As coal company profits fell, mining firms rewarded executives handsomely

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In 2011, the coal industry went on a shopping spree. China’s economy was humming and there seemed no limit to the amount of coal the country’s steel mills could consume. America’s coal companies, sensing an opportunity, rushed to acquire mines that produced the metallurgical coal essential to steel fabrication.

Arch Coal paid $3.4 billion cash for the International Coal Group. Peabody Energy plunked down $5 billion for a majority stake in Australia’s MacArthur Coal. And Alpha Natural Resources shelled out$7.1 billion for Massey Energy, a metallurgical miner based in Appalachia country.

Executives at the three firms were handsomely rewarded in the years after the acquisitions. The three companies paid their respective management teams a combined $186 million in stock awards, incentives and other forms of compensation between 2012 and 2014, according to a Casper Star-Tribune review of the firms’ financial filings.

Their companies did not benefit to the same degree. Alpha, Arch and Peabody have failed to record an annual profit since 2011. Two of the firms, Alpha and Arch, are now in bankruptcy, and Peabody may soon join them.

The story of their demise is now well known. Chinese demand faltered, metallurgical coal prices collapsed and American mining firms watched as the domestic market for thermal coal contracted, decimated by cheap natural gas.

But executives’ lavish pay packages, and the acquisitions that preceded them, are now drawing increased criticism, as mining firms move to cut payroll, reduce retiree benefits and unload old debts.

Peabody and Arch laid off a total of 460 miners at their North Antelope Rochelle and Black Thunder mines on the same day last month. The companies have not said how much the cuts will save. But based on the average annual coal miner's wage of $82,000, the layoffs would save the

pair around $37 million in annual wages, or 84 percent of the $44 million Peabody and Arch paid their executives teams in 2014.

Alpha is seeking to cut retiree benefits for some 4,580 non-union miners and their spouses. That move is expected to save $3 million annually, or about 14 percent of the $20.8 million Alpha paid its management in 2014.

“The behavior of these executives seems to me pretty outrageous. They could see the handwriting on the wall,” said Gary Hufbauer, a senior fellow at the Peterson Institute for International Economics in Washington, D.C. “The numbers are there. They started paying themselves out way back in 2012 or early 2013 when the numbers were turning.”

The coal industry is hardly alone in offering its executives generous compensation. CEO pay at America’s largest firms grew by 997 percent, adjusting for inflation, between 1978 and 2014, according to datacompiled by the Economic Policy Institute, a think tank.

But the nature of the coal industry sets the compensation industry executives received apart, observers say. The mining sector is cyclical. Fortunes rise and fall with commodity prices. And coal executives should have recognized they were entering a metallurgical market at or near its height, critics argue.

“To me, it seems like a rookie mistake. Everyone was getting into the coal business at the same time. That is the classic commodity bubble mistake,” said Clark Williams-Derry, an analyst at the Sightline Institute, a Seattle-based nonprofit that supports a transition to renewable fuels. “My sense of how compensation really works is successful deals are key, not performance. If you consummate a $7 billion purchase of a coal company, you are handsomely rewarded.”

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Peabody, the world’s largest private-sector coal company, has lavished more money on its leaders than any of its Powder River Basin counterparts. The firm paid its executive team around $75 million between 2012 and 2014, the last year for which complete compensation figures were available. Peabody lost nearly $1.9 billion over the same period.

Executives at the St. Louis-based firm were hailed as visionaries in 2011 for their push to expand into Asia’s energy-hungry economies. Former Peabody CEO Gregory Boyce, who headed the company from 2006 until last year, punctuated investor presentations at the time with photos of Shanghai’s growing skyline. The message was clear: China needed steel, and Peabody would be its supplier.

"Boyce had the early recognition that Asia would fuel demand," BB&T Capital Markets Analyst Mark Levin told the St. Louis Post-Dispatch in 2011. "I think he's done an excellent job growing Peabody to a global powerhouse."

Peabody paid its top executive accordingly. Boyce's total compensation was $9.5 million in 2012, $10.8 million in 2013 and almost $11 million in 2014, according to filings with the U.S Securities and Exchange Commission.

A Peabody spokeswoman noted the company has reduced executive compensation as part of its wider cost-cutting measures in recent years. Boyce, who now chairs Peabody's board, and current CEO Glenn Kellow took a 10 percent cut in salary last year. In 2014, salary accounted for 11 percent of Boyce's total compensation and 14 percent of Kellow's pay.

New members of Peabody's executive team are being paid less than their predecessors, company officials noted. Amy Schwetz, who was appointed chief financial officer in 2015, received a base salary of $440,000 last year. Michael Crews retired from that position in 2014 with a salary of $600,000.

Many of the awards made to Peabody's executives have diminished in value along with the company's earnings, said Beth Sutton, the firm's spokeswoman. Stock awards accounted for 41 percent of Peabody executives' total compensation between 2012 and 2014. The company's stock has fallen from roughly $34 a share at the start of 2012 to around $2.10 a share today. The company took measures to boost its stock price in 2015 by reducing the number of shares by a 15-to-1 ratio.

"It is important to remember that a good portion of executive compensation is stock-related, which has been impacted in line with shareholder returns due to the unprecedented decline in coal and capital markets," Sutton wrote in an email to the Star-Tribune. "Other compensation elements have changed, including a voluntary 10 percent reduction in base compensation by the President and CEO and board of directors in 2015."

Peabody has not yet filed complete executive compensation figures for 2015, but records show the mining giant has continued to award its executives bonuses in recent years. In January, the company announced a new incentive program for four executives. Kellow received $2.1 million cash award. Three other members of Peabody's executive team, including Schwetz, received cash rewards totaling roughly $940,000. All four received company stock.

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Peabody was hardly the only mining firm with designs on Asia at the beginning of the decade. China accounts for roughly half of global steel consumption. The Rhodium Group estimates Chinese steel demand grew by an average of 16 percent annually between 2002 and 2012.

Metallurgical coal accounts for about 7 percent of total U.S. production. But it fetches a far higher price than the thermal coal used for electricity generation. In 2011, metallurgical coal

prices surpassed $200 a ton. Powder River Basin coal, by contrast, hovered around $13 a ton at the time.

Numbers like those were a big part of the reason that Arch Coal paid $3.4 billion for International Coal Group in 2011. John Eaves, a longtime Arch executive who assumed the reigns as the company's CEO in 2012,spoke at the time of a fourfold increase in the St. Louis firm's exports.

Arch acquired a 38 percent stake in the Millennium Bulk Terminal Project in Longview, Wash. — a deal largely aimed at boosting Powder River Basin thermal exports — and signed an agreement with Houston-based energy infrastructure company Kinder Morgan to boost its shipments out of the Gulf Coast.

But just as Arch and its peers began ramping up export efforts, the Chinese economy began to shift. Growth rates slowed from around 10 percent annually to 6.9 percent in 2015. The country's economy is now transitioning away from the heavy industries that were the drivers of growth in the past toward service sector businesses, Rhodium analysts noted in a recent blog post.

"I definitely think the coal consumption forecasts that these companies were using for China itself were optimistic in the sense that they predicted much higher consumption than was realized," Peter Marsters, a Rhodium analyst, said in an interview. "The forecast didn't realize that the underlying structural makeup of the Chinese economy would change overtime. They weren't going to be building huge roads and buildings that require steel forever."

The decline in metallurgical coal revenues has decimated mining firms' finances. By Rhodium's estimate, metallurgical revenues fell by $3 billion in 2012, $6.7 billion in 2013 and $8.8 billion in 2014.

Eaves and fellow Arch executives profited nonetheless. Arch spent $48.8 million on executive compensation between 2012 and 2014.

No CEO at the three companies examined for this story recorded a greater percentage increase in pay than Eaves, who has spent more than 30 years at Arch and was working as the company's president and chief operating office at the time of the International Coal Group deal.

His total compensation rose from $3.95 million in 2012, his first as CEO, to nearly $7.35 million in 2014, according to SEC filings. Much of his 2014 compensation came in the form of a $3.15 million bonus.

Eaves was not the only longtime Arch executive to enjoy a pay raise over that three-year period. John Drexler, Arch senior vice president and chief financial officer, saw his compensation grow from $1.89 million in 2012 to $3.29 million last year. Executive Vice President and Chief Operations Officer Paul Lang recorded a 43 percent increase in compensation, rising from $2.6 million in 2012 to $4.58 million in 2014.

Arch lost $1.88 billion over that time period and filed for Chapter 11 protection in January.

A company spokeswoman declined comment.

Arch, too, has continued to give its executives bonuses. Seven Arch executives, including Eaves, Drexler and Lang, received about $8 million in bonuses three days before the company filed for bankruptcy in January, according to the Wall Street Journal. Eaves received $2.78 million on Jan. 8, while Lang and Drexler collected $1.75 million and $1.17 million respectively.

"Continuing to provide generous compensation packages, even those that have a lot of stock, does appear to be questionable because the CEOs are responsible for the saddling their companies with enormous debt at a time when their market was shrinking, or set to shrink," said Tyson Slocum, director of Public Citizen's energy program. "It does seem to show the amount of compensation has been climbing, as the performance has been tanking. That seems problematic."

Large executive pay packages are not inherently bad, said Thaya Brooks Knight, a fellow at the libertarian-leaning Cato Institute in Washington, D.C. Companies in struggling industries may need to pay more to attract and retain talented executives, she noted.

"CEOs are part of a labor market just like anyone else," Brooks Knight said. "There may be different considerations, but they are a part of a market. They are something that the company needs to go out and buy."

Alpha Natural Resource executives made just that argument in January, when the Virginia-based company submitted a request in bankruptcy court to pay its executive team up to $14.8 million in bonuses. The additional compensation, which is contingent on Alpha's financial performance, was needed to address a decrease in executive pay and to navigate a complexities of bankruptcy, the company said.

Alpha later reduced the request to $11.9 million — an amount ultimately approved by a federal bankruptcy judge. Alpha has recorded the biggest losses of the three firms analyzed for this story. The company lost $4.4 billion between 2012 and 2014. Bankruptcy filings for 2015 put its losses for that year at $1.3 billion.

And like its peers, Alpha rewarded its executives handsomely since its purchase of Massey Energy. The company paid its management team about $62 million between 2012 and 2014. The value of the company, meanwhile, plummeted. When Alpha released its restructuring plan last month, it set a minimum bid for the sale of its most productive mines. The sum was $500 million.

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Competition from natural gas, rising regulations and oversupplied coal markets are the most commonly cited reasons for the spate of bankruptcies plaguing the industry. But at least one major mining firm has shown it is possible to navigate a historic downturn in the market.

Cloud Peak Energy, which is solely based in the Powder River Basin, did not acquire any metallurgical mines in the buying binge of 2011.

The mining firm based in Gillette, Wyo., recorded profits totaling $305 million between 2012 and 2014. The market downturn ultimately caught up with the company in 2015, when it posted a $205 million loss and cut around 100 employees across its operations.

But the company has not been subject to the bankruptcy speculation of its peers, thanks in part to its relatively healthy balance sheet. Cloud Peak has also paid its executives less than other mining firms.

The company collectively doled out around $32 million in executive compensation between 2012 and 2014, or less than half what Peabody and Alpha each paid their management teams over the same period.

“I have to give Cloud Peak’s management some credit,” said Williams-Derry, the Sightline analyst. “They probably felt they were missing out on the party. But by not taking on massive debt, they’ve protected shareholders, bond holders and other stakeholders.

“It’s almost like company performance is inverse to pay in the coal industry.”