Research Brief: Westmoreland Coal Is in Trouble

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Seth Feaster, Energy Data Analyst

Overview

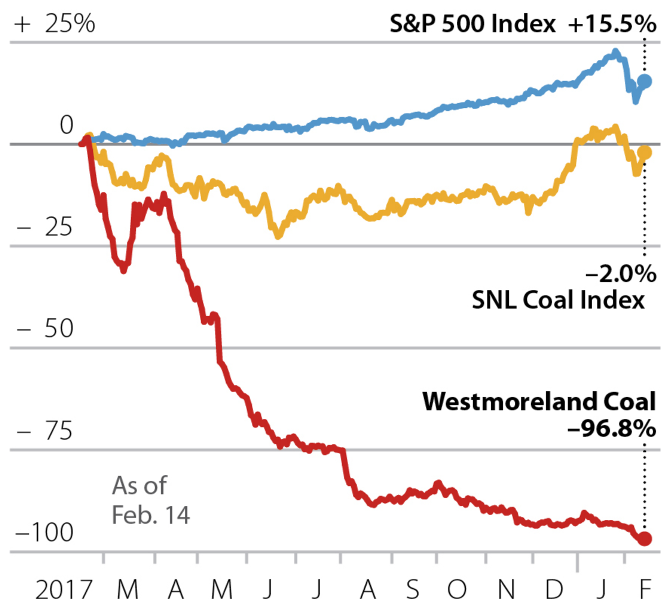
Colorado-based thermal-coal producer Westmoreland Coal Co, which had $1.5 billion in revenue and 3,200 employees in 2016, has been losing money quarter after quarter for the past few years as electricity-generation markets have moved away from coal.

The company's difficulties are far-reaching. Its holdings include major assets across a broad geographic area that includes Ohio, Montana, Wyoming, New Mexico, and Alberta, Canada.

The company has a market capitalization of only about $10 million (as of Feb. 15), following a 97 percent fall in its stock price over the past year, and shares are now trading well under a dollar. This stock collapse has occurred as the broader stock market has risen substantially. Westmoreland Coal is weighed down by more than $1.6 billion in debt, according to S&P Global Ratings, which gives them a credit rating of CCC, a junk rating that is so far below that of investment grade debt that it can be considered speculative. S&P Global Ratings downgraded Westmoreland this past November and warned at the time of possible default.

Westmoreland Coal Stock Performance

The company's shares, at $0.55 on Feb. 14, have lost 97 percent of their value over the past year. At the same time, other coal stocks were down slightly while the broader stock market gained significantly.



Source: S&P Global Market Intelligence

The company's CEO left at the end of November, and Westmoreland today is negotiating with lenders in talks that could allow those lenders to take ownership of Westmoreland assets in Ohio and Wyoming.

Risk is Growing for Investors; Ratepayers and Taxpayers in New Mexico and Montana Could Be Affected as Well

The growing possibility of a bankruptcy by Westmoreland raises risk not just to investors, but to electric ratepayers and taxpayers in some areas where the company does business. Effects could include job losses; loan defaults; mine closures; difficulties in paying for mine reclamation; and local and state and federal government revenue losses. Westmoreland could also run into trouble meeting long-term coal delivery contracts.

Those risks are particularly high in New Mexico, where the company borrowed $125 million from an affiliate of Public Service of New Mexico, the largest utility in the state, to buy the San Juan mine, which is the exclusive supplier to the San Juan Generating Station near Farmington. Public Service of New Mexico (PNM) retired two of four units at San Juan in December, cutting coal demand at the plant in half, and announced plans to close the remaining two units by 2022, raising obvious questions as to how Westmoreland will repay the $125 million loan. Also at issue: the true value of the mine itself.

In Montana, the company owns three mines—Absaloka, Rosebud and Savage—under growing pressure from declining demand and low coal prices. Only a few years ago, the owners of the 2,100-megawatt Colstrip Power Plant, supplied by the adjacent Rosebud mine, expected the plant to run well into the 2040s. Now, the utilities that own Colstrip plan to shut units 1 and 2 by 2022, and Colstrip's largest utility co-owner says it is prepared to shut the remaining units, 3 and 4, by 2027, almost two decades earlier than expected.

Westmoreland is proceeding nonetheless and inexplicably with plans to expand the Rosebud mine. Regulators involved with decisions on Westmoreland's mining permit, lease applications for extension, and reclamation liabilities would do well to be proceed with wariness. Vanishing demand for coal locally, regionally and nationally do not bode well.

Distress in Ohio

The immediate source of Westmoreland's current financial distress, and a potential trigger for a bankruptcy filing for the company, centers on $300 million in debt owed by its limited-partnership subsidiary, Westmoreland Resource Partners LP (WMLP).

The subsidiary was created in 2014 when Westmoreland acquired Oxford Resources. It owns about 10 thermal coal mines in Eastern Ohio and one in Wyoming. Its customer base is not diversified. Nearly 80 percent of Westmoreland Resource Partners' sales went to just three companies in 2016: AEP, Pacificorp Energy, and the East Kentucky Power Cooperative.

The acquisition that led to the creation of the subsidy was hailed as an advantageous one. But the promised benefits have failed to emerge, and the subsidiary is now sinking under the weight of its debt. Westmoreland seems to be trying to avert bankruptcy by transferring all of WMLP'S assets to it lenders—along perhaps with other assets—but no agreement has been reached.

If these negotiations fail, bankruptcy could be around the corner.

Company Missteps and Industry Headwinds

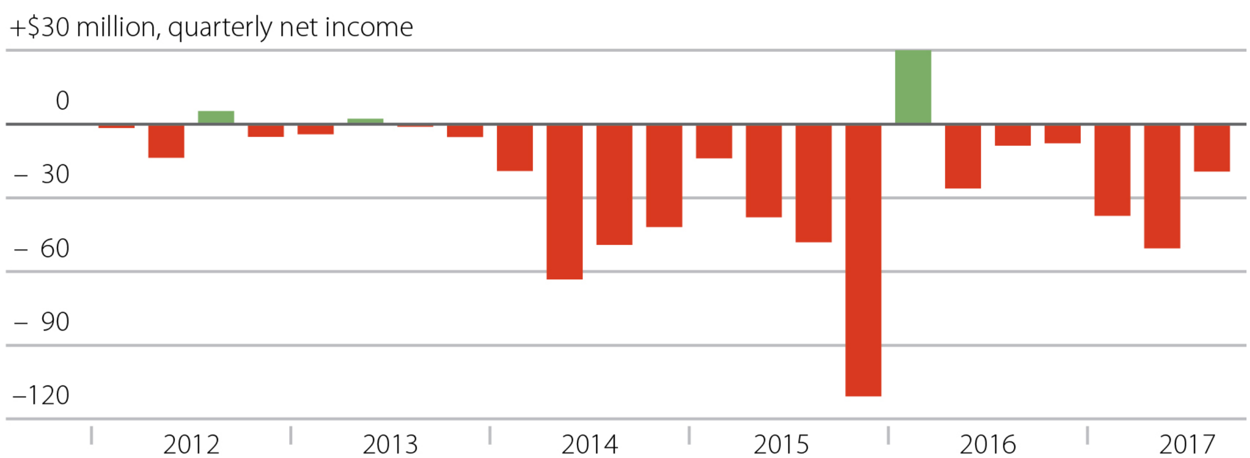
Because of its debt load, Westmoreland Coal has little room to maneuver.

First, their strategy of focusing on mines with power plants nearby (called mine-mouth plants) hasn't worked out well. That approach was originally seen by analysts as advantageous stabilizing for having a large, long-term customer dependent on using the specific coal mined nearby. Instead, it has often proven the opposite: mines have been more vulnerable to the utility decisions and market forces at a single plant; isolation from transportation networks has made it difficult or impossible to gain alternative customers; and these mines tend to be more susceptible to uncompetitive operational cost structures when mining challenges emerge or coal demand at the plant decreases.

In Texas, the company's Jewett lignite mine, whose only customer was NRG's Limestone Plant, was closed and began a reclamation program at the end of 2016 after NRG

In Most Quarters, Red Ink

Westmoreland Coal's quarterly net income reflects the financial difficulty the company has been having. In the 23 quarters starting in 2012, they reported only three quarters with profits.



Source: S&P Global Market Intelligence, based on company SEC filings cancelled its coal contract two years early and switched to coal produced in the Powder River Basin by a different mining company.

Westmoreland's Beulah Mine in North Dakota, next to the Coyote Generating Plant, has struggled since mid-2016 after that plant's coal contract was also lost to a competitor.

Public Service of New Mexico's decision to transition away from coal-fired electricity has resulted in a sharp drop in coal demand and higher depreciation, depletion and amortization expenses for Westmoreland by way of its San Juan mine ownership.

The company has been plagued by other problems.

Last year, it retired two coal-fired generating units it had built in North Carolina in the 1990s, as low power prices made running those plants uneconomic; Westmoreland had already written off over $130 million in losses for those plants.

In Canada, Westmoreland's four coal mines in Alberta and two in Saskatchewan, which sell primarily to Canadian electric utilities or for export to Asia, are imperiled as Alberta implements a phase-out of coal use by 2030 (Alberta's government has said the province produces more coal pollution than all other Canadian provinces combined). Two of Westmoreland's key power-producing customers, ATCO and TransAlta, announced their own, accelerated plans to eliminate coal and convert their plants to natural gas by 2020 and 2022, respectively. The companies say that abundant supplies and low prices for natural gas in the province make the early transition financially compelling.

Further, Westmoreland is facing the same headwinds hampering the rest of the U.S. coal industry.

Utilities across the country continue to retire coal-fired units at a rapid pace, which cuts heavily into overall demand for coal. Many plants' advanced age and relatively high maintenance and operating costs are making them uneconomic to run in competitive electric markets, where cheap natural gas and the falling cost of wind and solar generation are relentlessly stealing market share.

The coal mining industry as a whole has not adjusted to lower demand, however, leading to an intensely competitive, oversupplied thermal coal market with low- or nonexistent-profit margins for many producers. Companies that appear to be doing better than some include those that have already gone through bankruptcy recently; that produce metallurgical coal, which feeds a separate market with higher prices at the moment; or that are able to export thermal coal, particularly to Asia.

While Westmoreland does export a limited amount of coal to Asia, it does not produce metallurgical coal and is almost entirely dependent on selling to U.S. and Canadian power generators.

Summary: Westmoreland Is in a Precarious Financial Position

The company's current stock price is currently trading around 50 cents a share, reflecting an almost total loss in value over the past year. Westmoreland is well over a billion dollars in debt and faces debt-service costs that will only increase as interest rates rise. Its debt is in junk-bond territory and deteriorating. It continues to report losses, quarter after quarter. Its negotiations with lenders has led it to try to give away assets to avoid default. Intense competition, low prices, and overall falling demand for coal are also buffeting the company.

All of these suggest that Westmoreland is in a precarious financial position that stands to adversely affect its business and potentially expose investors, lenders—and, in some instances, ratepayers and taxpayers—to fallout should the company go bankrupt.

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Important Information

About the Author

Seth Feaster is an IEEFA energy-data analyst and former data analyst for the New York Times and the Federal Reserve of New York.