PARTICIPANTS

Corporate Participants

Christina Kmetko – NACCO Investor Relations Consultant, NACCO Industries, Inc.
J.C. Butler, Jr. – President, Chief Executive Officer & Director, NACCO Industries, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the NACCO Industries 2023 First Quarter Earnings Call. My name is Prica and I'll be your event specialist running today's call. At this time, all participants are in a listen-only mode; and after the speakers' prepared remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

I would now like to hand the conference over to Christina Kmetko. So, Christina, you may proceed.

Christina Kmetko, NACCO Investor Relations Consultant, NACCO Industries, Inc.

Thank you. Good morning, everyone, and welcome to our 2023 first quarter earnings call. Thank you for joining us this morning. I'm Christina Kmetko and I'm responsible for Investor Relations at NACCO Industries. Joining me today are J.C. Butler, President and Chief Executive Officer; and Elizabeth Loveman, Vice President and Controller. Yesterday, we published our first quarter 2023 results and filed our 10-Q. This information is available on our website. Today's call is also being webcast. The webcast will be on our website later this afternoon and available for approximately 12 months.

Our remarks to follow, including answers to your questions, contain forward-looking statements. These statements are subject to several risks and uncertainties that could cause actual results to differ materially from those expressed in the forward-looking statements made here today. These risks include, among others, matters that we've described in our earnings release issued last night and in our 10-Q and other filings with the SEC. We disclaim any obligation to update these forward-looking statements, which may not be updated until our next quarterly earnings conference call, if at all.

In addition, we'll be discussing non-GAAP information that we believe is useful in evaluating the company's operating performance. Reconciliations for these non-GAAP measures can be found in our earnings release and on our website. In a moment, I'll discuss our results for the quarter. But first, let me turn the call over to our president and CEO, J.C. Butler, for some opening remarks. J.C.

J.C. Butler, Jr., President, Chief Executive Officer & Director, NACCO Industries, Inc.

Thank you, Christy, and good morning, everyone. Our first quarter 2023 results were not as strong as the results we've reported in 2021 and 2022, but that was to be expected. Results in those prior quarters benefited from significantly higher natural gas prices and income generated by the early termination of two of our Coal Mining contracts. We explained on our last quarterly call that we expected 2023 results to decrease significantly due to those factors, as well as a reduction in earnings of Mississippi Lignite Mining Company as it moves into a new mine area. That is what played out in the first quarter. Christy will go into more detail about our first quarter earnings and provide an overview of our outlook in a minute, but first, let me provide a few thoughts on the quarter, on our future expectations.

As we described in the earnings release, significantly lower results of both our Coal Mining and Minerals Management segments drove the decrease in our first quarter operating results. We've talked quite a bit over the last few years about moving Mississippi Lignite Mining Company's Red Hills Mine into a new mine area. That is one of the primary reasons for the substantial decrease in our Coal Mining segment's operating profit. At Red Hills, we're dealing with operational inefficiencies as we complete final mining at the existing mine area, while we're also incurring significant costs associated with moving to the new mine area.

These higher costs and inefficiencies are expected to continue through much of 2023, but these costs should moderate by the end of the year when we are fully operational in the new mine area. You'll recall that we've invested significant capital to open this new mine area, which is why we've been emphasizing that increased depreciation expense will be masking the underlying performance of Mississippi Lignite Mining Company. To me, EBITDA tells a better story since we don't have to keep investing in replacement capital at the same pace as the last few years.

During our last quarterly call, I mentioned that the owner of the power plant served by our Sabine Mine in Texas, planned to retire the plant. I'm disappointed to report that the Pirkey power plant was retired at the end of March and we commenced mine reclamation activities on April 1st. This action did not affect our first quarter. In fact tons delivered at Sabine rose in the 2023 first quarter versus 2022. Sabine is receiving compensation for providing final mine reclamation services, but that annual income will be much less than income received during active mining.

Shifting to Minerals Management, we've benefited significantly from higher natural gas and oil prices over the last two years. Prices in Q1 were a lot lower than over much of the last two years. The combination of lower natural gas and oil prices and the expected production decline of existing wells led to a significant decrease in Minerals Management's first quarter 2023 results compared with the 2022 first quarter. Our team at Catapult Mineral Partners continues to look for opportunities to expand our portfolio through acquisitions, while also promoting development of our existing mineral and royalty interest. The team acquired approximately $12 million of additional mineral and royalty interest in 2022 and is targeting additional investments of up to $20 million in 2023. Our 2023 forecast assumes oil and gas market prices moderate to levels in line with 2022 (sic) [2021] averages. However, we all know commodity prices are inherently volatile and changes in natural gas and oil prices could result in adjustments to our current forecast. On the upside, the development of additional wells on existing reserves beyond our forecasts or future acquisitions could be accretive to future results.

Shifting to our North American Mining segment. On the surface, operating profit declined year-over-year. However, the main reason for the decline is because final mine reclamation activities at Caddo Creek are largely completed. These activities were in full swing in the 2022 first quarter, which boosted our results. Once you remove the effect of Caddo, our aggregates operations had an increase in customer demand and earnings compared with the prior year first quarter.

During the last quarterly earnings call, I mentioned that we are implementing changes that should drive future improvements to financial results at North American Mining. It is too soon to judge the full effect of those initiatives, but I'm optimistic these initiatives can build upon the current quarter results. That said, until profit improvements incur on a consistent basis, we've narrowed our business development efforts at North American Mining.

Sawtooth Mining, which is part of our North American Mining segment, is the exclusive contract miner for Lithium Americas Thacker Pass lithium project in Northern Nevada. Construction at Thacker Pass commenced during the 2023 first quarter, and phase one production is projected to begin in the second half of 2026. This is an important step forward in what is expected to be a key project for domestic lithium production. We are acquiring equipment for this project in 2023. We also expect to recognize moderate income in 2024 and 2025 with higher levels of income expected when our customer starts production, which as of now is planned for 2026.

Then mitigation of resources (sic) [The Mitigation Resources] of North America team continues to advance existing mitigation projects and build on the substantial foundation it has established over the past several years.

Mitigation Resources ended the first quarter with eight mitigation banks and four permittee-responsible mitigation projects located in Tennessee, Mississippi, Alabama and Texas. Mitigation Resources was recently selected to be a designated provider of abandoned mine land restoration by the State of Texas and recently completed its first project for the state. The Mitigation Resources team is hard at work pursuing additional abandoned surface marine restoration projects and mitigation banks during 2023. I am very pleased with the level of growth Mitigation Resources has achieved within its first two years of startup. Overall, I expect 2023 to be a year of unfavorable comparisons for the reasons I discussed in my opening remarks. Despite this, I'm still very optimistic about our outlook as we look past 2023. I have a lot of confidence in our team and I'm pleased with the way all of these businesses continue to advance their strategies, including efforts to protect our Coal Mining business.

With that, I'll turn the call back over to Christy to cover our results for the quarter in more detail.

Christina Kmetko, NACCO Investor Relations Consultant, NACCO Industries, Inc.

Thank you, J.C. I'll start with some high-level comments on our consolidated first quarter financial results and then add detail on our individual segments. As J.C. mentioned, our first quarter 2023 results were significantly lower than the 2022 first quarter. On a consolidated basis, our 2023 first quarter operating profit decreased $1.8 million from an operating profit of almost $15 million in the prior year first quarter. Consolidated net income decreased to $5.7 million or $0.76 per share, compared with net income of $12.6 million or a $1.72 per share last year. EBITDA decreased to $10.8 million, roughly half of the prior year EBITDA of $21.4 million. These decreases were primarily due to significantly lower earnings in the Coal Mining and Minerals Management segments. With substantial decrease in income tax expense and other income of $1.2 million from a post-closing purchase price adjustment related to the 2022 Midwest AgEnergy transaction as well as higher interest income partly offset the significant operating profit decrease.

Coal Mining first quarter 2023 operating profit and segment adjusted EBITDA decreased significantly compared with last year, primarily due to the substantial decrease in Mississippi Lignite Mining Company results and lower earnings at the unconsolidated operations. These declines were partly offset by a reduction in Coal Mining operating expenses. A significant increase in the cost per tons sold drove the lower Mississippi results. As J.C. discussed in his remarks, the cost per ton increase was due to the inefficiencies and additional costs incurred to establish the new mining area. A $2.4 million write down of inventory to net realizable value also contributed to the significant increase in the cost per ton.

J.C. already explained the primary reasons behind the decreases in Minerals Management's lower results, as well as North American Mining's lower first quarter operating profit. So let me focus on North American Mining's first quarter 2023 segment adjusted EBITDA. A substantial increase in depreciation expense due to elevated historical capital expenditures to support growth initiatives is included in the unfavorable operating profit variance. Segment adjusted EBITDA excludes the effect of depreciation expense. Once this is excluded, you can see the underlying operations achieved comparable operating results over the two periods.

Looking forward, in 2023, operating profit and segment adjusted EBITDA at the Coal Mining business are expected to significantly decrease year-over-year with or without the $40 million GRE termination payment we received in 2022. The decline is primarily the result of an expected significant reduction in earnings at Mississippi Lignite Mining Company, from increased costs associated with establishing operations in the new mine area, as well as higher depreciation expense related to recent capital expenditures to develop this new area.

As J.C. mentioned, the anticipated ongoing inefficiencies of this project are expected to continue through the third quarter of 2023 and then moderate in the fourth quarter and into 2024. We don't expect Mississippi Lignite Mining Company to open additional mine areas through the remaining contract term. As a result, mine development capital expenditures should moderate from 2024 through the end of the contract in 2032. Earnings of unconsolidated operations is also expected to decrease and contribute to the decline in Coal Mining operating profit. This is a result of the reduction in the per ton management fee at Falkirk for all 12 months in 2023 compared with 8 months last year and the cessation of deliveries at Sabine as of April 1st.

Shifting to North American Mining, we expect a continuation of improved results at the aggregates operations for the remaining quarters of 2023. Despite this improvement, North American Mining's full year operating profit is expected to decrease moderately versus the prior year due to the substantial completion of the income generating mine reclamation activities at Caddo Creek in 2022. Conversely, we expect segment adjusted EBITDA to improve over last year because improvements at the underlying aggregates operations are being masked by a significant increase in depreciation expense in 2023 versus 2022.

Finally, at our Minerals Management segment, we expect 2023 operating profit and segment adjusted EBITDA to decrease significantly from the prior year, primarily driven by current market expectations for natural gas and oil prices, an anticipated reduction in volumes as existing wells follow their natural production decline and limited forecasted development of additional new wells by third-party exploration and production companies. As J.C. mentioned, changes in natural gas and oil prices from current expectations as well as new well development or additional investments in mineral reserves could affect our 2023 results.

To summarize, on a consolidated basis, we expect full year 2023 consolidated net income to decrease significantly due in part to the $30.9 million of pre-tax contract termination income recognized last year. Excluding this settlement income, net income is expected to decline as a result of significantly reduced royalty income in the Minerals Management segment and lower earnings in the Coal Mining segment. These reductions are expected to be partially offset by lower income tax expense.

Looking beyond 2023, we continue to remain optimistic about our long-term outlook. The Coal Mining segment expects increased profitability due in part to improvements at Falkirk once there're temporary price concessions end, and Mississippi Lignite Mining Company. In addition, we will continue to pursue activities which can strengthen the resiliency of our Coal Mining operations. As J.C. previously mentioned, opportunities for growth remain strong in the Minerals Management and Mitigation Resources businesses.

In addition, we remain committed to North American Mining and are encouraged by recent developments at Thacker Pass. Lastly, from a liquidity standpoint, we ended the quarter with consolidated cash of almost $110 million and debt of $20.4 million. In addition, we had availability of $117 million under our revolving credit facility. For the 2023 full year, we expect cash flow before financing activities to remain positive but be substantially lower than 2022 because of anticipated high capital expenditures, primarily for Sawtooth. We will now turn to any questions you may have.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions]

Christina Kmetko, NACCO Investor Relations Consultant, NACCO Industries, Inc.

I think that concludes our Q&A, since I don't see any questions. I'll close with a few final reminders. A replay of our call will be available online later this morning. We'll also post a transcript on the Investor Relations website when it becomes available. If you have any questions, please reach out to me. You can reach me at the phone number on the press release. I hope you enjoy the rest of your day. And now I'll turn the call back to Prica to conclude the call.

Operator: Thank you. I can confirm that's it for today's call. Please note a replay will be available until Thursday, May 11th. Please dial 1-929-458-6194 and enter the access code 960936. Thank you. You may now disconnect your lines.