Ramaco Resources Inc.
Q3 2018 Earnings Conference Call

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Executives

Michael Windisch - Chief Accounting Officer

Randy Atkins - Executive Chairman and Chief Financial Officer

Mike Bauersachs - President and Chief Executive Officer

Chris Blanchard - Chief Operating Officer

Analysts

Jeremy Sussman - Clarksons

Mark Levin - Seaport Global

Lucas Pipes - B. Riley FBR

David Gagliano - BMO Capital Markets

Michael Dudas - Vertical Research

Nick Linnane - Sefton Place

Operator

Good day, ladies and gentlemen and welcome to the Ramaco Resources Third Quarter 2018 Earnings Conference Call. [Operator Instructions] It is now my pleasure to turn the conference over to your host, Michael Windisch, Chief Accounting Officer for Ramaco Resources. Please go ahead.

Michael Windisch

Thank you, Hayley. On behalf of Ramaco Resources, I would like to welcome all of you to our third quarter earnings conference call. With me this morning is Randy Atkins, our Executive Chairman and CFO; Mike Bauersachs, our President and CEO; and Chris Blanchard, our Chief Operating Officer.

Before we start, I would like to share our normal cautionary statement regarding forward-looking statements. Certain statements discussed on today's call constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements represent Ramaco's expectations or beliefs concerning future events and it is possible that the results discussed will not be achieved. These forward-looking statements are subject to risks, uncertainties and other factors, many of which are outside of Ramaco's control, which could cause actual results to differ materially from the results discussed in the forward-looking statements.

Any forward-looking statement speaks only as of the date on which it is made and except as required by law, Ramaco does not undertake any obligation to update or revise any forward-looking statement whether as a result of new information, future events or otherwise. New factors emerge from time to time and it is not possible for Ramaco to predict all such factors. When considering these forward-looking statements, you should keep in mind the risk factors and other cautionary statements found in the company's filings with the Securities and Exchange Commission, including our annual report on Form 10-K and our Form 10-Q. The risk factors and other factors noted in the company's SEC filings could cause the actual results to differ materially from those contained in any forward-looking statement.

With that said, I would like to introduce Randy Atkins, our Chairman and CFO.

Randy Atkins

Thanks Mike. I want to thank everyone for joining us today for our call to discuss our third quarter results and some recent events. For all of us at Ramaco, it's been quite a week. As you are probably aware on Monday, we had a structural failure at our Elk Creek complex, involving a single 2,000 ton raw storage coal silo. We have two other silos there, those other two hold about a combined of 1,500 additional tons. To give some overall context, we have got over 350,000 tons of raw coal storage at Elk Creek and are planning to add more. So, the single silo that failed represents less than 1% of that storage capacity. The significance of the failure of the silo, however, involves the overall system that we have got between a number of conveying belts and equipment, the silo served as the conduit for delivery of our coal to our prep plant. We have provided some **slides** on this call, which illustrate the connection.

Given the damage even the single silo, we have had to shutdown the entire conduit system until we build an alternative beltline conveyer to the prep plant from our existing raw coal storage pile. Mike Bauersachs and Chris Blanchard will be commenting on all the operational aspects of this in much greater detail in a moment. But I would like to stress that we do not anticipate any long-term negative impacts and we hope to be back running the prep plant later in the fourth quarter. We are also continuing to mine coal at Elk Creek and without stopping. In the meantime however, we have temporarily idled our prep plant operations, while we construct the alternative beltline conveyor. And also since we will not be processing coal until this is completed, we have suspended coal deliveries from Elk Creek and it provided force majeure notices to the affected customers. I would also point out that financially we have insurance in place, which we feel covers us on both, business interruptions and any costs associated with restoring our prep plant capacity. We also enjoy sufficient liquidity to ride out the period until we are fully operational.

Now I would like to turn to our earnings results for the second quarter, which unfortunately, saw declines from the strong June quarter. When we analyzed the decline, over half was from productivity issues related to geology and changes in mining conditions at Elk Creek. The balance related to changes in sales price on export tons and the loss of a weeks worth of production from the customary July 4 Miner's Holiday. Let's start with some of the financial milestones we've released late yesterday.

Revenue for the quarter was $62 million, down about 5% from the second quarter. Net income was roughly $6 million, which have been $10 million in Q2. That translated to earnings per share of roughly $0.15. Quarterly adjusted EBITDA was $11 million, which gives us overall about $35 million of total adjusted EBITDA for the year through September. We will discuss the operational details in a moment, but we have managed to work around a sandstone issues at Berwind, which we mentioned in our Q2 call, and we anticipate production to rebound to expected levels. We are also on track to reach for more prolific Pocahontas #4 Seam in mid-2020 at Berwind. Operationally and again based primarily on geology, production volumes declined slightly. As you recall, we had guided 2018 cost to the low 60s. This quarter, our cash mining costs grew to roughly $65 per ton, which makes our 9-month average approximately $62 per ton. We hope with the geological issues behind us, we will move to more normalized cost.

Now moving to marketing and sales, we have now placed 1,240,000 tons of various qualities for met coal for 2019, to domestic customers. The average sales price is roughly $113 FOB mine, which compares to our '18 average sales price to domestic customers of roughly $79 FOB mine. This is an increase of roughly 43% year-over-year. Needless to say, assuming we are able to hold our 2019 cash mining cost, we anticipate very strong cash margins at these levels. We had also contracted earlier this year, with various export customers for the sale of an additional 250,000 tons of met coal for delivery in the first half of 2019. These prices will be set against the index.

Our initial guidance for 2019 production will be approximately 1.9 million tons, a company owned production. We are actively looking at ways to organically increase that level. Beyond the domestic sales I just discussed, we anticipate that balance of available 2019 tons will go primarily into the export markets. To talk a little bit about capital, we have spent about $40 million, thus far, primarily, on development CapEx. We had guided to basically the same level of spending for the entire year. And indeed, some of the CapEx Creep we have got is attributable to increased capitalize development cost, mainly related to our sandstone work around at Berwind.

Our full year CapEx levels of '18 will be revised, once we are able to define what amount of new spend we will need to rehabilitate the prep plant and the conveying system at Elk Creek. And we will intend to file a Form 8-K, once we're in a position to provide that information as well as all other prep plant related guidance. I would also like to mention rather prominently that this week we closed on a major financing with KeyBank of Cleveland. This is a $40 million combined equipment term loan and an asset-based revolver secured by our receivables and inventory. We are looking forward to a long successful partnership with KeyBank, providing support for our growing working capital financing requirements. We would also like to express appreciation to the bank for professionally working with us right out of the box on, what is no doubt, a fast-moving situation from a lender's perspective.

I would also add that in a sense this financing validates, are somewhat of a graduation from a development company a full-fledged operating producer, which candidly we take some pride in. So now let's turn to some of our forward views on the macro environment. We obviously like this market right now and continue to remain very encouraged that it has legs well into 2019 and hopefully into early 2020 as well.

A few signposts we are looking at on our last call, the spot benchmark was $170 per ton in June. It's now over $215. The '19 forward curve was around at $175 in June, it now set at $200. And even the 2020 curve is over $180. And since our last call in June, there's been almost 5 million tons of high-quality met production lost between the [indiscernible] mine in Australia and Pinnacle in West Virginia. This represents almost 3% of all seaborne supply.

Also turning to the steel markets, both the Chinese and domestic steel production and utilization continues to be quite strong. Production in China through September shows year-over-year production increases of over 6%. In the U.S., for the week ended October 27, steel capacity hit 81% for the first time since 2012. We see all these factors as driving both, domestic and international strength in forward pricing. And finally, on the supply side, we continue to see some financing struggles with our peers and obviously, no meaningful announcements on new production. All of this leads us to harbor some optimism moving into 2019. As we alluded to, we certainly have challenges in front of us near term, but we feel that there are substantial opportunities as we're moving into '19.

And with that, I'll turn the floor over to Mike to dive on some operating detail.

Mike Bauersachs

Thank you, Randy. The third quarter of 2018 was a solid quarter from an earnings standpoint negatively impacted by some localized geologic conditions, fewer workdays and uneven export shipments. More importantly, for the long-term, actions during the quarter have provided us with a clear pathway to realizing our goal of reaching the prolific Pocahontas #4 Seam in Berwind. To maintain some order in my comments, I will begin with a discussion that deals with non-silo related topics and will include my comments with a more detailed update of the partial structural failure of our raw coal silo at Elk Creek. Chris Blanchard, our Chief Operating Officer has joined us for the call and will also be available to answer questions.

During the third quarter, we experienced a normal reduction in operating days at all of our mines due to the July 4 holiday and miners vacation. We also experienced due to multiple issues, a sizable drop off in productive operating hours and in turn feet of advance per shift at our deep mines. We also had a disproportionately large number of section moves in the third quarter. Virtually, every section relocated during the quarter. The largest quarter-over-quarter variance occurred at our #2 gas mine, which experienced a transition to single-bench mining in the third quarter. This created more difficult cutting conditions and also reduced the coal height. Due to a number of condition and operational changes, we returned to more normalized productivities at our #2 gas mine in October. Our Eagle mine also experienced the drop off in productivities, some of which related to dealing with issues associated with the high seam height in this mine. The Eagle Seam height has been over 20 feet. These multiple headwinds led the fewer tons production than anticipated, especially in September as well as higher per unit costs. See the PowerPoint slide that depicts speed of advanced at our Elk Creek deep mines through June.

To specifically highlight the change, the average peak per ship for July was $178 August $195, while September was $179. The following slide shows the negative impact of these productivity challenges on production at Elk Creek for the quarter. Note on the same side that our Elk Creek surface mine created positive variances quarter-over-quarter to partially offset the impact of the negative deep mine variance, production increased from 62,000 tons in the second quarter to 86,000 tons in the third quarter. This compares even more favorably to first quarter production of 38,000 tons. Per our commitment earlier in the year, we completed revisions to our surface mine plans to reflect the reality that we're seeing on the ground.

Going forward, we anticipate that our surface mine will produce at levels exceeding 300,000 tons per year, with low cost, high-vol mining making up over the half of the production. The remaining question mark at the surface mine, since we will be operating in some new coal seams during 2019, is how many tons will be shipped as metallurgical and what portion will be steam tons. We continue to sort through this as our budget process advances. The outcome of this determination could have a meaningful impact on our 2019 earnings. During the fourth quarter, we have also added another continuous miner to our second section at the Alma mine as well as the second ship. While our original projections for 2018 did not include this second section, we chose to move forward with this given continued strong market conditions. We expect this second section to be operational for all of 2019.

Moving to our Berwind mine, as we previously communicated, our core drilling program provided us with a revised path to reach our targeted Pocahontas #4 production. During the quarter, the Berwind mine was in full development mode as it transitioned through an old mine to initiate production in our new development mining corridor. The startup of development mining commenced in mid October. Near-term mining is in thin and challenging conditions, which are expected to transition the better, but still relatively thin conditions in 2019. While we will experience a delay in reaching the #4 Seam until 2020, our development of section is projected to produce approximately 200,000 tons of low volatile coal during 2019. This mine is configured in a way to add some additional production during 2019 depending on how we choose to treat it in our final budget. We discussed turnover and retention during our last conference call and our situation remains pretty much the same period. We currently have 338 employees and plan to end the year with approximately 360 employees. While retention continues to be an issue that we monitor, we are continuing to find experienced candidates for employment at Ramaco.

In support of maintaining our hiring edge, we have made some slight changes to our benefits and wage package for 2019. We have also stepped up our communication efforts with all of our employees to make sure that they get the facts, regarding our recent silo issue. From a forward-looking standpoint, we are in the midst of our annual budget process. At this point, we remain committed to our Berwind development project, which will contribute significant production increases in 2020 and beyond. At this point, we have not committed any new CapEx to add production at Elk Creek, although we have numerous permits that could be acted upon to influence 2019 production.

In our budgeting, we will seek to balance our strong desire to generate substantial free cash flow and taking advantage of the strongest pricing runway that we've seen in a long time. All of these considerations are now impacted by the timing of restoring feed capacity to our preparation plant.

Even with an idled Elk Creek plant, we expect year end company production during 2018 to be approximately 1.75 million tons, which is slightly below the low end of our guidance. At this point, because of the near-term impact of the silo issue, it is difficult to predict where we will end up relative to tons sold for the year. The silo issue also makes it difficult to finalize our 2019 budget plans. We will provide more clarity on production and sales plans on a later date. Even with our current headwinds, 2019 will be the year that we have transitioned our sales profile to reflect the quality of our coal. From a shipment and marketing perspective, we had a very busy third quarter. Note that series of **slides** that depict year-to-date domestic shipments for 2018, and the slide clearly depicts the transformation to a full-scale production company with a diverse customer base.

As the next series of **slides** illustrate, we've entered into both, domestic high-volatile and low-volatile business that attracted pricing. We've committed approximately 1.04 million tons at Elk Creek and 200,000 tons of our Knox Creek low-volatile coal. We continue to believe that low-volatile coal will be tight in 2019. I can also confirm that we continue to feel inquiries about additional low-volatile availability. As touched on earlier, we've also increased the pricing of our typical Elk Creek high-volatile AB coal, from $79 per ton to approximately $113 per ton. This is also illustrated on the slide. As expected, we have migrated to fewer domestic customers, resulting in our tons being placed with those who value our coals the most. With the domestic business being set, we now need to focus on export business and extend these desired AB qualities and associated valuations to our export tons. Note the slide that depicts 2018 export shipments year-to-date as well as the slide that depicts 2018 export commitments and current index based 2019 commitments.

From a capital expenditure standpoint, we have seen a gradual upward trend in capital spending for the year. The largest reason for the increase has been substantially higher non-budgeted development costs related to our extensive drilling program and mine development costs at our Berwind mine. Overall, much of our 2018 CapEx included long-lived assets, like paved haul roads, plate presses and peripheral capital associated with the Elk Creek preparation plant. Each of these projects are expected to contribute to production and efficiency for decades to come. Going forward, we anticipate spending less CapEx on infrastructure related projects and existing operations. With a number of moving parts, we have decided not to issue full year guidance for 2018 capital spending.

Moving on to the recently disclosed silo situation, over the past 3 days, we have started and made progress on the review of the raw coal silo failure at Elk Creek. Once the area was safely secured, we brought in several experts for structural examinations. The results of these examinations are that the silo is not in danger of additional eminent failure. The 2 remaining silos have no structural damage but due to the connected infrastructure, they are not immediately able to be reactivated. The damaged silo is not economically repairable and must be taken down. We are designing and will shortly begin the installation of a bypass belt system in order to reactivate the preparation plant bypassing the raw coal silos completely while they are recovered and connected to the preparation plant. The approximate location of the bypass in relation to the preparation plant in silos is depicted on the final slide.

Based on the structural examination and with the safety of our workforce as our primary concern, it became apparent that the plant will need to be idled for a number of weeks. As such, we have sent force majeure notices to all our customers who are currently scheduled to receive coal from our Elk Creek complex. Fortunately, as the slide decks depict, we are in good shape with our customers as to being current on 2018 shipments. No force majeure notices have been sent relative to new 2019 domestic contracts that are not anticipated at this time. We have a property damage and business interruption insurance with respect to the preparation plant and loading facilities that we believe, is sufficient to cover costs necessary to restore processing capability and provide significant protection from business interruption.

The silo issue could also impact potential expansion plans that we have been reviewing. In particular, we need to make sure that we do not have an intermediate term bottleneck that prevents us from fully implementing our growth plans at Elk Creek. No new mines will be put in place until we are confident that we can process and ship the tons. Most importantly, we continue to run our existing mines. We have substantial coal stock pile space both at the mines and on the property. Therefore, we do not expect production for the mines to be negatively affected. While shipment and sales volumes will be affected, production volume should not be impacted.

In conclusion, I want to thank the team at Elk Creek who acted quickly for everyone's best interest on the silo issue. Safety is everyone's responsibility at Ramaco. And our future efforts and to restore processing and shipping will be guided by not just saying the phrase, but practicing it. Let me also add that no one else comes to mind relative to the comparable company that has developed 5 coal mines in approximately 24 months. We remain firmly committed to our business plan and we continue to believe that the end result will be the best metallurgical coal company profile in the country.

Thank you. And I will now ask Mike Windisch to provide a brief update of the third quarter financial performance.

Michael Windisch

Thank you, Mike. I would like to refocus the discussion on our third quarter financial results. During the 3-month period, we reported net income of $6.2 million or $0.15 per share and adjusted EBITDA of approximately $11 million. Both represent decreases sequentially over the second quarter, but obviously huge increase year-over-year. For the 9 months ended September 30, net income totaled $21.7 million or $0.54 per share and adjusted EBITDA was $35.2 million.

Total revenues during the third quarter were $62.2 million, down about 5% from the second quarter. This was driven by a decrease in revenues from purchased coal and a slight decrease in export pricing. The larger impact in our bottom line and adjusted EBITDA was an increase in our cash costs for $56 per ton in the second quarter to $65 per ton in the current quarter. This was primarily caused by geology-driven productivity issues. Including some capitalized development costs at our Berwind mine, capital expenditures totaled approximately $12.4 million during the quarter and $39.9 million year-to-date. Given the situation with the damaged silo at Elk Creek, we are still evaluating our CapEx plans for the fourth quarter and beyond.

We also recognized income tax expense of $62,000 and approximately $1.4 million during the 3 and 9 months period ended September 30. This represents an effective tax rate of 6.3%, which is our current projection for the full year. Cash taxes are still anticipated to be less than $400,000 for 2018. As Randy mentioned, subsequent to quarter end, we closed on a combined $40 million, 2-year amortized and equipment loan and a 3-year ABO with KeyBank. Proceeds were used to retire $15 million of higher interest short-term debt. The new loans will provide us with enhanced working capital flexibility moving forward.

This concludes managements prepared remarks. At this time, we would like to open up the line for any questions that you might have.

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] And our first question comes from Jeremy Sussman of Clarksons. Your line is now open.

Jeremy Sussman

Hi, good morning and thanks very much for taking my questions.

Randy Atkins

Thanks, Jeremy.

Jeremy Sussman

I guess, let me just starting with the recent event, if I understand it correctly, it sounds as if you expect the silo event to be largely confined to 2018. And obviously, in your prepared remarks, you noted that you plan to build an alternative conveying system to the prep plant from an existing stockpile area. I guess, can you elaborate maybe a little bit more on this work around kind of what it entails maybe a rough timeline that you envision? I recognize that obviously this is a very recent event, so any color you can provide would be very helpful?

Mike Bauersachs

Great. Jeremy, I am going to let Chris Blanchard key that one up since he is closer to it here.

Chris Blanchard

Jeremy, we are not going to bring a bypass from a stockpile per say, but we are going to put in additional belt between the belt that set the silos previously and the prep plant. At this time, it's premature to give you a timeline but we do expect it to be completed in the fourth quarter. We are in the process of doing the ground engineering work for the installation and the fabrication of that beltline.

Mike Bauersachs

Jeremy, the only other impact that I will kind of note really is the fact we will be building the stockpiles and working our way through that as we work our way into next year. So well, in essence, we are running that prep plant as hard as we can as soon as we are able to run it. And a lot of the projections we are working on is trying to figure out how to balance reducing the stockpiles in the current production. So we are continuing to work on that.

Chris Blanchard

And Jeremy, one other thing, to the extent that a picture tells a thousand words, if you look at the last slide in our deck that we provided for the call, there is a picture of the proposed bypass belt system. So you can sort of see it's not a particularly dramatic new amount of construction, it's basically tying in one line to the back of the prep plant.

Jeremy Sussman

I appreciate all the color. And yes, Slide 8 is definitely helpful. And maybe if I follow-up, from a marketing perspective, if I think about the forced majeure event that sounds as if you could really be producing a lot of coal in the fourth quarter, even if you don't process it immediately. So does this mean that we could see shipments, maybe let's exclude purchased coal for a second, so does this mean we could see shipments above production in 2019? And either way, are you able to sell the balance of this production sort of at market rates given that you've invoked force majeure, do you need to kind of sell it at what you previously contracted? I guess, I'm just trying to understand the dynamics a bit here.

Mike Bauersachs

So, Jeremy, the short answer to your question is yes. And I'll let Mike sort of fill in a blank there because we will have a lot of production coming out in '19.

Michael Windisch

Yes, before the failure, we would have had the same issue this year, Jeremy. We would have had more tons sold than produced because we work through stockpiles. The same thing will happen next year inevitably now at this point. So we'll have more tons likely sold than produced. At this point, each coal sales contract that we set force majeure on is different. And in many cases, customers had the right to elect to take coal in the future. We're really working on a case-by-case basis with our customers. Most of them are repeat customers. We want to take good care of them. From a pricing standpoint, each case will be different. I'll say that I anticipate that a great deal of the pricing will be this year's pricing versus alternate pricing.

Jeremy Sussman

This year meaning, 2018?

Michael Windisch

Yes.

Jeremy Sussman

Okay. Now that's very helpful. And maybe just one last follow-up, if I can. Randy, I appreciate the market color that you gave earlier, and I think domestically, you noted that the steel capacity utilizations hit the highest levels that we've seen in the past 5 years or so. And clearly this shows in your year-over-year increase in pricing that you guys were able to achieve for your 2019 business with the domestic mills. I guess, can you maybe elaborate a little bit on the state of the domestic market? And in particular, did you see the mills come out either a bit earlier or a bit more aggressively in the past – than in the past years given this environment?

Randy Atkins

I – the short answer is again, Jeremy, yes, they did come out early. If you remember some of the domestic mills got burned a little bit in '16 as the prices ram up pretty quickly, so they were out early in '17. We saw them again this year come out quite early.

Some play poker better than others, thinking that the prices were going to come down. Obviously, the prices have strengthened as we've gone into the fall. So if I was to crystal ball it, I would say going into the future you'll probably find a new normal is that you will find the domestic mills coming out and trying to lock in at least a substantial portion of their domestic requirements probably much earlier than in the past.

Jeremy Sussman

Appreciate all the color, and good luck obviously with everything.

Randy Atkins

Thanks.

Mike Bauersachs

Thanks, Jeremy.

Operator

Thank you. Our next question comes from Mark Levin of Seaport Global. Your line is now open.

Mark Levin

Yes. Couple of quick questions. First, to the extent, you're able to provide any detail around the insurance coverage, deductibles, how – maybe some of the other specific details about – financial details about how the insurance would work?

Mike Bauersachs

Mark, the – basically, we've got a couple of different policies, some merely relate to the infrastructure and the replacement of it. In this case, we'll be working closely with the insurer because we're actually going to – we're going to eliminate a silo and work with what we have and make some changes to what we have. So I think that will all be fine. We have business interruption coverage that the deductible actually is a certain number of days. I think it's actually 14 working days and of course, we work 7 days a week.

So it's – the clock's ticking on that. And it basically deals with loss profits, which will help us, of course, with cash flow working our way through the situation. Obviously, there will be a gap of some kind there, where we've not placed coal and have receivables. So again, continuing to work with the insurance providers on that and they need to make an assessment on the property that's going to happen I think in the next day or so.

So it's too – it's probably too early to give you any more clear indication than that, but the numbers are tens of millions of dollars that we could get access to. And we think it's adequate. And I – can I point out one other thing, Mark? So as you obviously understand most of all of our sales arrangements have a 60-day to 90-day payment term. So as far as '19 – 2018 are concerned, this is not going to impact what we we've already sold. This is really going to be more of a '19 advantage as far as cash flow is concerned.

Mark Levin

Got it. And coming back to just sort of what Chris was talking about and Mike what you were talking about with the silo failure. And seeming, I guess reasonably confident that the issue will be remedied between now and the end of the year. What's the worst-case situation? I know that's the base case expectation is that it will be fixed by the end of the year. Is there any potential slippage or are there any issues along the way whether from regulators or anyone else that could take that base case will have it done by the end of the year and push it into '19?

Mike Bauersachs

Mark, I'd love to answer that question, but it's just so early at this point.

Mark Levin

Okay, fair.

Mike Bauersachs

The footprint is permitted. We – at this point, do we foresee any regulatory issue, I don't think so. It's one of those things though that, I mean, we're 3 days into this thing –

Mark Levin

Sure. Yes, that's alright.

Mike Bauersachs

And learn as much as we can. What I will say is and I think Randy alluded to this is, this is so important that we will continue to issue more guidance as things develop.

Randy Atkins

Yes. I think the reality check here Mark is, as Mike correctly noted, this is sort of ground zero at the moment here. So as soon as we get our handle, which I think will probably be in a matter of probably 2 weeks or less, we would intend to probably give some more guidance on a number of aspects of this pretty much across the board in terms of how it's going to impact both operationally and financially anything that we're able to predict at this time.

Mike Bauersachs

It might also help to let Chris kind of describe, I mean, we actually have some structural steel that we think we can use them. And it's – when we think about the construction of this, I mean, it's not like we're having to fabricate these things and ship them from overseas, right, Chris?

Chris Blanchard

Yes. Thanks, Mike. No, we do have some structural belt thrust on the property that we believe that we can use. And the bypass belt that we're talking about building is roughly 700 feet long. So it's not a tremendous infrastructure project. It's more of a – an engineering and foundation design project and then field fabrication. So we have some confidence in that, of course, the devil is in the details. And until we finalize all the engineering work we can't say with certainty that we can use what we have on the property, but certainly helped having it as opposed to not having anything available at all.

Mark Levin

It makes sense. Thanks, Chris. And then the final question just has to do with non-silo related issues just sort of operationally in the third quarter, Mike, you mentioned some temporary adverse mining conditions. As you looked at the fourth quarter and assess because I guess we're sitting here now almost in mid-November. How are the mining conditions in the fourth quarter? How are you feeling about cash cost as they might look this quarter versus – this quarter being the fourth quarter versus the third?

Mike Bauersachs

Sure. I'm going to let Chris since he has joined just give you some more details. I can tell you that as we look at the numbers in October, really our second-best month ever. And with that, I'll let Chris give you a little bit more granular detail here.

Chris Blanchard

Keeping in mind that we haven't closed the financials on October yet, we just have the production numbers, it was our second-best production month that Ramaco has had, second only to June in the second quarter this year. So we would expect just on that, the cost to move downward. The surface mine continues to improve month-over-month and October was its best month of the year. So obviously, it's a short quarter. We have 2 planned vacation periods in November and December. So production volume was going to be lower because of that anyway, but on a sort of a ratable basis based on run days, we were off to a good start.

We did move out of the area at our Eagle Mine and our #2 gas mine in the areas where they can return to normal productivity levels and both of those did in October. We also – as Mike alluded to – we finished the ramp-up of our #2 section at our Alma Mine, which also is in favorable conditions similar to the #1 section. So we should – we're expecting that productivity to slightly ramp-up out of our Alma Mine through the rest of this year on a run-day basis.

Mark Levin

Yes. That all sounds really good. So just to kind of put a bow around that, does the fourth quarter from a cost perspective look more like the second quarter or more like the third quarter or likely somewhere in between?

Mike Bauersachs

I think it's likely somewhere in between, but again, it's – I'm not even having –

Mark Levin

I know it's early, yes, yes. That's fair.

Mike Bauersachs

Well, it's a tough quarter always, Mark, as you know, because you, I mean, really lose one-sixth or so of your production as it relates to lost days worked. So –

Mark Levin

Sure. Appreciate the color and the update, guys. Thanks.

Operator

Thank you. Our next question comes from Lucas Pipes of B. Riley FBR. Your line is now open.

Lucas Pipes

Hey, good morning, everyone.

Mike Bauersachs

Hey, Lucas.

Lucas Pipes

I wanted to ask a question on your sales strategy for 2019, obviously, you've locked up about 1.5 million tons, vast majority of that in the domestic market. As you kind of look to the remaining tons to be sold, are you targeting the export market? Should we be thinking about kind of an index strategy or is there may be more opportunity to layer in fixed price contracts here at this time? Thank you.

Mike Bauersachs

I think Lucas that what we're seeing is that there's still a inclination on the part of foreign buyers to go on index. So we anticipate – we've got a round numbers, we've got about 400,000 tons left a placement for '19. We're going to – some of that's going to be a blend of cross-over coal plus pure met coal. And we anticipate trying to move as much of that in the export markets as we can.

Lucas Pipes

Perfect. So we should be thinking about kind of company produced sales of 1.9 million tons?

Mike Bauersachs

That's correct. Yes, at this point, I think that's what we're comfortable with, Lucas. The – with all these things going on, budget process is going on, we continue to debate a few things about additional production, but I would think about at this point like that.

Lucas Pipes

Got it. That's helpful. And Michael, a quick follow-up question for you. If I heard you right, in your prepared remarks, you mentioned changes to benefit plans attracting qualified labor and such. How much pressure could this put on the – on costs if at all? I would appreciate your thoughts on that topic. Thank you.

Mike Bauersachs

Yes. I think the impacts are pretty minor. I mean, maybe it's $1 a ton or so at sort of worst-case for us. I mean, we've been pretty fortunate in continuing to have a flow of people when it come to workforce, did a little bit of work on our benefits plan to make it a little more attractive and – but I would think about it that way. I think frankly we did see worse inflation really in steel and roof faults and those sort of things than we will. I don't – Chris, any comments on inflation?

Chris Blanchard

Well, I would just say there's probably the 3 main categories. We might see as much as $1 a ton on the labor side. But the real risk on the labor side is, we don't want to lose qualified miners and have a slip in productivity because that would drive our costs higher faster.

We may have $1 or $2 in steel depending on where the steel markets go and steel surcharges. And then with almost a $40 increase year-over-year in sales price or just our sales related costs will move us $3 to $4 between royalties and severance-type payments. So that's a cost that we're willing to pay for certain.

Mike Bauersachs

And I think the other wildcard is, of course, always rail. So when you got a really strong market, the rails will probably step in and take their piece and also we've got demurrage on ending the export business.

Chris Blanchard

I will say, even with the production decrease in the third quarter, we saw basically flat tons shipped between the second and third quarter and railroad performance on the CSX at Elk Creek was very good.

Lucas Pipes

Very helpful. I really appreciate the color, gentlemen.

Mike Bauersachs

Thanks, Lucas.

Operator

Thank you. [Operator Instructions] Our next question comes from David Gagliano of BMO Capital Markets. Your line is now open.

David Gagliano

Hey, great. Thanks for taking my questions. I'll try and keep them pretty tight. Just trying to get a little more details for modeling purposes that kind of thing. First off, for the fourth quarter, looks like – for example, if we see November and December, the conveyors being built and prep plants down. Is it reasonable? I would assume basically 1 month of sales volumes about 150,000, 160,000 tons for the fourth quarter?

Chris Blanchard

Yes, I mean, obviously, we've had a month and a few things that leaked over into November. At this point, Dave, it's really hard to tell, I mean, we actually could resume and maybe it is 1.5 of downtime, maybe it's 1 month. It's just really hard to tell. We'll be ready to ship as soon as we can get this thing in place, I can tell you that. It's just very difficult. But I will say and I appreciate the fact that you're trying to build the model, we will absolutely come out with some clarity on guidance as soon as we can, Dave.

David Gagliano

Okay. And then just in terms of 2019, 1.9 million tons from – of sales from production, should we be adding 300,000, 400,000 tons out of inventory for our sales volume number?

Chris Blanchard

David, if presuming that the base case and the plant is down, the bulk of the year will be – we will probably build an additional 200,000 tons of company produced inventory, so you would move up to $2.1 million in sales for your base case for '19 if the prep plant doesn't operate any in the fourth quarter past Monday this week.

Mike Bauersachs

And of course, we also will have purchased tons.

Chris Blanchard

Right. And the layer in purchased tons on top of that.

David Gagliano

Right, okay. Perfect. Thanks. And just one last one, real quickly. In terms of – just to sort of calibrate the cost commentary earlier for the fourth quarter. It seems to me your costs would kind of blow up in the fourth quarter if you are producing, but not selling your cost of sales because you've got a fixed cost absorption issue that was in income statement or am I wrong?

Mike Bauersachs

On a sales basis, yes, the cost has to go up with a third of the volume on a produced basis and with the inventory change that moderated some on an EBITDA basis. So on a produced basis, our costs should be between the second and the third quarter.

David Gagliano

Okay, but – okay, so on an EBITDA basis – so the cost of goods sold will include the fixed costs associated with production, but not sales, correct?

Mike Bauersachs

Will you be booking in the inventory, your cost of the tons that are part of the inventory build, so it won't go through the P&L until those are sold for GAAP accounting.

David Gagliano

Okay, alright. Thanks for the color and good luck with the next phase. Thanks.

Mike Bauersachs

We appreciate it, Dave.

Operator

Thank you. Our next question comes from Michael Dudas of Vertical Research. Your line is now open.

Michael Dudas

Thanks. Good morning, gentlemen. Two things First you mentioned in prepared remarks, I guess, Mike, about assuming everything is back to normal in certain – into first part of 2019, about maybe additional tons out of Elk Creek or maybe out of some development tons of Berwind. What are some of the metrics that you're looking about or thinking about other than better market prices, is that just all that or would it require for you to try to do that?

Mike Bauersachs

Yes, I really think especially since pulling the trigger on some of these things is absolutely delayed with some of the potential bottleneck issues, those sort of things that I mentioned, which we need to sort through. I mean, I would think about it as more as maybe plus 200,000 tons rather than a larger amount.

I just really think it will be difficult to get everything in place and make a larger impact. So I kind of at this stage and again it could change, Mike, but that's the way I'd kind of look at it. With this being more a year where we kind of more fully realize our margins and then with 2020 being a much larger impactful year with the increased high-volatile production and substantially increased low-volatile production, but –

Michael Dudas

I appreciate that. And then following up with Berwind, looking – what are some of the milestones opposed to get to the Pocahontas #4. Are we still kind of thinking the similar timeframe you guys have talked about in the past or anything, one way or the other that you see now that you've been a few months in that could accelerate or defer that goal?

Chris Blanchard

The – obviously, when we hit the sandstone channel initially in April of this year, it put mine development behind about 8 to 9 months, so we are still on that track.

Michael Dudas

Okay.

Chris Blanchard

But we are now projecting mining in the #4 Seam in mid-2020, we will start development to the #4 Seam by the end of '19, we should have reached the area where we planned to slope up into the #4 – towards the end of '19, but the slope development timeframe puts us in production in the #4 in 2020.

Michael Dudas

That's very helpful. Thanks, gentlemen.

Mike Bauersachs

Thanks, Mike.

Operator

Thank you. Our next question comes from Nick Linnane of Sefton Place. Your line is now open.

Nick Linnane

Thanks for taking my questions. The first one is, can you make any comments on the average quality of committed domestic sales versus overall production? And if you can sort of put any kind of dollar per ton value on that, if there is any material difference? And then the second question is, what is – what do you think currently is the capacity of the prep plant in terms of saleable tons? And hence, once we're able to operate it again, kind of at what rate can you catch up on running down the inventories of raw coal?

Mike Bauersachs

Yes, sure. Let me take a crack at the quality. What we have – what we in essence been able to place and from our blending strategies have created a very strong kind of A, B coal blend that – just one of the reasons why we talk about fully realizing in our qualities far closer to an A coal than a B coal. And we like to look at things like reflecting so that sort of stuff. And a very good B coal can be in the low 90s or all kind of coal, this would be the product that we tend to ship is closer to a 1 or 101 or that kind of level. And our pricing kind of in this $113 area probably slightly more, if we placed it export-wise today, it's kind of what we've seen and I think pretty much what we've kind of seen across the market place domestically, so that versus being a first entrant into the market last year kind of validates where our quality levels are at. And I think as we look at export wise, what we believe should happen is that we should be higher up on some of the index as – which basically are an A or B and we'll see how all of that shakes out as we begin to refocus on that. As far as prep plant goes especially since we have Chris here, let me let him jump in and talk about the capacities.

Chris Blanchard

It sounded like there maybe were two questions on the prep plant, I'll try and answer them both. First being that, assuming again in the base case that we don't begin operating the preparation plant is the rest of the fourth quarter and we build inventories that entire time. We would then work off the excess inventory and our baseload production at Elk Creek by the end of the summer of 2019. A lot of that has to do obviously with the recoveries that the underground mines realize, which is dependent again on mining conditions, but mid-summer. And then sort of from a more macro view, the prep plant at Elk Creek can pretty comfortably process 2.5 million tons potentially up to 3 million clean tons per year. Again, largely dependent on the recoveries that we see at our mine.

Nick Linnane

Okay, thank you. One just follow-up, going back to the coal quality question. I mean, would you say that the coal you haven't sold is higher quality or lower quality than the coal you have committed for domestic sales or it's basically about the same?

Chris Blanchard

Well, I think generally it is about the – it's about the same. I would say that it's probably weighted more towards slightly better qualities. It still remains to be seen. I noted the breakout between steam and met and we do ship a little bit of steam coal. It's been fairly minor, I must say, 40,000 tons, 50,000 tons or so in the past. And as we get a little further down, we're just basically starting to experience a couple of the qualities from some new seams, but typically, those have been able to be blended into our normal stuff. So I would say generally the same, but slightly better targeting some slightly higher qualities in the export market.

Nick Linnane

Okay. Thank you very much.

Operator

Thank you. Ladies and gentlemen, this concludes today's question-and-answer session. I would like to turn the call back to Randy Atkins for any closing commentary.

Randy Atkins

Great. Well, we certainly appreciate everyone being on the call today. We certainly have had a challenging week and I think we're going to work through this and look forward to have a good 2019. And we will as Mike also indicated be out shortly with some further guidance on any impacts that we'll analyze relating to the prep plant, and thank you very much.

Operator

Ladies and gentlemen, thank you for participating in today’s conference. This concludes today’s program, and you may all disconnect. Everyone have a great day.