HALLADOR PETROLEUM CO
Form 10-K
March 26, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-K

[x] ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended: December 31, 2008
OR

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number: 0-14731

HALLADOR PETROLEUM COMPANY

COLORADO	84-1014610
(State of incorporation)	(IRS Employer Identification No.)
1660 Lincoln Street, Suite 2700, Denver, Colorado	80264-2701
(Address of principal executive offices)	(Zip Code)
Issuer's telephone number: 303.839.5504	Fax: 303.832.3013

Securities registered pursuant to Section 12(b) of the Exchange Act: NONE

Securities registered pursuant to Section 12(g) of the Exchange Act: Common Stock, $.01 par value

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15 (d) of the Act. Yes o No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities and Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x Noo

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "larger accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

o Large accelerated filer	oAccelerated filer
o Non-accelerated filer (do not check if a small reporting company)	xSmaller reporting company

Indicated by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.) Yes o No x

The aggregate market value of the common stock held by non-affiliates on June 30, 2008, was about $3.1 million based on the closing price reported that date by the OTC Bulletin Board of $3.50 per share.

As of March 24, 2009 we had 22,446,028 shares outstanding.

DOCUMENTS INCORPORATED BY REFERENCE: NONE

PART 1

ITEM 1. BUSINESS.

General Development of Business

Hallador Petroleum Company (Hallador), a Colorado corporation, was organized by our predecessor in 1949. Over 90% of our stock is closely held; see Item 12 of this Form 10-K for a listing of our major shareholders. Our stock is thinly traded on the OTC Bulletin Board.

Our primary operating property is the Carlisle coal mine located in western Indiana of which we own an 80% interest. The Carlisle mine was in the development stage through January 31, 2007. Commercial coal production began February 5, 2007. We also have a 45% equity interest in Savoy Energy, L.P., an oil and gas company which has operations in Michigan.

In late 2006, we concluded to deemphasize our oil and gas operations and concentrate our efforts in the coal business. In July 2007, we sold our San Juan producing oil and gas properties and in October 2008 we sold substantially all of our unproved oil and gas properties. Our remaining oil and gas properties are not significant.

With that in mind, the following events have occurred during the last two years:

Through a series of transactions which began in 2006 and ended in July 2008, we now own an 80% interest in Sunrise Coal, LLC (Sunrise). On July 31, 2006, we entered into a partnership with Sunrise to develop the Carlisle mine. Sunrise contributed all of their assets for a 40% interest and we agreed to a $20.5 million funding commitment (which we fulfilled during 2007) and guaranteed Sunrise's bank debt for a 60% interest. Our funding commitment was subsequently increased to $21.2 million and was fulfilled.

In July 2008 we purchased an additional 20% interest in Sunrise for about $12 million and such amount was allocated to mine development costs. Through approximately 92% of the partnership's cash flow we are to receive $22.9 million (our funding commitment of $21.2 million plus $1.7 million of acquired basis attributable to the interests sold by certain Sunrise members) plus interest at 10%. Thereafter, cash flow will be distributed 80% to us and 20% to the remaining original Sunrise members.

Prior to the purchase of the additional 20% interest, we consolidated 100% of the Sunrise operations with a 13% minority interest. Subsequent to the purchase, we are now using an 8% minority interest. Once we receive our $22.9 million plus interest at 10%, the minority interest will change to 20%.

Carlisle Mine

We sell all of our coal to producers of electric power. Currently, we have only one mine (Carlisle) and our top three customers purchased about 90% of our 2008 coal production. First commercial production began February 5, 2007 and we sold about one million tons during 2007 at an average price of $28/ton. During 2008, we sold about 1.9 million tons at an average price of about $36.39/ton.

Coal production for 2009 is estimated at 3 million tons and about 3.3 million tons in each of the years 2010 and 2011. Recoverable reserves that are presently leased are about 43.5 million tons. Additional unleased reserves that could be mined in the future are about 12.5 million tons. There can be no assurance that we will be able to obtain suitable lease terms.

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Sunrise currently employs 230 people and will increase employment to 260 as production from a new fourth unit begins in April 2009. The mine currently operates two production shifts and one maintenance shift while coal is produced 270 days of the year. The Carlisle mine is non-union.

Customers and Backlog

As of December 31, 2008, we had a sales backlog of 15.3 million tons of coal and our coal supply agreements have remaining terms up to 6 years. For 2009 we are committed to sell 2.7 million tons; for 2010 - 3 million tons; 2011 - 2.8 million tons and for 2012 and later - 6.8 million tons.

These commitments represent approximately 88%, 90% and 84% of our estimated production for 2009, 2010 and 2011, respectively, and represent about 1/3 of our recoverable reserves.

In 2008, 90% of our coal was sold to three electricity generating plants, all located in Indiana, which is where we have our primary customer base.

We expect to continue selling a significant portion of our coal under supply agreements with terms of one year or longer. Our approach is to selectively renew, or enter into new, coal supply contracts when we can do so at prices we believe are favorable.

Typically, customers enter into coal supply agreements to secure reliable sources of coal at predictable prices while we seek stable sources of revenue to support the investments required to open, expand and maintain or improve productivity at the mines needed to supply these contracts. The terms of coal supply agreements result from competitive bidding and extensive negotiations with customers. Consequently, the terms of these contracts vary significantly in many respects including price adjustment features, coal quality requirements, quantity parameters, permitted sources of supply, treatment of environmental constraints, extension options, force majeure, and termination and assignment provisions.

Our contracts contain provisions to adjust the base price due to new statutes, ordinances or regulations that impact our cost of performance. Additionally, our contracts contain provisions that allow for the recovery of costs impacted by modifications or changes in the interpretation or application of existing statutes or regulations.

Quality and volumes for the coal are stipulated in coal supply agreements, and in some limited instances buyers have the option to vary annual or monthly volumes if necessary. Variations to the quality and volumes of coal may lead to adjustments in the contract price. Our coal supply agreements contain provisions requiring us to deliver coal within certain ranges for specific coal characteristics such as heat content (BTU), sulfur and ash content.

Suppliers

The main types of goods we purchase are mining equipment and replacement parts, steel-related (including roof control) products, belting products, lubricants, fuel and tires. Although we have many long, well-established relationships with our key suppliers, we do not believe that we are dependent on any of our individual suppliers other than for purchases of certain underground mining equipment. The supplier base providing mining materials has been relatively consistent in recent years, although there has been some consolidation. Purchases of certain underground mining equipment are concentrated with one principle supplier; however, supplier competition continues to develop.

U.S. Coal Production

The United States is the second largest coal producer in the world, exceeded only by China. Coal in the United States represents approximately 94% of the domestic fossil energy reserves with over 200 billion tons of recoverable coal, according to the U.S. Geological Survey. The U.S. Department of Energy estimates that current domestic recoverable coal reserves could supply enough electricity to satisfy domestic demand for more than 200 years. Coal production in the United States has increased from 434 million tons in 1960 to approximately 1.2 billion tons in 2008 based on information provided by the Energy Information Administration.

Illinois Basin

The Illinois Basin includes Illinois, Indiana and western Kentucky and is a major coal production center in the interior region of the United States. Coal from the Illinois Basin varies in heat value and predominately has a high sulfur content. Despite its high sulfur content, coal from the Illinois Basin can generally be used by electric power generation facilities that have installed pollution control devices, such as scrubbers, to reduce emissions. We anticipate that Illinois Basin coal will play an increasingly vital role in the U.S. energy markets in future periods.

Safety and Environmental Regulations

Our operations, like operations of other coal companies, are subject to regulation, primarily by federal and state authorities, on matters such as: air quality standards; reclamation and restoration activities involving our mining properties; mine permits and other licensing requirements; water pollution; employee health and safety; management of materials generated by mining operations; storage of petroleum products; protection of wetlands and endangered plant and wildlife protection. Many of these regulations require registration, permitting, compliance, monitoring and self-reporting and may impose civil and criminal penalties for non-compliance.

Additionally, the electric generation industry is subject to extensive regulation regarding the environmental impact of its power generation activities, which could affect demand for our coal over time. The possibility exists that new legislation or regulations may be adopted or that the enforcement of existing laws could become more stringent, causing coal to become a less attractive fuel source and reducing the percentage of electricity generated from coal. Future legislation or regulation or more stringent enforcement of existing laws may have a significant impact on our mining operations or our customers' ability to use coal.

While it is not possible to accurately quantify the expenditures we incur to maintain compliance with all applicable federal and state laws, those costs have been and are expected to continue to be significant. Federal and state mining laws and regulations require us to obtain surety bonds to guarantee performance or payment of certain long-term obligations, including mine closure and reclamation costs.

Reclamation

Carlisle is a new mine and is operating in compliance with all local, state, and federal regulations.   Since Carlisle is new, we have no old mine properties to reclaim, other than the Howesville mine, which also was a new mine and operated for only eight months before it was closed in June 2006 due to safety concerns.   During 2007, we finished Phase I of the reclamation of the Howesville mine. To reach final reclamation we must raise commercial crops for a period of five years.

Mining Permits and Approvals

Numerous governmental permits or approvals are required for mining operations. When we apply for these permits and approvals, we may be required to prepare and present data to federal, state or local authorities data pertaining to the effect or impact that any proposed production or processing of coal may have upon the environment. The authorization, permitting and implementation requirements imposed by any of these authorities may be costly and time consuming and may delay commencement or continuation of mining operations. Regulations also provide that a mining permit or modification can be delayed, refused or revoked if an officer, director or a shareholder with a 10% or greater interest in the entity is affiliated with another entity that has outstanding permit violations. Thus, past or ongoing violations of federal and state mining laws could provide a basis to revoke existing permits and to deny the issuance of additional permits.

In order to obtain mining permits and approvals from state regulatory authorities, mine operators must submit a reclamation plan for restoring, upon the completion of mining operations, the mined property to its prior condition, productive use or other permitted condition. Typically, we submit the necessary permit applications several months or even years before we plan to begin mining a new area. Some of our required permits are becoming increasingly more difficult and expensive to obtain, and the application review processes are taking longer to complete and becoming increasingly subject to challenge.

Under some circumstances, substantial fines and penalties, including revocation or suspension of mining permits, may be imposed under the laws described above. Monetary sanctions and, in severe circumstances, criminal sanctions may be imposed for failure to comply with these laws. Compliance with these laws has increased the cost of coal mining for domestic coal producers.

Mine Health and Safety Laws

Stringent safety and health standards have been imposed by federal legislation since Congress adopted the Coal Mine Health and Safety Act of 1969. The Federal Mine Safety and Health Act of 1977 significantly expanded the enforcement of safety and health standards and imposed comprehensive safety and health standards on all aspects of mining operations. In addition to federal regulatory programs, the state in which we operate also has programs for mine safety and health regulation and enforcement. In reaction to several mine accidents in recent years, federal and state legislatures and regulatory authorities have increased scrutiny of mine safety matters and passed more stringent laws governing mining. For example, in 2006, Congress enacted the Mine Improvement and New Emergency Response Act of 2006, which we refer to as the MINER Act. The MINER Act imposes additional obligations on coal operators including, among other things, the following:

- development of new emergency response plans that address post-accident communications, tracking of miners, breathable air, lifelines, training and communication with local emergency response personnel;
- establishment of additional requirements for mine rescue teams;
- notification of federal authorities in the event of certain events;
- increased penalties for violations of the applicable federal laws and regulations; and
- requirement that standards be implemented regarding the manner in which closed areas of underground mines are sealed.

Environmental

Legislators are considering the passage of significant new laws, regulators are considering using existing laws to limit greenhouse gas emissions, and other measures are being imposed or offered with the ultimate goal of reducing greenhouse gas emissions. For instance, in addition to the potential for the EPA to impose regulations on carbon dioxide emissions as described above, we also anticipate that Congress will evaluate greenhouse gas legislation in the short-term. If successful, there could be reductions in or other limitations on the amount of coal our customers could utilize.

The permitting of new coal-fueled power plants has also recently been contested by state regulators and environmental organizations based on concerns relating to greenhouse gas emissions. As a result, certain power generating companies may reconsider short-term or long-term plans to build coal-fueled plants or may elect to build capacity using alternative forms of electrical generation.

Coal Mining Methods

The geological characteristics of coal reserves largely determine the coal mining method employed. There are two primary methods of mining coal: surface mining and underground mining. The Carlisle mine is an underground mine, and is operated using room-and-pillar mining.

Room-and-pillar mining is effective for small blocks of thin coal seams. In room-and-pillar mining, we cut a network of rooms into the coal seam, leaving a series of pillars of coal to support the roof of the mine. We use continuous mining equipment to cut the coal from the mining face and battery cars to transport the coal to a conveyor belt for further transportation to the surface. The pillars generated as part of this mining method can constitute up to 50% of the total coal in a seam.

Coal Preparation

Coal extracted from Carlisle contains impurities, such as rock and sulfur impurities. We use a coal preparation plant located at the mine to remove impurities from the coal and to insure our product meets contract specifications. Our coal preparation plant allows us to treat the coal we extract from Carlisle to ensure a consistent quality.

Transportation

We sell our coal FOB the mine. Most of our coal is transported by rail and some by truck.

Competition

The coal industry is intensely competitive. The most important factors on which we compete are coal quality, transportation costs from the mine to the customer and the reliability of supply. Most of our competitors are larger than us and have greater financial resources and larger reserve bases.

Additionally, coal competes with other fuels, such as nuclear energy, natural gas, hydropower, and petroleum for steam and electrical power generation. Costs and other factors, such as safety and environmental considerations, relating to these alternative fuels affect the overall demand for coal as a fuel.

Other

We have no significant patents, trademarks, licenses, franchises or concessions.

Other than the coal employees in Indiana, we have four full-time and two part-time employees in Denver. When needed we also engage consultants, accountants and attorneys on a fee basis.

Our office is located at 1660 Lincoln Street, Suite 2700, Denver, Colorado 80264, phone 303.839.5504, fax 303.832.3013.

Sunrise Coal's corporate office is located at 1183 Canvasback Drive, Terre Haute, Indiana 47802, phone 812.299.2800, fax 812.299.2810. Terre Haute is approximately 70 miles west of Indianapolis, Indiana. Our website is www.sunrisecoal.com.

ITEM 1A. RISK FACTORS.

Smaller reporting companies are not required to provide the information required by this item.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

Smaller reporting companies are not required to provide the information required by this item; however, there were none.

ITEM 2. PROPERTIES.

The Carlisle mine, located near the town of Carlisle in Sullivan County, Indiana, is an underground mine which became operational in January 2007; during 2006 the mine was under development. The coal is accessed with a slope to a depth of 340'. The coal is mined in the Indiana Coal V seam which is high volatile B bituminous coal.

Our current mine plan indicates 13,500 acres of mineable coal with approximate 4' to 5' thickness in the project area. Of the 13,500 acres, 11,900 are currently under lease to Sunrise. The Indiana V seam has been extensively mined by underground and surface methods in the general area and is the most economically significant coal in Indiana.

Findings are based on generally accepted engineering principles and professional experience in the mining industry. All judgments are based on the facts that are available at this time.

Coal Reserve Estimates

We estimate that, as of December 31, 2008, we had total recoverable reserves of approximately 43.5 million tons consisting of both proven and probable reserves. “Reserves” are defined by the SEC Industry Guide 7 (Guide 7) as that part of a mineral deposit, which could be economically and legally extracted or produced at the time of the reserve determination. “Recoverable” reserves mean coal that is economically recoverable using existing equipment and methods under federal and state laws currently in effect. Approximately 29.5 million tons of reserves are classified as proven reserves. “Proven (measured) reserves” are defined by Guide 7 as reserves for which (a) quantity is computed from dimensions revealed in outcrops, trenches, workings or drill holes; grade and/or quality are computed from the results of detailed sampling and (b) the sites for inspection, sampling and measurement are spaced so closely and the geologic character is so well defined that size, shape, depth and mineral content of reserves are well-established. The remaining approximately 14 million tons of our reserves are classified as probable reserves. “Probable reserves” are defined by Guide 7 as reserves for which quantity and grade and/or quality are computed from information similar to that used for proven (measured) reserves, but the sites for inspection, sampling, and measurement are farther apart or are otherwise less adequately spaced. The degree of assurance, although lower than that for proven (measured) reserves, is high enough to assume continuity between points of observation. Our reserve estimates were prepared by Samuel Elder, Sunrise's mining engineer. Mr. Elder is a licensed Professional Engineer in the State of Indiana and has over 20 years experience estimating coal reserves.

The Mine Reserve estimate for the 11,900 leased acres was made utilizing Carlson mining 2007 (software developed by Carlson Software). To convert volumes of coal to an in-place tonnage, a weight of 80 pounds/cubic foot was used. To convert to product tonnage, a 55% mine recovery and an average of 81% washed recovery (coal only recovery, no out-of- seam dilution included) were used.

Example: In-place tonnage x 55% x 81% = product tonnage.

Standards set forth by the United States Geological Survey were used to place areas of the mine reserves into the Proven (measured) and Probable (indicated) categories. Under these standards, coal within 1,320' of a data point is considered to be proven, and coal within 1,320' to 3,960' is placed in the Probable category. All reserves are stated as a final saleable product.

ADDITIONAL DISCLOSURES

1. The Carlisle mine currently has road frontage on State Highway 58, and is adjacent to the CSX railroad. The Carlisle mine has a double 100 car loop facility. The majority of our sales are shipped by rail and the remainder is trucked.

2. Currently only the Indiana V seam is planned to be mined, and all of the controlled tonnage is leased to Sunrise. Most leases have unlimited terms once mining has begun, and yearly payments or earned royalties are kept current. Mineable coal thickness used is greater than four feet. The current Carlisle mine plan is broken into four areas– North Main – South Main – West Main – 2 South Main. Approximately 88% of the total mine plan is currently under lease ("controlled"). It is believed that all additional property that would be required to access all lease areas can be obtained but, if some properties cannot be leased, some modification of the current mine plan would be required. All coal should be mined within the terms of the leases. Leasing programs are continuing by Sunrise staff.

3. Mine construction began in 2006 and the first coal sales were in February 2007.

4. The Carlisle mine has a dual use slope for the main coal conveyor, and the moving of supplies and personnel without a hoist. There are two 8' diameter shafts at the base of the slope for mine ventilation. Two additional shafts are under construction to facilitate the mine expansion. The slope is 18' wide with concrete and steel arch construction. All underground mining equipment is powered with electricity and underground compliant diesel.

5. Current production capabilities are 2.7 million tons per year. Additional equipment is planned to increase production to 3 million tons per year in 2009. Total reserves in the current mine plan (both controlled and uncontrolled) indicates approximately 19 years production at 3 million tons per year. The mine plan is a basic room-and-pillar mine using a synchronized continuous miner section with no retreat mining. Plans are for 60'x80' pillars with 18' entries for our mains, and 60'x60' pillars with 20' entries in the rooms.

6. The Carlisle mine has been in production since January 2007. The North Main, Sub Main #1, and the South Main have been developed with three units currently in production.

7. Quality specifications for saleable product are 13%-16% moisture; 10,900-11,400 BTU; 8%-10% ash; and 5-6.5 LB SO_2.

8. The Carlisle mine has a 400 tons/hour raw feed wash plant. The wash plant is modular in construction and construction is currently underway to double the current capacity (anticipated completion date of April 2009).

9. Mine dilution is assumed to be from 6% - 10% depending on seam height.

10. Controlled and proven (measured) reserves are 29.5 million tons and controlled and probable (indicated) reserves are 14.0 million tons.

ITEM 3. LEGAL PROCEEDINGS. None

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS. None

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Our common stock is traded on the OTC Bulletin Board under the symbol "HPCO.OB". The following table sets forth the high and low sales price for the periods indicated:

	High	Low
2009		
(January 1 through March 24, 2009)	$ 3.00	$ 2.95
2008		
First quarter	4.55	4.00
Second quarter	4.50	3.25
Third quarter	5.50	3.25
Fourth quarter	5.50	2.50
2007		
First quarter	3.25	2.50
Second quarter	3.50	2.50
Third quarter	3.25	2.85
Fourth quarter	3.55	2.75

During the last two years no dividends were paid. We have no present intention to pay any dividends in the foreseeable future. Our loan agreements restrict our ability to pay dividends.

At March 24, 2009, we had about 400 shareholders of record of our common stock; this number does not include the shareholders holding stock in "street name." The last recorded sales price was $2.95.

Equity Compensation Plan Information

We have 550,000 options outstanding, at an exercise price of $2.30. The issuance of our stock options were not approved by security holders. We also have 170,000 restricted stock units that have been granted to certain employees and 360,000 are available for future issuance.

ITEM 6. SELECTED FINANCIAL DATA.

Smaller reporting companies are not required to provide the information required by this item.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION.

Overview

Our consolidated financial statements should be read in conjunction with this discussion. Our primary operating property is the Carlisle coal mine located in western Indiana of which we own an 80% interest. The Carlisle mine was in the development stage through January 31, 2007. Commercial coal production began February 5, 2007. We also have a 45% equity interest in Savoy Energy, L.P., an oil and gas company which has operations in Michigan. Over 90% of our stock is closely held; see Item 12 of this Form 10-K for a listing of our major shareholders. Our stock is thinly traded on the OTC Bulletin Board.

In late 2006, we concluded to deemphasize our oil and gas operations and concentrate our efforts in the coal business. In July 2007, we sold our San Juan producing oil and gas properties and in October 2008 we sold substantially all of our unproved oil and gas properties. Our remaining oil and gas properties are not significant.

We have entered into significant equity transactions with the Yorktown Energy group of partnerships (Yorktown) and other entities that invest with them. Yorktown, our largest shareholder, owns about 55% of our common stock and represents one of the five seats on our board.

Liquidity and Capital Resources

In December 2008, we entered into a new loan agreement with a bank consortium that provides for a $40 million term loan and a $30 million revolving credit facility. Through December 31, 2008, we have fully drawn down the $40 million term loan (which matures in 2012) and have $27 million available under the revolver due to outstanding letters of credit of $3 million. Substantially all of Sunrise's assets were pledged under this loan agreement and we are the guarantor. The loan agreement requires customary covenants, required financial ratios and restrictions on dividends or distributions. The current interest rate is LIBOR (0.9%) plus 3.50% or 4.4%.

In connection with the old loan agreements, we entered into two interest rate swap agreements swapping variable rates for fixed rates. The first swap agreement covered $26 million in debt and commenced July 15, 2007 and matures on July 15, 2012. The second swap agreement covers $10 million and commenced December 28, 2007 and matures on December 28, 2011. The two swap agreements fix our interest rate at about 8.3%. At December 31, 2008 and 2007, we recorded the estimated fair value of the two swaps as a $2.29 million and $1.18 million liability, respectively. The increase of $1.11 million was recorded as additional interest expense for 2008. Such amount in 2007 was about the same.

Accounting rules require us to recognize all derivatives on the balance sheet at estimated fair value. Derivatives that are not hedges must be adjusted to estimated fair value through earnings. We have no derivatives designated as a hedge.

We plan to fund future mine expansion through a combination of draws from the $30 million revolver and cash from operations.

We have no material off-balance sheet arrangements.

Results of Operations

During 2008, we sold about 1,933,000 tons of coal at an average selling price of about $36.39/ton. January and February 2009 average prices were in the $45 range. During 2008, we had three major contracts with three utilities that accounted for over 90% of our coal sales. Two of the contracts run through 2013 and the third runs through 2012 with an option for two more years. We anticipate our sales under these three contracts to range from 2.7 million tons per year to 3.2 million tons per year.

Coal sales began in February 2007 and for the year 2007 we sold 972,500 tons at an average price of about $28/ton.

During the last two years, we have sold substantially all of our oil and gas properties at a cumulative gain of about $3.8 million. We do not expect such gains in the future.

The $2.3 million equity loss from Savoy resulted primarily from Savoy taking a $2.6 million impairment charge relating to their oil and gas properties. Furthermore, the difference between the purchase price and our pro rata share of Savoy's partners' capital was amortized based on Savoy's units-of-production rate and amounted to about $333,000 for 2008 and $279,000 for 2007. In addition, due to deteriorating industry conditions, we took a $1.4 million impairment charge relating to our investment in Savoy. We concluded that Savoy's balance sheet, considering their impairments, reflected our best estimate of Savoy's fair value. Accordingly, we compared our investment account in Savoy to 45% of Savoy's equity accounts and the excess amounted to about $1.4 million. Consequently, we impaired our investment account by such amount. Considering this impairment charge, we no longer have a difference between the purchase price and our pro rata share of Savoy's partners' capital.

The increase in cost of coal sales and DD&A was due to the significant increase in our coal sales.

During 2008 and 2007, we issued restricted stock units to our officers and others. The expense for 2008 was about $1.7 million higher than in 2007 for such units. The additional increase in G&A was due primarily to the higher level of operations.

Interest expense stayed about the same for both years.

For most of our history, we operated in a loss position and had significant net operating loss carry forwards. At December 31, 2008, we have federal net operating loss carry forwards of about $2.5 million and expect to utilize them in 2009. For 2008, we had pretax income of about $11.8 million and a tax provision of about $2.9 million. We expect these income trends to continue and estimate our effective tax rate to be in the 35% - 40% range for the foreseeable future. We no longer deem it necessary to have a deferred tax valuation allowance.

Sale of Oil and Gas Properties

In early July 2007 we sold our interest in the San Juan properties for $2.3 million. We recognized a gain of about $1.7 million. During 2007, certain unproved properties were sold resulting in a gain of about $200,000. In October 2008, we sold unproved properties for about $2 million and recognized a gain of about $1.4 million. Other sales during 2008 resulted in gains of about $400,000.

Other than our equity investment in Savoy, our remaining oil and gas properties are not significant and we will be making minimal disclosures, if any, regarding them.

Critical Accounting Estimate and Significant Accounting Policies

We believe that the estimate of our coal reserves is our only critical accounting estimate. Since the Carlisle mine has only been in production since February 2007 we do not have a long history to rely on. The reserve estimates are used in the DD&A calculation, in our impairment test and in our internal cash flow projections. If these estimates turn out to be materially under or over-stated, then our DD&A expense and impairment test would be affected. In addition, if the reserves are materially overstated then our liquidity would be adversely affected.

Our significant accounting policies are set forth in Note 1 to the Financial Statements.

New Accounting Pronouncements

Other than SFAS 160, none of the recent FASB pronouncements had, or will have any material effect on us. In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements, an amendment of Accounting Research Bulletin No. 51. This statement requires an entity to separately disclose non-controlling interests as a separate component of equity in the balance sheet and clearly identify on the face of the income statement net income related to non-controlling interests. This statement is effective for financial statements issued for fiscal years beginning after December 15, 2008. The adoption of this statement will change how we present our minority interest with Sunrise but will not have a material affect on our financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Smaller reporting companies are not required to provide the information required by this item.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

Smaller reporting companies are not required to provide supplementary data.

REPORT OF INDEPENDENT REGISTERED
PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
Hallador Petroleum Company
Denver, Colorado

We have audited the accompanying consolidated balance sheet of Hallador Petroleum Company and Subsidiaries as of December 31, 2007 and 2008 and the related consolidated statements of operations, cash flows and stockholders' equity for each of the years in the two year period ended December 31, 2008. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial condition of Hallador Petroleum Company and Subsidiaries, as of December 31, 2007 and 2008 and the consolidated results of their operations and their cash flows for each of the years in the two year period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

/s/ Ehrhardt Keefe Steiner & Hottman PC

March 25, 2009
Denver, Colorado

Consolidated Balance Sheet
(in thousands, except share data)

ASSETS	As of December 31, 2008	2007
Current assets:		
Cash and cash equivalents	$ 21,013	$ 6,978
Certificate of deposit – restricted		1,800
Federal income tax receivable	1,531	
Accounts receivable	6,113	2,361
Coal inventory	776	92
Other	1,928	861
Total current assets	31,361	12,092
Coal properties, at cost:		
Land, buildings and equipment	55,027	32,548
Mine development	45,289	32,137
	100,316	64,685
Less - accumulated depreciation, depletion, and amortization	(7,233)	(2,743)
	93,083	61,942
Investment in Savoy	7,911	11,893
Other assets	3,710	1,330
	$ 136,065	$ 87,257
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of bank debt	$ 2,500	$ 1,893
Accounts payable and accrued liabilities	11,563	5,550
State income tax payable	605	
Other	310	620
Total current liabilities	14,978	8,063
Long-term liabilities:		
Bank debt, net of current portion	37,500	33,464
Interest rate swaps, at estimated fair value	2,290	1,181
Deferred income taxes	1,700	
Asset retirement obligations	686	646
Other	4,345	4,346
Total long-term liabilities	46,521	39,637
Total liabilities	61,499	47,700
Minority interest	1,683	384
Stockholders' equity:		
Preferred stock, $.10 par value, 10,000,000 shares authorized; none issued		
Common stock, $.01 par value, 100,000,000 shares authorized; 22,446,028 and 16,362,528 outstanding, respectively	224	163
Additional paid-in capital	69,739	44,990
Retained earnings (deficit)	2,920	(5,980)
Total stockholders' equity	72,883	39,173
	$ 136,065	$ 87,257

See accompanying notes.

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Consolidated Statement of Operations
For the years ended December 31,
(in thousands, except per share data)

	2008	2007
Revenue:		
Coal sales	$ 70,337	$ 27,228
Gain on sale of oil and gas properties	1,822	1,933
Equity income (loss) – Savoy	(2,320)	35
Other	359	533
	70,198	29,729
Costs and expenses:		
Cost of coal sales	40,413	21,866
DD&A	4,630	2,420
G&A	6,128	4,161
Interest	4,029	4,113
Impairment – Savoy	1,396	
	56,596	32,560
Income (loss) before minority interest and income taxes	13,602	(2,831)
Minority interest	(1,776)	416
Income (loss) before income taxes	11,826	(2,415)
Income taxes:		
Current	1,226	
Deferred	1,700	
	2,926	
Net income (loss)	$ 8,900	$ (2,415)
Net income (loss) per share:		
Basic	$ .47	$ (0.18)
Diluted	$ .46	$ (0.18)
Weighted average shares outstanding:		
Basic	18,980	13,300
Diluted	19,286	13,300

See accompanying notes.

Consolidated Statement of Cash Flows
For the years ended December 31,
(in thousands)

	2008	2007
Operating activities:		
Net income (loss)	$ 8,900	$ (2,415)
Deferred income taxes	1,700	
Minority interest	1,776	(416)
Equity income (loss) – Savoy	2,320	(35)
Impairment – Savoy	1,396	
Gain on sale of oil and gas properties	(1,822)	(1,933)
Depreciation, depletion, and amortization	4,630	2,420
Change in fair value of interest rate swaps	1,109	1,181
Stock-based compensation	2,826	1,899
Other	133	195
Change in current assets and liabilities:		
Accounts receivable	(3,707)	(2,361)
Coal inventory	(684)	(92)
Income taxes	(925)	
Accounts payable and accrued liabilities	2,484	1,368
Other	(1,384)	(136)
Cash provided by (used in) operating activities	18,752	(325)
Investing activities:		
Acquisition of additional 20% interest in Sunrise	(11,772)	
Capital expenditures for coal properties	(21,898)	(17,244)
Sales of oil and gas properties	2,676	2,548
Investment in Savoy		(6,020)
Other		(1,501)
Cash used in investing activities	(30,994)	(22,217)
Financing activities:		
Proceeds from bank debt	42,000	10,140
Payments of bank debt	(37,357)	
Proceeds from stock sales	21,984	11,050
Capital contributions from Sunrise minority owners		800
Proceeds from exercise of stock options		460
Other	(350)	(136)
Cash provided by financing activities	26,277	22,314
Increase (decrease) in cash and cash equivalents	14,035	(228)
Cash and cash equivalents, beginning of year	6,978	7,206
Cash and cash equivalents, end of year	$ 21,013	$ 6,978
Cash paid for interest (net of amount capitalized - $176 and $148)	$ 2,879	$ 2,290
Cash paid for income taxes	$ 2,000	
Non-cash investing activity -accounts payable for coal properties	$ 3,032	$ 2,136
Acquisition of minority interest	$ 477	

See accompanying notes.

Consolidated Statement of Stockholders' Equity
(in thousands)

	Common Stock	Additional Paid-In Capital	Retained Earnings (Deficit)	Total
Balance December 31, 2006	$ 121	$ 31,623	$ (3,565)	$ 28,179
Stock sale to Yorktown and others (3,564,517 shares)	36	11,014		11,050
Exercise of 200,000 stock options	2	458		460
Restricted stock awards	4	1,393		1,397
Stock-based compensation		502		502
Net loss			(2,415)	(2,415)
Balance December 31, 2007	163	44,990	(5,980)	39,173
July stock sale, net of issuance costs (5,500,000 shares)	55	21,929		21,984
Restricted stock awards	6	2,280		2,286
Stock-based compensation		540		540
Net income			8,900	8,900
Balance December 31, 2008	$ 224	$ 69,739	$ 2,920	$ 72,883

See accompanying notes.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) Summary of Significant Accounting Policies

Basis of Presentation and Consolidation

The consolidated financial statements include the accounts of Hallador Petroleum Company (the Company) and its majority-owned subsidiary Sunrise Coal, LLC (Sunrise). All significant intercompany accounts and transactions have been eliminated. We are engaged in the production of coal from a shallow underground mine located in western Indiana. We also own a 45% equity interest in Savoy Energy L.P., a private oil and gas company which has operations in Michigan.

We have entered into significant equity transactions with Yorktown and other entities that invest with Yorktown. Yorktown currently owns about 55% of our common stock and represents one of the five seats on our board.

Reclassification

To maintain consistency and comparability, certain amounts in the 2007 financial statements have been reclassified to conform to current year presentation.

Inventories

Coal and supplies inventories are valued at the lower of average cost or market. Coal inventory costs include labor, supplies, equipment costs and overhead.

Advance Royalties

Coal leases that require minimum annual or advance payments and are recoverable from future production are generally deferred and charged to expense as the coal is subsequently produced.

Coal Properties

Coal properties are recorded at cost. Interest costs applicable to major asset additions are capitalized during the construction period. Expenditures that extend the useful lives or increase the productivity of the assets are capitalized. The cost of maintenance and repairs that do not extend the useful lives or increase the productivity of the assets are expensed as incurred. Other than land and underground mining equipment, coal properties are depreciated using the units-of-production method over the estimated recoverable reserves. Underground mining equipment is depreciated using estimated useful lives ranging from five to twenty years.

If facts and circumstances suggest that a long-lived asset may be impaired, the carrying value is reviewed for recoverability. If this review indicates that the carrying value of the asset will not be recoverable through estimated undiscounted future net cash flows related to the asset over its remaining life, then an impairment loss is recognized by reducing the carrying value of the asset to its estimated fair value.

Mine Development

Costs of developing new coal mines, including asset retirement obligation assets, or significantly expanding the capacity of existing mines, are capitalized and amortized using the units-of-production method over estimated recoverable (proved and probable) reserves.

Asset Retirement Obligations - Reclamation

At the time they are incurred, legal obligations associated with the retirement of long-lived assets are reflected at their estimated fair value, with a corresponding charge to asset retirement obligation assets. Obligations are typically incurred when we commence development of underground mines, and include reclamation of support facilities, refuse areas and slurry ponds.

Obligations are reflected at the present value of their discounted cash flows. We reflect accretion of the obligations for the period from the date they are incurred through the date they are extinguished. The asset retirement obligation assets are amortized using the units-of-production method over estimated recoverable (proved and probable) reserves. We are using a 6% discount rate.

Federal and state laws require that mines be reclaimed to their previous condition in accordance with specific standards and approved reclamation plans, as outlined in mining permits. Activities include reclamation of pit and support acreage at surface mines, sealing portals at underground mines, and reclamation of refuse areas and slurry ponds.

We assess our ARO at least annually, and reflect revisions for permit changes, as granted by state authorities, for revisions to the estimated reclamation costs, and for revisions to the timing of those costs.

The following table reflects the changes to our ARO:

	2008	2007
Balance beginning of period	$ 646	$ 912
Accretion	40	38
Settlements		(304)
Balance end of period	$ 686	$ 646

Statement of Cash Flows

Cash equivalents include investments, which includes mutual funds, with maturities when purchased of three months or less.

Income Taxes

Income taxes are provided based on the liability method of accounting pursuant to SFAS 109, Accounting for Income Taxes. The provision for income taxes is based on pretax financial income (loss). Deferred tax assets and liabilities are recognized for the future expected tax consequences of temporary differences between income tax and financial reporting and principally relate to differences in the tax basis of assets and liabilities and their reported amounts, using enacted tax rates in effect for the year in which differences are expected to reverse.

Earnings per Share

We follow the provisions of SFAS 128, Earnings Per Share. For 2007, no additional shares were added in the calculation of diluted earnings per share as they would be anti-dilutive. Diluted net income per share for 2008 was calculated using 308,000 additional shares relating to our restricted stock units.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual amounts could differ from those estimates.

Revenue Recognition

We recognize revenue from coal sales at the time risk of loss passes to the customer at contracted amounts.

Long-term Contracts

As of December 31, 2008, we are committed to supply to four utilities about 15.3 million tons of coal during the next 4.5 years. These contracts represent about 1/3 of our recoverable reserves. During 2008, three of our utility customers accounted for 90% of our sales: one customer accounted for 43%, the second for 31%, and the third customer for 17%. For 2007, one customer accounted for 55% and the other for 38%. We are paid every two to four weeks and do not expect any credit losses.

Transportation

Currently, we use both truck and rail transportation. Disruption of these services due to weather, mechanical issues, strikes, lockouts, bottlenecks and other events may have a temporary adverse impact on shipments and, consequently, to coal sales.

Stock Based Compensation

Effective January 1, 2006, we adopted the fair value recognition provisions of SFAS 123R, using the modified prospective transition method.

New Accounting Pronouncements

Other than SFAS 160, none of the recent FASB pronouncements had, or will have any material effect on us. In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements, an amendment of Accounting Research Bulletin No. 51. This statement requires an entity to separately disclose non-controlling interests as a separate component of equity in the balance sheet and clearly identify on the face of the income statement net income related to non-controlling interests. This statement is effective for financial statements issued for fiscal years beginning after December 15, 2008. The adoption of this statement will change how we present our minority interest with Sunrise but will not have a material affect on our financial statements.

(2) Income Taxes (in thousands)

Our income tax is different than the expected amount computed using the applicable federal and state statutory income tax rates. The reasons for and effects of such differences are as follows:

	2008	2007
Expected amount after minority interest	$ 4,021	$ (821)
State income taxes, net of federal benefit	57	