

Tri-Cities Business Journal

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Business of the Year:
**Alpha Natural
Resources**

Kevin Crutchfield, CEO, Alpha Natural Resources

Plus:
Why Virginia kids are
more likely to become
good businesspeople
than Tennessee kids
and
Bristol Compressors
Lays Off 248

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Cover Story

8 Business of the Year: Alpha Natural Resources

The acquisition of troubled Massey Energy Company doubled Alpha's size and created the fifth largest supplier of coal on (and below) the face of the Earth. It also made all of Massey's old problems into Alpha's new ones. CEO Kevin Crutchfield talks about how his company took the good with the bad, and is now positioned for a future as a global player



Cover Photo Courtesy Alpha Natural Resources

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Business of the Year: Alpha Natural Resources



At the end of 2010, Alpha Natural Resources was a company with \$3.9 billion in annual revenues. It employed 6,400 people and operated 60 coalmines. At the end of 2011, Alpha was an \$8 billion company, with 14,000 employees and 150 mines.

2011 was obviously a watershed year for Alpha, which has had more good years than bad. Despite having been in existence for only nine years, the company has grown to be the world's No. 5 supplier of coal and the No. 3 supplier of metallurgical coal (used in the production of steel, while thermal coal is used in the production of electricity). Alpha now has the largest export capacity of any U.S. producer.

Alpha grew through acquisition in 2011 by completing a long-rumored merger with Massey Energy Company on January 31. Massey was eager to merge with Alpha, and federal regulators were happy to see Massey's assets under new management after an April 2010 explosion at Massey's Upper Big Branch (UBB) mine killed 29 miners. A December 2011 Mine Safety and Health Administration report on the blast laid the blame squarely on Massey's pre-merger management, saying, "The physical conditions that led to the explosion were the result of a series of basic safety violations at UBB and were entirely preventable. The investigation also revealed multiple examples of systematic, intentional, and aggressive efforts by Massey to avoid compliance with safety and health standards, and to thwart detection of that non-compliance by federal and state regulators." Alpha's superior record on safety issues was not lost on those same regulators when the merger was being discussed.

Kevin Crutchfield, Alpha CEO, met with *The Tri-Cities Business Journal* to discuss Alpha's remarkable 2011 and its plans for the future on December 15, 2011, as he was moving into his office in Alpha's new LEED certified corporate headquarters, where a ribbon-cutting had been held only days before.

Tri-Cities Business Journal: You closed the merger with Alpha at the end of January 2011...

Kevin Crutchfield: January 31, yes.

BJ: How long had you been working on that deal before the announcement?

KC: We had been thinking about a combination between ourselves and Massey for several years but we couldn't really get the stars to line up for a host of reasons. After the Upper Big Branch tragedy we felt that the timing in putting something together with Massey could actually make a lot of sense for what we thought were the right reasons. So we started having some conversations in the late spring of 2010. It didn't really pick up a lot of steam until the fall. The more we thought about it the more we became convinced that this was a good fit from a strategic standpoint because it could create an entity that could be one of the best metallurgical bases in the world and created the third largest metallurgical coal seller on a global basis and also the fifth largest coal company in the world. "Largest" was never our strategy but we felt like from a strategic sense, the synergies, how our properties butted up against one another, we felt like it was compelling for a host of reasons. So we began to pursue it in the fall and Massey, of course, ran a brief public process and we were able to get the transaction done. From the day we agreed on it to the day we announced it, maybe three days elapsed. It was pretty quick. It was probably one of the worst kept secrets also. There for a while we would read about our previous days activities in *The Wall Street Journal*.

BJ: You said that after the Upper Big Branch incident, it started to make more sense for Massey. Not to be insensitive but can you expound on that?

KC: Well, they had a pretty tough run. They had a big impoundment failure that leaked a lot of black water into the river system; they had an incident previous to that, one of their long lines. They just had a spate of issues and we felt like our system, not that it's perfect, but we felt like it was time for the assets to come together. We felt that our management system would allow the Massey assets and the Massey people to flourish versus the sort of system that they were under at that time. We felt that those were pretty serious issues that

they had been dealing with, and maybe their resolve to get something done for their employees and their shareholders would resonate with them perhaps a little more than it had in the past.

BJ: Alpha has always been very quick to talk about safety, specifically the Running Right initiative, and that obviously didn't hurt in trying to put a package together in light of the problems they had.

KC: There was a perception issue around Massey. Whether the perception was real or not is another discussion, but it didn't really matter because we were smart enough to realize that there was a perception. So our goal from day one was the rapid deployment and implementation of our Running Right system. We're not saying it's perfect; it just works very well for us. We think the reason it's so powerful is because it gives everybody a voice. Everybody says in what happens at their coal mine, their plant, and their load out. When you start listening to the voices that do the work you find that these are really smart people, they know their jobs very well and all that they want to do is help. So we gave them that mechanism to do that through our Running Right methodology.

We spent six months training and we lost (a great deal) of production because people were in the classroom as opposed to mining coal, but we felt like that was the right type of investment. We needed to make that investment because we needed to set the expectations very clearly from day one that this is how the combined company is going to operate. We had to be very clear with those expectations. We know that it's not for everybody, Running Right is not for everybody; we understand that and that's fine, but it's the way we're going to run the company so you've got a choice to make. We're okay either way, but if you're going to be here this is how it's going to operate.

It's served us very well. We've made great strides, we're in day 197 now and the total reportable incident rate, which is one of the safety statistics we track, is down in excess of 20 percent from the day we took over, which was June 1. We think over time we'll continue to bend that curve down versus the previous trend, not because we're smartest guys in the room but because of the Running Right methodology - giving the coal miners a voice in the outcomes and a process in which their voice can be heard.

BJ: In reading the reports on the Upper Big Branch incident, one of the things that stood out first was that Massey was in some cases using old equipment. The inference I got was it should have been replaced some time ago. When you talk about the changes you've made in the legacy Massey mines how much have you had to do in terms of not just training, but in terms of bringing the equipment up to where it needs to be?

KC: I think by and large, when Massey engaged in capital expenditures they bought good gear. They had a good rebuild schedule and they used belts a lot of times in place of hauling coal on the road, that sort of thing. There hasn't been a lot of recapitalization required. Most of our efforts have been focused on expectations around people and what the standards of a coal mine need to be and those are culture and people related as opposed to needing to spend money. We have spent some money to upgrade monitoring systems and those kinds of things but by and large it's been a resetting of expectations of how we expect the coalmines to be operated.

BJ: So you're just setting a corporate culture that's new.

KC: Yes, as part of this settlement we've agreed to spend even more money in a few areas but we think it could be revelational from a mine safety standpoint. I figure that's one of your questions.

BJ: Then let's go ahead and ask it. Let's talk about the settlement process. When you went into the Massey deal, you knew that this would be a part of what you would have to do, taking the good and bad together. Tell me about the process of working with the MSHA, the Department of Justice, and how you came to this final settlement and non-prosecution agreement.

KC: First and foremost our deepest sympathies go to the families and to those twenty-nine men. It was never strategy to resolve an issue, as it was a strategy to understand what happened so we could put plans in place to do our level best to make sure that nothing like that ever really happens again.

But, we did know that there was some exposure there and I think the reason that we were able to reach a settlement with the government with a non-prosecution agreement so quickly was because frankly of our reputation of our people, the way they run, the way they live their lives and the way they lead. But also, the extraordinary amount of cooperation with the Department of Justice. Which we planned from the outset and I think they understood that we were very serious about this, this was not just happy talk, that this was something that we were very serious about. I think that as much as anything led to the rapidity of the settlement.

It's a big number. (Ed. Note: Just shy of \$210 million, including \$80 in new safety measures at legacy Massey and Alpha mines, \$48 million to mine safety research and development, \$46.5 million to families of the fallen miners and \$34.8 million in fines.) That \$48 million is associated with a trust fund that's not only designed for safety for Alpha miners but all miners, administered by an advisory board that will be approved by the Department of Justice.

From our standpoint, we're glad to have that chapter closed. Nothing can heal the families of those twenty-nine fallen miners, no amount of money; it was never about the amount of money. It was about trying to run our own analysis so we can understand, to the best of our ability, what happened there. A lot of reports are out there now and we're feeding those reports into our own thinking and we've hired our own team of experts who are looking into the matter as well. We're looking forward to getting their final view on what they believe happened

BJ: What's the ETA on that?

KC: It's going to be sometime next year, we don't know exactly; probably spring plus or minus before they're in a position to wrap up. We'll decide on whether their findings are something we want to make public or not later. The goal from our standpoint has always been very consistent around No. 1, empathy and sympathy to the families and No. 2, let's do our level best to understand what happened at that coal mine. We don't need events like that in the future. Nobody does, us or anybody else.

BJ: So with that chapter, as you say, closed, you now find yourself the No. 3 met coal supplier in the world, the No. 5 coal supplier, and you have the largest export capacity of

any U.S. coal producer. All that in nine years and two day of existence, not a bad record. Let's talk about where you are now as your position in the world market goes. This year you expanded your operations in India and Australia. Obviously China's burgeoning steel industry is a huge factor in global coal. Tell us about the world market and where Alpha stands in it.

KC: It's a tale of two hemispheres, the eastern hemisphere and the western hemisphere and it's also a discussion around global electricity and global steel. For us, the western hemisphere is not as exciting as the eastern hemisphere, just from a growth perspective.

As you mentioned, China produces nearly half the world's steel now where as 10 years ago it was 10 or 15 percent. The amount of growth there is been nothing short of breathtaking and while we think it will moderate, it will still be upper single digits. It will outpace the rest of the world and while we don't sell a lot of coal ourselves, directly into China, other producers in the eastern hemisphere do which frees up markets for us. Those for us are, principally, Eastern and Western Europe, South America and parts of Asia. They are easier for us to get to from here. India is a big market for us; Turkey and Egypt are big markets for us. So we're very constructive for global coal for the next twenty years.

Globally, near term, we're probably a little more constructive on met than thermal but long term we believe the world is going to consume about two billion tons of additional coal above what it consumes today and that's two times the size of the US coal industry. So we're pretty excited about how we can play in those mining jurisdictions in the future.

The U.S. is a little less exciting, especially from an electricity standpoint. Markets here are tough, with very cheap natural gas prices, lots of regulation that are working very hard to limit the amount of coal that can be burned. We're feeling that. They way we're trying to respond to it is, move our BTUs to a world market that will want them as opposed to domestic markets that are kind of indifferent. That's a little bit of new strategy for us but it's a function of the legislative and regulatory environment that we find ourselves in now.

We remain pretty optimistic for the next decade or even two. We're going through a state right now where there is a lot of uncertainty, especially with Europe. They have a fiscal issue, obviously, that they are trying to sort out. There's a lot of uncertainty on whether they'll get that sorted out or whether they'll just kick the can down the road for a while. It's an issue for us because a lot of our exports go into the European region; it's something we're watching very closely.

We ship coal into about 30 different countries now, so we think we can manage that portfolio effectively based on the prevailing market conditions. But over the long term we're very constructive on both coal use for electricity and coal use for steel. We're very nicely positioned.

BJ: The regulatory environment in the U.S., obviously has changed a fair amount in the nine years that Alpha has existed. This year there has been a lot of talk about the Cross State Air Pollution Rule (Casper). The last I read there was some uncertainty about that. Has that been nailed down? Do you know what you're facing with that? Do you know once that's taken care of what the next thing might be down the road?

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KC: Collectively there are rafts of EPA regulations that we refer to as “the train wreck.” Casper is one of many. The one that’s on the heels of that is one they call Utility MACT, Utility Maximum Allowable Control Technology. It has to do with the removal of mercury from particulate emission standards.

Our assessment is, if this stuff goes forward that is out now it could take a pretty serious bite out of coal’s market share. It could be anywhere from 20 percent to 30 percent. It’s pretty significant. It’s not going to happen overnight, it will happen over a decade or 15 years. But it’s not clear.

There’s been a lot of resistance to the Casper rule that’s scheduled to go out on January 1, 2012 on the basis of, it’s going to take valuable coal-fire capacity offline. So, A) What are we going to replace it with and what’s the cost going to be - and B) Are we going to compromise the grid reliability? So there’s been a lot of resistance, there has been a total of like forty-five motions or suits to delay, postpone, or even eliminate the implementation of it. It’s uncertain, is the best thing you can say about it, it’s something we’re watching very carefully. We’ve done an assessment of all of our customers, from each boiler to each customer to determine who we need to sell more coal to and who’s got coal plants that are going to phase out over time so we can spend our time appropriately but also begin to cultivate international markets for our products, to get it out of the country, because we do have unutilized export capacity that we’d be happy to use in that regard.

BJ: Obviously, the justification for most of the regulatory environment right now is the environment. In addition to trumpeting safety, Alpha’s done a good job with PR in talking about clean coal for green technology and trying to make coal not the “boogie man” that some people want to make it out to be.

KC: A lot of people believe that if you’re in the coal business you can’t be a good environmental steward; the two just don’t go hand in hand. A lot of people fundamentally believe that. We of course, don’t.

I think if you look at our practices in the past and our practices going forward you’ll see that we try to strike that balance of serving the greater good and providing affordable electricity while meeting the needs of the environment. I think to the EPA’s credit, they’ve done a job in terms of our water and our air. But we’ve reached a point some refer to as the point of diminishing returns, where you need to do a careful analysis of the benefit of all these regulations and the cost to society, so you get a sense of the cost benefit. The EPA is not inherently designed to do that, unfortunately. There was a piece of legislation passed last year in the house, called the Train Act, that caused the EPA to do just that, to do a cost benefit analysis. For us business folk that’s just a very logical approach.

We like to think of ourselves as good environmental stewards. We know that we’re the temporary steward of these assets that we have and these lands that we have and we have to take good care of them. Our goal is to restore the lands to at least as of good of shape as they started, if not better. And in a lot of cases, these land restoration activities that we undertake do leave the land in better shape. We all know what the land in Appalachia is like, it’s very steep terrain and a lot of times we can put these hill tops back kind of flat or rounded, so they’re suitable for housing development.

We helped Mingo County, West Virginia build an airport. We built a road that’s every bit as scenic as the parkway that runs up and down the east coast and comes through here in Virginia. And if you talk to a lot of landowners they’ll openly admit that the value of their land increased on a post-mining basis than it was pre-mining.

We also acknowledge that as an industry, we probably haven’t done as good a job there as we needed to do and part of our strategy is to be able to demonstrate that you can mine coal safely and at a profit yet also be a good steward of the land and sensitive of the needs of the community. We started a lot of outreach activities to give people input to how we’re thinking and how can we change our practices to better serve the communities where we operate.

BJ: You talked about involvement in the communities with the expressway, the airport, and here locally the partnership with Wellmont that you announced a little while back. How are you able in all the places where Alpha has a presence to find out the community involvement opportunities that make the best sense to you? Does your head person in each community have to come back to Bristol and get approval? Do they have autonomy to do it themselves? How does it work?

KC: It’s something that you struggle with, because there’s always a much longer list of needs that what you’re able to satisfy, so you have to have some process in place to guide you. The guiding values for us have been, make a difference in the lives of people, because there are people who are less fortunate than we are and we feel an obligation to try and help in some way.

A few years back we put a group of people in place, a community involvement group, that kind of fields these requests. We do our best on trying to rank them on impact. For every dollar we move how much of that is actually going toward the activity versus that charities overhead or whatever? You try to work your way through a process that says, “Here’s a ranking, it’s not perfect, but at least it’s something in place that allows us to think about things and how they’ll impact the communities.



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We do give our folks in the field a lot of autonomy. They can come to us and say, this is what we think we need to spend. It ranges from sponsoring little league ball fields to helping rescue squads and lifesaving groups and fire departments and police departments to some of the bigger things like support of the Barter Theatre and the thing we did at Wellmont. It's a wide array of activities, but we feel very strongly that that's part of our purpose, part of our DNA of what we need to do and what we have an obligation to do.

BJ: You're a publicly traded company. Let's do some forward-looking statements. We've already talked about the fact that you had planned to expand in Sidney and New Delhi in 2011. Are those efforts up and running? What can you say in general terms about your global strategy in 2012?

KC: The near term strategy for us is to get Massey integrated and performing as advertised. We can't take our eye off of that ball. There'll be a lot of activity associated with that in 2012. That's also part of the strategy of why we put independent teams in India and Australia.

We think of Australia as a potential home to domicile assets in the future. If you look at where Australia is located geographically relatively in terms of some of the big demand centers, there's a huge transportation advantage, say over the United States for coal going into India, into China, into other emerging economies in that region and even into established economies like Korea and Japan. It's hard to get there from here. We can't compete with the Australians from here because it's so far away. So the design there is to come into the country for investment opportunities. It's been pretty open, we've been pretty public about that. The price tag for entry into Australia

is pretty high so we have to be very thoughtful and very careful about how we go about that. We have a team of six people there now, full-time, very smart, very capable people. They have a lot of autonomy. There's a lot of communication; you wake up every morning and have emails from Australia because of the time difference. And we're very optimistic that in a matter of time we'll get something up and running in Australia. We think it's a strategic area for us in the future.

In respect to India, it's not so much a place to have domicile assets, as it is a big commercial in use center for both thermal and metallurgical coals. India doesn't have the quality of thermal and metallurgical coals as the US or Australia so they're very dependant on imports. The team's responsibility in India is to understand what those needs are going to be in the next decade or two so we can figure out how to grow our business there. We ship them between two and three million tons now and over time we'd like to grow that very steadily. It's a big economy. It's very dependant on imports and we'd like to oblige them with those imports over the next 20 years or so.

Beyond that we have taken a lot of steps to comb the globe for opportunities. You've got some emerging assets that are coming into play, such as Mozambique, Mongolia, Botswana and places like that. We think the market will find those assets eventually. We just don't think we're in a position yet, from a maturity standpoint, to be able to play well in those markets. It takes a huge balance sheet when you're talking about building big coalmines and building big railroads and building ports. We don't have the kind of balance sheet to handle those ourselves but we do keep an eye on those markets and those assets to see if there is a way we can play there, if it would make sense for us over the long term. Coal truly has become a global commodity. **BJ**

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