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Not the color green

The reasons to avoid coal are too obvious to belabor. The reasons to invest in coal (for any with a tolerance for pariah assets) are equally obvious but maybe less familiar: The stocks are extraordinarily cheap. In preview, *Grant's* is bullish on Alliance Holdings G.P. L.P. (AHGP on the Nasdaq). We are no longer bullish on former pick-to-click Contura Energy, Inc. (CNTE in the over-the-counter market).

Two consecutive warm winters and the deluge of shale gas notwithstanding, inventories of gas and coal have begun to return to normal. According to the U.S. Department of Energy, natural-gas storage as of May 4 was at the lowest level since 2014, a year in which the gas price averaged $4.26 per thousand cubic feet. It's $2.84 today.

While coal consumption is down by 3.6% in the year through March, coal stockpiles are falling even faster than gas inventories. "When you look at stocks at the end of March, they are down to about 126 million tons," Lucas Pipes, who covers the coal sector for B. Riley FBR, Inc., tells colleague Evan Lorenz. "We are starting to approach normal ranges. Days of burn were 71 days. To put this in perspective, in March 2017 coal stockpiles were 161 million tons or 87 days of burn."

Alliance is a low-cost coal producer with a strong balance sheet and an investor-repellent capital structure. There are 10 Alliance mining operations: seven in western Illinois, Kentucky and Indiana (collectively, the Illinois Basin mines) and three in eastern Kentucky, Maryland and West Virginia (collectively, the Appalachian mines). In the four quarters ended March 31, Alliance sold 37.4 million tons of coal, of which the Illinois Basin produced 74%.

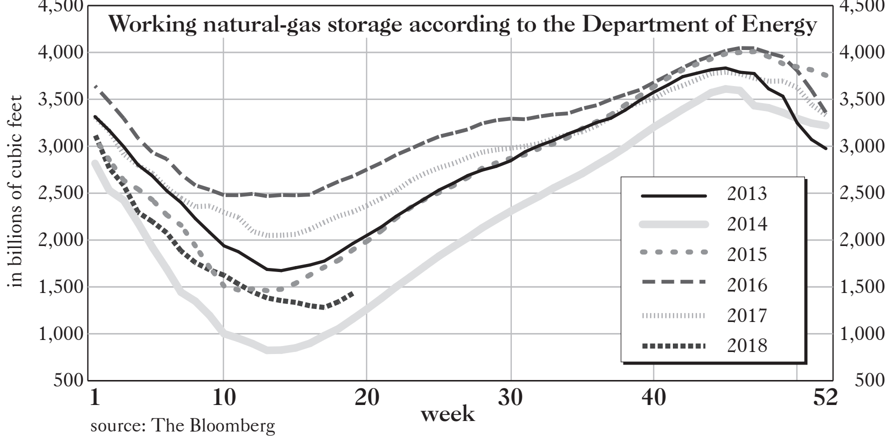
"In the U.S., continued changes in power generation mix are likely to result in overall domestic coal demand declining over time, particularly in Central Appalachia and the Powder River Basin," Brian Cantrell, CFO of Alliance, tells Lorenz. "When you look at our primary markets, however, the Illinois Basin and Northern Appalachia, we continue to see opportunities for modest growth in the future and, with our long-lived, low-cost assets, Alliance expects to participate in that growth. Internationally increasing coal-fired power generation is driving growth in global coal demand and providing meaningful opportunities for U.S. coal producers to supply that growth." Exports have risen to 17% of sales in 2017 from less than 5% in 2016.

"If you look at not just costs but margins, they lead the pack," says Pipes, who rates Alliance a buy. Per ton of coal produced, Alliance generated $17.58 in earnings before interest, taxes, depreciation and amortization (EBITDA) in the first quarter vs. $11.80 for low-cost Hallador Energy Co., also in the first three months (*Grant's*, Sept. 8, 2017). "They have a transportation advantage on the [Ohio River]," Pipes continues. "They have successfully focused on some of their most prolific mines, in particular River View," an Illinois Basin mega-mine with 166 million tons of reserves situated in Union County, Kentucky with barge access to the Ohio River.

Encircling these positive attributes is a kind of Trumpian capital-structure wall. Alliance Holdings, a K-1-issuing master limited partnership (MLP), right away has a strike or two against it. Institutional investors want no part of the tax complications that the MLP structure entails.

"Follow the bouncing ball," Lorenz beckons you, the readers of *Grant's*. "Alliance Holdings is the general partner to Alliance Resource Partners L.P. (ARLP on the Nasdaq), the MLP that

Less in the tank



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actually mines coal. AHGP insiders own one-third of the combined AHGP/ARLP complex through shares in Alliance Holdings and shares that AHGP, in turn, owns in ARLP. If you don't follow, you aren't alone."

On Feb. 23, management threw the market a kind of lifeline by announcing that ARLP and AHGP would merge into a single MLP, with AHGP holders receiving 1.478 ARLP shares for each Alliance Holdings share; the transaction is expected to close in June.

"Pro forma," Lorenz continues, "the combined company is pleasingly cheap. Shares provide an 11.5% dividend yield and trade at 3.6 times trailing enterprise value to EBITDA. The ratio of net debt to EBITDA stands at 0.86 times. The combined ARLP/AHGP entity commands a $4 billion market cap."

"Our capital-allocation priorities are first to invest in growing the company," says Cantrell, "both within our core coal business and in opportunities outside of coal, with a goal of generating increasingly long-term cash flows. Alliance's second capital-allocation priority is to use this cash-flow growth to return cash to unitholders. The primary way we've been doing that is by growing unitholder distributions, and on our last call we indicated that a second way to do that is through a unit buyback program. That is something under active evaluation today and which we could pursue once the pending simplification of the Alliance Partnerships is completed."

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Since our last say on Contura, the stock has appreciated by 8%, in line with the rise in the S&P 500 (*Grant's*, Sept. 8, 2017). As you may recall, the company was formed when the first-lien holders of Alpha Natural Resources Holdings, Inc., the former giant East Coast coal miner, bought the struggling miner's best assets in bankruptcy.

The story has changed. On April 30, Contura and Alpha Natural Resources agreed to an all-stock merger that will retain the Contura name and management team. Contura is diluting the average quality of its portfolio (after all, the first lien holders had cherry-picked Alpha's best mines), and much can go wrong when two companies become one.

After failing to list on the New York Stock Exchange (management cited poor "capital market conditions"), Contura announced a $31.8 million tender offer on Sept. 26, 2017. Buried in the press release was an admission that the insiders had given themselves a liquidity event (the company had bought $17.4 million shares from the insiders on Sept. 15) before vouchsafing the same opportunity to the public.

It's hard to be bearish on a stock that trades at 3.9 times enterprise value to 2017 EBITDA pro forma for the merger, and we aren't bearish on CNTE. It's the front office we'd like to sell short.

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