tip of the tongue for many corporate leaders is “labor,” which is a wide-ranging topic that covers everything from a shortage of personnel to the evolving challenges of hybrid or remote work. Labor can also refer to unionization efforts, which many companies, including Amazon and Starbucks, have been experiencing this year.

The labor issue felt most acutely within the coal industry is competition for workers, which has increased both inside and outside of the industry. Many companies— including Alpha—have publicly discussed the rising costs of retaining their current workforce. Since the beginning of 2021, and on an annualized basis, Alpha have invested an additional 120 million dollars in their employees in the form of wage increases, expanded benefits offerings, and incentive bonuses.

Alpha have created new programs to train up first-time miners, and have expanded our recruiting efforts to bring in additional workers. Labor has been a major hurdle for their transportation partners as well. As you can imagine, it takes a vast network of trucks, trains, barges, and ocean vessels to get coal from the mine to their customers. Rail service has been a hot topic of conversation among coal producers in the last year as the railroads have been working to address their labor. Shortages and establish new operating practices to create a more reliable service framework. These issues are complex and cannot be solved overnight, but we continue to see improvement from rail partners, and Alpha are grateful for their cooperation in moving toward pre-pandemic benchmark levels of performance.

In addition to the pandemic; inflation and labor as well as other geopolitical factors have affected the global marketplace, including China’s refusal to import certain Australian goods—including coal— and Russia’s war on Ukraine. In coal markets specifically, these two situations have upended natural trade flows and injected additional uncertainty into the system.

After years of underinvestment in new development within the coal industry, demand outstripped supply, which created an environment with record high prices across the entire menu of coal qualities. This happened first in the metallurgical coal space with index levels rising considerably throughout the second half of last year and into first quarter of 2022.

To pinpoint how dramatic these increases were, a spot metric ton of coal priced on the Australian premium low vol index would have cost 112 dollars on march 17th of 2021, but exactly a year later that same ton of coal on the same index was priced at 670 dollars. That’s a 500 percent increase in a year’s time. The market has since cooled from those incredible spikes, coming down to levels that are still strong by historical averages, but much lower than in the first half of the year.

For example, since Statson just mentioned the Aussie plv, it has most recently been hovering around 270 dollars. This kind of drop has been seen across most of the metallurgical coal indices. While the trade tensions between China and Australia played a significant role in metallurgical pricing over the past year, the Russian invasion of Ukraine served as an added jolt of volatility in those markets.

However, the thermal markets have garnered the most attention in recent months as bans on Russian fuels upended the electricity generation system, especially in Europe.

“Although not nearly on the same scale, we have some challenges of our own here in the United States with our baseload power as well,” said Stetson. Historically, thermal coal has yielded a much more modest price as compared to what a metallurgical ton would fetch. However, as a result of these unique circumstances with Russia and Ukraine, thermal coal indices have jumped higher than even the highest quality met coals, inverting what has historically been a predictable pricing hierarchy.

The word “unprecedented” gets overused, but when it comes to the significant factors that have played into our current coal market circumstances, it has truly been an unprecedented couple of years. With that backdrop, Stetson talked about what all of this has meant for coal producers, and how they’ve responded.

At Alpha, the record-high pricing environment—along with a lot of hard work—allowed them to post three quarters of back-to-back-to-back record earnings in adjusted EBITDA. This also permitted them to pay over 550 million dollars on their term loan in roughly a year’s time, completely eliminating the long-term debt in June of this year.
The Board of Directors also authorized a share repurchase program that allows them to buy back up to $600 million dollars of their common stock. As of august 31, they have bought back 2.3 million shares, utilizing about 326 million dollars of the 600 million authorization. “I’m proud of how we capitalized on the circumstances to strengthen our company and position ourselves for an even brighter future,” Stetson said.

Each individual company has been affected differently based on portfolio mix, overall production size, and ability to export their products. The upsetting of “normal” trade flows presented opportunities for producers who were astute enough to look for them and agile enough to respond. For example, after years of shipping no coal at all into China, Alpha sent nearly two million tons of their metallurgical coal there last year. They were able to accomplish this while continuing to service existing customers and, even though they understood that this opportunity may not last forever, they were pleased to branch out into this new market.

Stetson turned to thermal coal. Alpha announced on their most recent earnings call that they increased their guidance for thermal coal shipments in 2022 by two hundred thousand tons at the midpoint as an opportunistic response to the elevated pricing environment. The radically changing economics in the thermal market have also increased the reserve life at their Slabcamp deep mine. Formerly planned to idle this year, more resource tons have been identified and mine plans are being developed. Alpha's last pure play thermal mine is now expected to operate into the first quarter of next year.

While actions like these can incrementally add hundreds of thousands of tons into the market, global coal supply levels remain quite constrained—for both metallurgical and thermal coals. Regulatory hurdles and anti-coal governments across the globe have hindered plans for some larger scale mine development projects, especially overseas.

For those who might be able to pass the necessary bureaucratic hurdles, access to capital has gotten exponentially more expensive, with far fewer funding options available to coal producers today as compared to even five or ten years ago. Lastly, whether it's due to a combination of these obstacles or simply the short memories of the last down cycle that pushed many companies into bankruptcy, there has been a noticeable restraint that hasn't existed in prior boom markets.

Usually when prices shoot up, producers rush to open new mines. From the smallest operators to the largest, however new tons aren't being developed at a pace anywhere close to what we saw in prior elevated pricing environments. This has tightened the overall coal supply.

Consider the many outside influences that have shaped the industry's transformation over the last couple of years, These circumstances have solidified the importance of coal and its role in society. Despite the wide-ranging pressures the industry faces, we produce a resource that is critically important to everyday life. Roads and bridges, building construction, vehicles, household appliances—they all need steel, which is made from metallurgical coal.

Affordable energy to heat and cool our homes has long been derived from thermal coal, and there are countless examples across the world suggesting that it must continue to be part of the baseload mix—from both a practicality and an affordability standpoint. All in all, Stetson is proud of what our industry has provided modern society, and he believes we will continue to serve a critical role for many decades to come

So, what does the future hold for the coal industry? In the near term, Stetson believes there is still a high level of uncertainty that will understandably dictate some of the coal market movements. Overall weakening of the global economy, the ongoing war between Russia and Ukraine, inflation concerns, and recession fears have all influenced the pricing and movement of coal across the globe, and he expects these factors to have a continued impact in the near term.

Assuming the Russian war continues, and China remains steadfast in rejecting Australian coal, we expect both of these major geopolitical factors to continue influencing trade flows. Inflationary pressure and recessionary fears will also play a role. Alpha monitors several economic indicators to understand the health of the steel industry, with one of those being the world steel association's crude steel production figures. In general, there is evidence of a cooling off in steel production. Even with a pullback on steel production, Alpha are still receiving consistent interest in their products, and they remain cautiously optimistic about sales prospects for 2023 and beyond.

From a revenue generation perspective, the current levels of the indices have retreated from the record highs we saw earlier in the year, but they still represent very solid prices that are above historical averages. Unlike other commodities, the coal futures market is highly illiquid, but it still serves as a barometer of industry expectations. The futures strip currently predicts an improvement in pricing for Australian premium low vol, with estimates near $300 per metric ton

Through March of 2023. supply remains relatively consistent, as few incremental tons are positioned to enter the marketplace. Just yesterday Alpha announced that they have wrapped up a majority of their 2023 domestic negotiations, committing roughly 4.5 million tons to our domestic steel companies.

From a longer-term perspective, Stetson did not attempt to speak on behalf of the entire industry, but mentioned what Alpha has done and how they are preparing. They recently completed a strategic planning exercise to chart Alpha's next 15 years. While they obviously have reserves extending well beyond this time horizon, a decade and a half is a period lengthy enough to require long-range planning into development, permitting, and capital needs, yet still tangibly close enough to yield meaningful projections and actionable information they can use in their current operational decision-making. A few key takeaways from this process:

Alpha believes their current portfolio of assets should allow the company to maintain a consistent level of production, similar to Alpha's recent average production rates, across the next fifteen years, without any need for inorganic growth. This not only serves as a solid foundation for long-term planning, but it also offers longevity and consistency in shipment volumes.

Alpha also expect to be able to gradually improve the company's coal rank and quality while maintaining the flexibility and optionality provided by a diverse product mix.

As Alpha looks to build on their existing customer bases, they see strategic opportunities to develop new relationships by expanding sales and marketing efforts in areas projecting the most growth in demand for met coal. These cultivation efforts are already underway, and they plan to intensify these endeavors in the coming years.

The final takeaway in this process was simply that they are encouraged by the analysis and excited about what lies ahead for the company.

Stetson summarized: "I will reiterate the fact that no one knows exactly what the future will hold. I have frequently said that one of the most important parts of my job is to create a framework through which the company is prepared to operate safely and efficiently, no matter the circumstances. I saw our deleveraging efforts as a critical step in this journey toward long-term strength. Now, after paying off our long-term debt and returning capital to shareholders, Alpha is far better positioned than we were even a few short years ago, and I believe our future is very bright," he said.

“Our successes are due to the incredible people who make up this organization, from prep plant supervisors to surface mining engineers, underground roof bolters to continuous miner operators. Each plays a role in making Alpha strong. Behind the front-line employees who directly operate our mines, there is a vast system of people supporting those efforts in corporate functions that keep the business running administratively. And leading it all is an executive team that I believe is second-to-none. I’ve been proud to be surrounded by top-notch leaders who care as much about the future of Alpha as I do.

“In closing, I want to thank you again for your time and attention and thank you for the services you provide to our industry. I hope my remarks were a helpful framework to kick off this outstanding event and provide a window into what the future of our industry will hold. Again, thank you for allowing me to spend some time with you this morning.”