



## DTC Flash©: Arch Coal Q3 2017 Earnings Analysis and Call Comments

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**DTC Short and Sweet:** Q3 revenues totaled \$613.5mm, up from \$549.9mm in Q2 mostly driven by higher PRB sales. Net income was \$68.4mm, up from Q2 (\$37.2mm). Operating costs rose in their Met segment to \$64.46 from \$60.95 in Q2 due to difficult mining conditions and rail service issues and fell in their PRB segment from \$10.82 to \$10.27 on higher volume. **ARCH** raised its cash cost guidance in the Met segment as a result from \$51-56/ton to \$56-60/ton and lowered its met coal sales guidance to 6.6 – 6.8 mm tons from 6.9 – 7.1 mm tons in Q2 noting startup issues in the Cedar Grove seam at Mtn Laurel and a roll in the coal seam at Leer. **ARCH** noted that at the midpoint of their guidance they are now 99% committed for thermal sales in 2017 and more than 98% committed for coking coal sales with 10% of that on index-based pricing.

- **Q3 2017 EPS:** \$2.83 diluted; \$2.54 adjusted diluted (vs average analyst estimates of \$1.82 and a range of \$1.12 – \$2.78)
- **Q3 2017 Adj EBITDAR:** \$104.27 mm (vs \$95.4 mm seq)
- **Q3 2017 Sales (total):** 26.2 mm tons (vs 22.5 mm tons seq)
- **2017 Guidance**
  - **Sales:** 96.6 – 102.8 mm tons (vs 93.9 – 102.1 mm tons at Q2 2017)
  - **Met Coal Sales:** 6.6 – 6.8 mm tons (vs 6.9 – 7.1 mm tons at Q2 2017)
  - **Thermal Coal Sales:** 90.0 – 96.0 mm tons (vs 87.0 – 95.0 mm tons at Q2 2017)
  - **Met Avg Cost:** \$56.00 – \$60.00 /ton (vs \$51.00 – \$56.00/ton from Q2 2017)
  - **PRB Avg Cost:** \$10.20 – \$10.60/ton (unch from Q2 2017)
  - **Other Thermal Avg Cost:** \$22.50 – \$26.50/ton (vs \$23.00 – \$27.00/ton at Q2 2017)
  - **Capex:** \$52 – \$58 mm (vs \$52 – \$60 mm from Q2 2017)
  - **DD&A:** \$120 – \$127 mm, excl Sales Contract Amortization (\$124 – \$132 mm at Q2'17)
  - **SG&A:** \$84 – \$88 mm (vs \$85 – \$89 mm from Q2 2017)
- **2017 Sales Contracts (ARCH restructured sales contract guidance to account for the Lone Mountain divestiture—the PCI breakdown was removed and Thermal has been renamed to Thermal Byproduct)**
  - **Met Committed, Priced:** 6.0 mm tons at \$100.20/ton (vs 5.0 mm at \$97.14/ton at Q2'17)
  - **Met Committed, Unpriced:** 0.6 mm tons (vs 1.4 mm tons at Q2 2017)
  - **Thermal Byproduct Committed, Priced:** 0.9 mm tons at \$24.86/ton (vs 0.9 mm tons at \$24.45/ton at Q2 2017)
  - **Thermal Byproduct Committed, Unpriced:** 0 tons (unchanged from Q2 2017)
  - **PRB Committed, Priced:** 81.1 mm tons at \$12.47/ton (vs 76.4 mm at \$12.47/ton at Q2)
  - **PRB Committed, Unpriced:** 0.9 mm tons (vs 1.8 mm tons at Q2 2017)
  - **Other Thermal Committed, Priced:** 9.3 mm tons at \$34.74/ton (vs 8.4 mm tons at \$34.61/ton at Q2 2017)
  - **Other Thermal Committed, Unpriced:** 0 tons (unchanged from Q2 2017)
- **2018 Sales Contracts**
  - **Met Committed, Priced:** 0.5 mm tons at \$105.00/ton (vs 0.1 mm at \$97.37/ton at Q2'17)
  - **Met Committed, Unpriced:** 2.4 mm tons (vs 2.0 mm tons at Q2 2017)
  - **Thermal Byproduct Committed, Priced:** 0.4 mm tons at \$30.45/ton (vs 0.4 mm tons at \$30.33/ton at Q2 2017)
  - **PRB Committed, Priced:** 47.5 mm tons at \$12.05/ton (vs 36.5 mm at \$12.20/ton at Q2)
  - **PRB Committed, Unpriced:** 2.8 mm tons (vs 3.0 mm tons from Q2 2017)
  - **Other Thermal Committed, Priced:** 5.0 mm tons at \$35.26/ton (vs 2.9 mm tons at \$37.94/ton at Q2 2017)

**Note:** Due to changes in the way Arch is reporting operational performance, historical comparisons are no longer relevant. The table below illustrates Q3 '17 performance vs Q2 '17.

ARCH Operational Results				
Segment	Metric	Q3 2017	Q2 2017	Seq Chg
PRB	Tons Sold	21.7	18.1	19.89%
	Sales Price	\$12.51	\$12.55	-0.32%
	Operating Cost	\$10.27	\$10.82	-5.08%
	Margin	\$2.24	\$1.73	29.48%
Met	Tons Sold	2.2	2.1	4.76%
	Sales Price	\$88.60	\$90.59	-2.20%
	Operating Cost	\$64.46	\$60.95	5.76%
	Margin	\$24.14	\$29.64	-18.56%
Other Thermal	Tons Sold	2.3	2.3	flat
	Sales Price	\$35.08	\$33.41	5.00%
	Operating Cost	\$26.05	\$22.06	18.09%
	Margin	\$9.03	\$11.35	-20.44%
<i>mm tons and \$/ton</i>				

#### ARCH Q3 Call Recap:

- Production Issues:** ARCH said production issues at its Mountain Laurel and Leer operations caused them to lose 400K tons in Q3, of which they expect to make up only 100K tons in Q4. This drove the increase in 2017 guidance for average costs from their Met segment to \$56 – \$60/ton, from \$51 – \$56/ton previously. Mountain Laurel's issues following the longwall move were mostly rectified by end of September and production is progressing as expected now in Q4. ARCH COO Paul Lang said at Leer, they cleared the acute roll in early September and decided to mine through a sandstone rock area at the end of the last panel that affected mechanical availability and pushed the longwall move initially scheduled for Q3 into October. He said ultimately he believes it was the right decision. They are currently setting up equipment in the new panel and expect to be up and operating this weekend.
- Spot Met Sales:** During Q3, ARCH was able to sell an additional 275K tons of met for 2017 delivery at an average price of \$106/ton and priced approx. 700K tons at about \$120/ton. This brings them to having approx. 6.0 mm tons priced for 2017 delivery at \$100.20/ton. Another 600K tons remain unpriced, but committed. Given the midpoint of 2017 met sales expectations, they are roughly 98% committed.
- 2018 Met Business:** ARCH also booked 850K tons of 2018 met sales during the quarter, representing approx. 500K from annual domestic negotiations at \$105/ton fixed, split roughly 50/50 between their low vol and high vol A products. They expect to achieve similar prices in the \$105 - \$110 range with any remaining domestic met sales. The other 350K tons were sold in the seaborne market to steel producers at indexed pricing. With 2.9 mm tons of 2018 met now committed, about 2.4 mm remains open to index pricing. They expect less than 20% of 2018 met sales will be with North American steel producers, down from their traditional 40% - 50% participation rate, due to the large discounts they were being asked to consider on the domestic side.
- Seaborne Thermal Demand:** ARCH expects to export roughly 2.7 mm tons from their 'Other Thermal' segment this year to customers in Asia, South America and Europe. Management said

teams at the West Elk and Coal Mac operations have been doing a great job of ramping up production to meet increased international thermal demand, even despite a longwall move at West Elk in Q3. According to MSHA data, West Elk (Gunnison County, CO) produced 3.57 mm tons in the first three quarters this year, up from 2.40 mm tons in the same period last year, while Coal Mac (Logan County, WV) saw an increase from 1.46 mm tons to 1.84 mm tons during Q1 – Q3 this year.

- **Share Repurchase Program:** During Q3, **ARCH** repurchased approx. 2.2 mm shares for \$167 mm (equates to roughly \$75.90/share), bringing the total to 2.9 mm shares, or almost 12% of total outstanding shares since the launch of their capital return program. Combined with **ARCH**'s dividends paid thus far, \$235 mm has been returned to shareholders. Also, the Board has authorized the purchase of an additional \$200 mm on top of the \$82 mm that remains from the initial authorization at quarter end. Current cash levels are sufficient to support capital return goals.
- **PRB Commitments:** During Q&A, executives clarified that all their PRB8400 product has been booked and priced for next year. Given the current market, this segment concerned them the most and felt it would be best to "put it to rest." All PRB supplies left to be priced for 2018 are from Black Thunder (PRB8800). Executives expect 2018 PRB demand to be relatively flat to 2017, assuming normal weather and gas prices.
- **Rail Issues:** **ARCH** executives said that the concerns they had in June, July and August around rail service didn't get better until early September but since then, they have had no complaints. They had some tough conversations with the railroads. Biggest issues was the demurrage they encountered on vessels they missed, and will be looking to get some of that back from the railroads.
- **M&A Opportunities:** When asked about M&A prospects, **ARCH** management replied that given where they are in the cycle, they said it makes the most sense right now to return cash to shareholders. They added that they don't want to damage current cost structure with external M&A. They believe they have a strong organic growth profile, particularly with Tygart Valley, and continue to move forward with permitting and mine planning activities.

### **EPS**

**Q3 2017:** \$2.83 diluted; \$2.54 adjusted diluted

**Q3 2017 Estimates:** Average analyst estimates of \$1.82 and a range of \$1.12 – \$2.78

**Q2 2017:** \$1.48 diluted; \$1.85 adjusted diluted

**Q1 2017:** \$2.03 diluted; \$2.55 adjusted diluted

**Q4 2016:** \$1.31 diluted; \$1.65 adjusted diluted

### **EBITDAR (adjusted)**

**Q3 2017:** \$104.27 mm

**Q2 2017:** \$95.4 mm

**Q1 2017:** \$120.5 mm

**Q4 2016:** \$94.5 mm

### **Total Sales**

**Q3 2017:** \$26.2 mm tons

**Q2 2017:** \$22.5 mm tons

**Q1 2017:** 25.7 mm tons

**Q4 2016:** 26.7 mm tons

**PRB Sales**

Q3 2017: 21.7 mm tons  
Q2 2017: 18.1 mm tons  
Q1 2017: 21.3 mm tons  
Q4 2016: 21.8 mm tons

**PRB Sales Price**

Q3 2017: \$12.51/ton  
Q2 2017: \$12.55/ton  
Q1 2017: \$12.57/ton  
Q4 2016: \$12.41/ton

**PRB Operating Cost**

Q3 2017: \$10.27/ton  
Q2 2017: \$10.82/ton  
Q1 2017: \$10.33/ton  
Q4 2016: \$9.88/ton

**PRB Margin**

Q3 2017: \$2.24/ton  
Q2 2017: \$1.73/ton  
Q1 2017: \$2.24/ton  
Q4 2016: \$2.53/ton

**Met Sales**

Q3 2017: 2.2 mm tons  
Q2 2017: 2.1 mm tons  
Q1 2017: 2.1 mm tons  
Q4 2016: 2.4 mm tons

**Met Sales Price**

Q3 2017: \$88.60/ton  
Q2 2017: \$90.59/ton  
Q1 2017: \$90.84/ton  
Q4 2016: \$65.61/ton

**Met Operating Cost**

Q3 2017: \$64.46/ton  
Q2 2017: \$60.95/ton  
Q1 2017: \$57.67/ton  
Q4 2016: \$52.98/ton

**Met Margin**

Q3 2017: \$24.14/ton  
Q2 2017: \$29.64/ton  
Q1 2017: \$33.17/ton  
Q4 2016: \$12.63/ton

**Other Thermal Sales**

Q3 2017: 2.3 mm tons  
Q2 2017: 2.3 mm tons  
Q1 2017: 2.3 mm tons  
Q4 2016: 2.5 mm tons

**Other Thermal Sales Price**

Q3 2017: \$35.08/ton  
Q2 2017: \$33.41/ton  
Q1 2017: \$35.51/ton  
Q4 2016: \$34.01/ton

**Other Thermal Operating Cost**

Q3 2017: \$26.05/ton  
Q2 2017: \$22.06/ton  
Q1 2017: \$23.82/ton  
Q4 2016: \$21.79/ton

**Other Thermal Margin**

Q3 2017: \$9.03/ton  
Q2 2017: \$11.35/ton  
Q1 2017: \$11.69/ton  
Q4 2016: \$12.22/ton

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