2019 Cloud Peak Resources 8.50% Senior Notes

Headquarters: Wyoming, USA

**Proposal:**

Buy 2019 Cloud Peak Resources 8.50% Senior Notes at 50 or lower.

**Reason of Brief:**

There is potential for a reorganization, whether it’s a formal Chapter 11 procedure or an out-of-court reorganization. This brief will explain why you will benefit from the proposal despite the result of either outcome. Under both a liquidation scenario valuation and a going-concern valuation based on an EBITDA multiple, bondholders would receive full recovery. In a worst-case scenario, bondholders would receive the fulcrum security. In the case that there is no reorganization, bondholders would receive full recovery.

**Company Background:**

Cloud Peak Energy Inc. (NYSE: CLD) is a holding company that manages its 100% owned subsidiary, Cloud Peak Energy Resources. The Company is a producer of coal in the USA and the Powder River basin (PRB).

The Company operates in three segments: 1) *Owned and Operated Mines*, 2) *Logistics and Related Activities*, and 3) *Corporate and Other*. The *Owned and Operated Mines* segment focuses on thermal coal production. The *Logistics and Related Activities* segment delivers coal to the customer at a terminal or the customer’s plant or other delivery point, remote from its mine site. The *Corporate and Other* segment include results relating to broker activity, its share of the Decker mine operations.

**Company’s Current Standing:**

A. The current price of CLD notes has been pounded by rapidly falling coal prices.

**Reasons of Negative Pressure:**

1. The vast quantities of natural gas available
2. Weak demand and significant oversupply for both thermal and metallurgical coal due to slower than expected economic growth in both the United States and overseas markets (such as China, the largest user of met and thermal coal in the world)
3. The imposition of restrictive regulations around coal
4. Credit downgrade by the major rating agencies
5. Forced selling
6. The possibility of bankruptcy
7. Subordination to the credit facility, which has a first priority lien on all assets except the LBA leases
8. Amendments to transportation and throughput agreements

B. Maintenance covenants on the (undrawn) credit agreement stand as follows:

1. EBITDA/Cash Interest Expense ≥ 1.50
2. Net Secured Debt/EBITDA ≤ 4
3. TTM EBITDA > $125M

As of September 2015, CLD is in full compliance of all the covenants, with 2.12 EBITDA/Cash Interest Expense and $167.4M TTM adjusted EBITDA\(^{(1)}\).

Cloud Peak currently has two fixed rate senior note issues outstanding (8.50% 2019 $300M / 6.375% 2024 $200M) and a capital leasing program. The company possesses sufficient liquidity - through cash ($123.5M), FCF ($34M), as well as an undrawn revolver ($500M) and an undrawn A/R Securitization facility ($45.2M).

**Analysis:**

Cloud Peak is one of the lowest cost producers in the industry and is currently one of the few coal companies with both positive EBITDA and Free Cash Flow. Additionally, the company has fixed price contracts set for most of 2016 and 2017 – which provide a margin of safety against descending coal prices.

**Scenario 1:** Under a liquidation scenario the notes are entitled to a full recovery. Even when applying a 25% haircut, the notes still receive full recovery. Were the company to draw on the $500M of the revolver, the secured debt would receive full recovery and the notes would receive 42.31%.

**Scenario 2:** Under a going-concern valuation utilizing comparable company EBITDA multiple, the notes would receive full recovery. Even when applying a 25% haircut, the notes still receive full recovery. Were the company to draw on the $500M of the revolver, the secured debt would receive full recovery and the notes would also receive full recovery. With a 25% haircut applied, the notes would receive an 88.25% recovery and, being impaired, would very likely also receive the fulcrum security. The comparable companies chosen are Peabody Energy, Consol Energy and Hallador Energy.

**Conclusion:**

Seeing as how there is enough asset coverage for the secured debt under every scenario, it is very likely that, if a technical default were to occur, the secured creditors would be willing to renegotiate terms instead of forcing a bankruptcy. Either way, whether the company goes through an out-of-court reorganization or through a formal Chapter 11 procedure, the notes are entitled to a full recovery in almost every scenario and, at worst, an 88.25% recovery while very likely receiving the fulcrum. The 2019 Cloud Peak Resources 8.50% senior notes are a real bargain at the moment and offer great potential returns under every scenario.

\(^{(1)}\) Note that the EBITDA calculation in the Credit Agreement differs from the standard calculation.