## PARTICIPANTS

### Corporate Participants

**Christina Kmetko** – Investor Relations & Media Contact, NACCO Industries, Inc.
**John C. Butler** – President, Chief Executive Officer & Director; President, Chief Executive Officer & Director – The North American Coal Corporation, NACCO Industries, Inc.

### Other Participants

**Andrew M. Kuhn** – Analyst, Focused Compounding Capital Management

## MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by, and welcome to the NACCO Industries' Q4 and Full Year 2019 Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions] I would now like to hand the conference over to Christina Kmetko, Investor Relations. Please go ahead.

### Christina Kmetko, Investor Relations & Media Contact, NACCO Industries, Inc.

Thank you very much. Good morning, everyone, and welcome to our 2019 fourth quarter and full year earnings call. I am Christina Kmetko and I'm responsible for Investor Relations at NACCO Industries. I will be providing a brief overview of our quarterly results and business outlook, and then I will open up the call for your questions.

Joining me today are J.C. Butler, President and Chief Executive Officer of both NACCO and North American Coal; and Elizabeth Loveman, NACCO's Vice President and Controller. Yesterday, we published our fourth quarter and full year 2019 results and filed our 10-K. Copies of our earnings release and 10-K are available on our website. For anyone who is not able to listen to today's entire call, an archived version of this webcast will be on our website later this afternoon and available for approximately 12 months.

As we begin, I would like to remind participants that this conference call may contain certain forward-looking statements. These statements are subject to a number of risks and uncertainties that could cause actual results to differ materially from those expressed in the forward-looking statements made here today in either our prepared remarks or during the following question-and-answer session. We disclaim any obligation to update these forward-looking statements, which may not be updated until our next quarterly conference call, if at all. Additional information regarding these risks and uncertainties were set forth in our earnings release and in our 10-K.

Now let me discuss our 2019 results. I will cover our consolidated results first and then provide the highlights for each segment. On a consolidated basis, while our full year 2019 net income solidly increased rising to $39.6 million from $34.8 million last year, our quarter did not fare as well. Our fourth quarter consolidated net income decreased to $6.4 million or $0.91 per share from $11 million or $1.57 per share last year. There are a number of contributing factors to this decline which are best explained by segment.

  

In our Coal Mining segment, operating profit decreased substantially from the prior year fourth quarter primarily driven by Centennial Natural Resources and Mississippi Lignite Mining Company. At Centennial Natural Resources, we recorded a $2 million unfavorable adjustment to mine reclamation liabilities in the 2019 fourth quarter whereas last year we recorded a favorable $1.8 million adjustment. At Mississippi Lignite Mining Company, there were fewer deliveries in the fourth quarter of 2019 than in 2018 because of a decrease in the number of days the customer's power plant was dispatched.

Also the prior year fourth quarter results included a favorable $3 million contractual settlement that did not reoccur in 2019. These items as well as the decrease in earnings at our unconsolidated operations because of fewer tons delivered drove the significant decrease in the Coal segment's operating profit.

As discussed in our release, the Minerals Management segment and to a lesser extent the North American Mining segment also had reduced operating profit.

A tax benefit on the quarter's earnings partly offset the reduced fourth quarter operating profit, but taxes are better understood on a full year basis. Our effective income tax rate for the 2019 full year was 8.7% compared with 17.5% in 2018. The 2019 effective income tax rate included a $2.5 million tax benefit, which resulted primarily from changes in prior year estimates and the settlement of certain tax items from ongoing examinations.

The 2018 effective income tax rate included $1.2 million of tax expense from the recording of an additional valuation allowance. If you exclude these items, our effective income tax rate would have been approximately 14.5% for 2019 and 14.7% last year.

Those are the significant factors affecting the fourth quarter results.Now let me turn to our outlook.

At the Coal Mining segment, we expect overall deliveries to increase modestly over 2019 at both the consolidated and unconsolidated operations because of an anticipated increase in customer requirements. Our customers are forecasting a reduction in planned power plant outage days and an increase in the number of days dispatched this coming year.

We expect 2020 Coal Mining operating profit to increase over 2019. This anticipated increase is primarily the result of an expected increase in gross profit at Mississippi Lignite Mining Company and the absence of the $2 million unfavorable adjustment to mine reclamation liabilities that was taken in the fourth quarter of 2019.

We also expect a modest improvement in earnings at our unconsolidated Coal Mining operations. These improvements are anticipated to be partly offset by an increase in operating expenses from anticipated higher professional fees and IT expenses.

In the Coal Mining segment, capital expenditures are expected to be approximately $24 million in 2020. We expect elevated levels of capital expenditures through 2021, primarily because of spending at Mississippi Lignite Mining Company associated with the development of a new mine area.

At our North American Mining segment, we anticipate limestone deliveries to increase and full year operating results to improve significantly over 2019 as results are expected to benefit from earnings associated with new limestone mining contracts. We expect the improvement in operating profit to be partly offset by an increase in operating expenses because of higher employee-related costs associated with the new mining operations.

We expect capital expenditures at North American Mining to be $9 million in 2020. These expenditures are primarily for the acquisition, relocation and refurbishment of draglines.

Our Minerals Management experienced a significant increase in royalty income in 2019 compared with 2018, primarily because of a significant increase in the number of gas wells operated by third parties to extract natural gas from Ohio Utica shale mineral reserves. Because new wells have high initial production rates and follow a natural decline before settling into relatively stable, long-term production, we expect royalty income in 2020 to decrease and be substantially lower than the 2019 level. This decrease is anticipated to occur primarily in the first half of the year, particularly in the first quarter, as comparisons are made to historically high revenue levels in the first half of 2019, associated with increased production levels in the early stages of production from new wells.

The reduction in royalty income is based on natural gas price expectations, fewer expected new wells and the natural production decline that occurs early in the life of a well. Decline rates can vary due to factors like well depth, well length, formation pressure and facility design. Also, as we mentioned in the earnings release, it is important to note these expectations for royalty income are dependent on a number of factors outside of our control.

To summarize, overall, we anticipate 2020 consolidated net income to decrease compared with 2019, predominantly in the first half of the year. This is mainly because of the anticipated reduction in Minerals Management operating profit as well as the absence of $2.7 million pre-tax that was received in 2019 associated with a prior India venture and the absence of the previously mentioned $2.5 million tax benefit recognized this quarter. The 2020 full-year effective income tax rate is expected to be between 10% and 12%, based on the estimated mix of earnings and excluding discrete items.

Before I open up the call for questions, let me quickly provide some balance sheet and cash flow information. We ended the year with consolidated cash on hand of $122.9 million and debt of $24.9 million.

With regard to cash flow, we anticipate cash flow before financing activities in 2020 to decrease significantly from 2019 as a result of expected increased capital expenditures and payment of deferred compensation and other payroll liabilities.

That concludes my prepared remarks. I will now open up the call for your questions.

  

## QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from Andrew Kuhn with Focused Compounding. Your line is open.

**<Q – Andrew Kuhn – Focused Compounding Capital Management>:** Hey, how's it going? Thanks for taking my questions.

**<A – J.C. Butler – NACCO Industries, Inc.>:** Good morning.

**<Q – Andrew Kuhn – Focused Compounding Capital Management>:** And so – good morning. So North American Mining has grown a lot in terms of revenues but not yet reported profits and it spends a lot on CapEx. So internally I'm assuming you could make decisions on stuff like business development spending, buy a new dragline, et cetera, based on what kind of customer retention rates you think this kind of work will have, the useful life of dragline and stuff like that, but externally shareholders obviously can't see that kind of information. So I was wondering if you could talk about whether you look at things like the internal rate of return or the expected eventual rate of return on capital you think North American Mining can have. And if so, what are the key factors for you in deciding if that upfront capital and a mining creates value over time?

**<A – J.C. Butler – NACCO Industries, Inc.>:** Great, great question. So the – yeah, just to talk about individual projects that we look at, obviously, this business is an important and we think would be a substantial part of the company. It's part of the one of the – it's one of the reasons that we turned this business into a segment a year ago or in 2019. As we look at new projects, obviously, we've got a couple of different business models and one of them is purely a service model, where we're really providing a service for a fee and there is very little capital involved in that. And the nature of the model of those contracts, the service-based contracts that the customers pay all the direct costs, they provide the capital. We do have some administrative cost that goes into overseeing the mine or the quarry to some extent.

So those are pretty simple to look at because it's really fee based and then we just have to consider what are our additional overheads – what additional overhead spending would be required for that project and you can see a fee income that comes out of it. We tend to look at those on sort of an NPV basis to say, okay, if we go do this project for three years, five years, whatever the term is, what do we think about that and given the nature of the project, how do we feel about the customer retention. We typically have had very high retention in all aspects of this business, so we feel pretty good about our ability to take care of our customers and be there for a long time even beyond the term of the contract.

When you get to the other model, which is a fixed-price model, that's where we are spending money on a dragline or potentially some other pieces of equipment, and we evaluate all those [ph] both on it (00:12:07). We look at them from an NPV and IRR basis, which are very similar formulas, just looking at it a couple of different ways. And we also measure – we look at ROTCE. You can't – ROTCE, which is return on total capital employed, and it's a total balance sheet view, so that you're not just looking at equity. You're looking at your total investment and do we believe that we can earn an acceptable return on the money that we might be investing in any given project.

And again, we do the same thing about retention and also how the contract is structured to really make sure that if we're going to put investment in a dragline work or other piece of equipment that it's – we're going to be there long enough to have that to be a worthwhile investment. So, yeah, we're very financial. We're very numerical as we analyze these projects, and we're – we will do projects that we think makes sense to grow the business. There are some that we look at that we don't think makes sense. So, we're taking a pretty disciplined approach to the growth.

Now, the other piece of this business that you said we can't – the investors can't see is the investments that we've been making really more as expense items than capital investments, but those are in business development. We have over the last couple years, and really quite a lot last year, added some people out of the rest of the company – sort of transferred people into the North American Mining business in regards to support business development, but also to provide sort of the administrative infrastructure that you need to scale up this business. And that's everything from additional people in the financial area to HR resources and things like that. As our customers – a number of customers grow, as our number of locations grow, as our geography spreads, you need to have the proper infrastructure in place, so you can really manage this as a business.

Again, we look at those pretty carefully about how are we spending money and we think this is a wise way to do this. And based on our confidence and our ability to grow this business, we feel pretty good about the investments that we've made, and I think we feel very good about the progress that we've made in business development over the last several years. In 2019, of course, the big highlight was adding the lithium mine into that whole equation.

**<Q – Andrew Kuhn – Focused Compounding Capital Management>:** Sure. And I guess, in relation to that the lithium mine, how do you think about the long-term earnings potential, the durability, the risks and stuff like that of a lithium mine differ from a lignite mine? Could you just compare lithium and lignite for us in terms of how you think about running one kind of mine versus running a different one? I mean, obviously, you're planning to be mining three different materials pretty soon, lignite, lime and lithium. Could you just talk about how the risks and returns differ for you, and if they do, or is it more so from NACCO's perspective, it's really similar running one kind of mine as a service versus running another kind?

**<A – J.C. Butler – NACCO Industries, Inc.>:** Yeah. You will see in our Annual Report and in the letter that's in the front of the Annual Report that's going to come out very soon, but we historically have been known as a Coal Mining company and the reality is we're a mining company. We happen to have a tremendous amount of experience in coal but the skills that we use in a surface mine and surface lignite mine are very, very similar to the skills that we will use at a lithium mine. You remove the overburden. You remove the ore body, whether that's lithium or coal or anything else, we deliver it to your customer and then you work on reclamation. Of course, there is permitting upfront and equipment selection and workforce management and all that stuff, which is important, but it's very, very similar.

So – and to use the same skill transfer into the limestone mining business, primarily what we've done in the limestone is operate and maintain draglines at wet quarries, quarries that we are mining the limerock under water. The skills that we have there all came out of our historical mining business. We operate more draglines than anybody else in North America, and so we refine those skills. We use that to mine limerock really no differently the way we operate draglines in our Coal Mining business. It's the same when you mine lithium, and frankly, we're studying all the other things [ph] that are mined (00:17:37), surface mined in the United States to see what else might make sense for us to add to our portfolio. Again, we really I think the way to think of us as a mining company and there's lots of other things we can mine.

Now from a risk standpoint, I mean, there is no hiding the risk in mining coal today. It's politically unpopular. I haven't heard of lithium mining being politically unpopular. In fact, there's just tremendous opportunities it seems from the research that I read for lithium to really grow as there's the electrification of transportation markets, transportation in the United States and around the world. Our customer, Lithium Americas, which is a public company, they state in their filings that this is the largest known lithium reserve in North America, and this is going to be a substantial supplier of lithium into the US and North American market. So, I mean those seem like pretty positive dynamics from a risk standpoint.

**<Q – Andrew Kuhn – Focused Compounding Capital Management>:** Sure. And thanks for answering that. And relating to the mineral interests, you now say and I'm quoting considering the acquisition of additional mineral interests or similar investments in the energy industry as part of the growth of Minerals Management, with an initial focus on smaller diversifying acquisitions with near-term cash flow yields. So I'm sure you don't want to tell us exactly what you're looking at, but by this do you mean you'd be looking to spend cash on buying non-coal properties that you could then lease out for royalties like what you've done with your legacy properties in Ohio being leased out for natural gas?

And then I guess when you say, or similar investments in the energy industry, does this mean you'd actually consider like diversifying into something as far as like owning solar assets, if you like the cash flow yields enough on something like that?

**<A – J.C. Butler – NACCO Industries, Inc.>:** Well, I mean, it's in the Minerals' segment. So I don't know that I would consider solar to be growth in the Minerals' segment.

**<Q – Andrew Kuhn – Focused Compounding Capital Management>:** Sure.

**<A – J.C. Butler – NACCO Industries, Inc.>:** And specifically around the Minerals, we're looking at just as you described acquiring mineral interests that we could lease out to others or perhaps it would be a mineral interest that's already been leased, and we're buying a position in an individual property or we could be buying a position in a portfolio of properties. There are people that put those together and from time to time they're available for purchase. So it's really for the most part and I'd say in the initial stages it's going to be just as you described, acquiring mineral interests that are not dissimilar to our positions in Ohio.

**<Q – Andrew Kuhn – Focused Compounding Capital Management>:** Got it. And then I guess I'll have – I have one last question and then I can hop back in the queue. You have authorization to buy back over 23 million more of your own shares and you now have a little over $120 million in cash at the parent company, but you do have some debt, you have some long-term liabilities for asset retirement. You have a pension plan and stuff like that that you always had, but now you also have a commitment to provide up to $50 million to start up the Thacker Pass project, and you're talking about doing some possible acquisitions of mineral rights, you're probably planning for the possibility that one of your biggest customers stops taking coal deliveries from you at some point, you are guiding for negative free cash flow this year, and you do still pay a dividend. So without saying what [ph] a cheap enough (00:21:38) stock price is, do you think your cash levels today versus all these things you want to be prepared for is close to the point where, even if your stock falls to a level you think is ridiculously cheap, you wouldn't necessarily buy in a meaningful amount of shares simply because there is a certain amount of cash you always want to have on hand no matter what? And I guess, basically, how should shareholders be thinking about whether NACCO needs to be run with a significant amount of cash on hand at all times simply because of the industry it's in and because you don't want a lack of cash to ever limit your long-term plans for growth that diversifies you away from coal versus using some of your cash to buy back stock?

**<A – J.C. Butler – NACCO Industries, Inc.>:** Lots of layers to that question.

**<Q – Andrew Kuhn – Focused Compounding Capital Management>:** Yeah.

**<A – J.C. Butler – NACCO Industries, Inc.>:** Yeah. So, I guess, first off – and we say this in a number of places both in our earnings release, in the Annual Report letter and elsewhere, we've got to – we take a very conservative view of our balance sheet. We just over time companies end up making – they get into short-term decision-making mode because they don't have a balance sheet that allows them to really think about the long term, and we do not want to be in that situation. So, if you then balance that with pretty substantial growth ambitions, growth and diversification ambitions, and the fact that a sizable part of our business is in coal, which has its own risks, we think pretty carefully about how we manage the balance sheet and we want to make sure from a business standpoint that we are doing the right things.

We're a 107 years old. We intend to be around when we are 200, doing a much more diverse group of things. As you think about paying dividends and we've paid dividends, gosh, Liz, I think our history goes back to maybe in the early – in the late 50s, and pretty consistently paid a dividend. So that's something that's obviously important to us. We want to make sure we continue to do that.

Share repurchases, we've been doing share repurchases I mean certainly for the last 15 years, maybe 20 years, but we do so selectively. We're not a company that just runs a program that says we're going to buy X number of shares every month. So, do we – how do we think about a price, would we buy it – would we get in a situation where we might not buy shares? Well, I mean, sure. Of course, that's possible. If we start to see the money that we might be spending on capital or risk increase, we can always decide not to buy shares. But historically, we've been opportunistic buyers when we think it's in the best interest of the company. Did that answer your question?

**<Q – Andrew Kuhn – Focused Compounding Capital Management>:** Thanks. Yes. Yeah. Yeah. Thanks a lot for answering for my question. I'll hop back in the queue.

**<A – J.C. Butler – NACCO Industries, Inc.>:** Thank you.

Operator: [Operator Instructions] And we have no further questions queued up at this time. I'll turn the call back over to the presenters.

**Christina Kmetko, Investor Relations & Media Contact, NACCO Industries, Inc.**

Thank you for joining us today. J.C., did you have any follow-up comments you wanted to make?

**John C. Butler, President, Chief Executive Officer & Director; President, Chief Executive Officer & Director – The North American Coal Corporation, NACCO Industries, Inc.**

No, I do not. Thanks, Christy.

**Christina Kmetko, Investor Relations & Media Contact, NACCO Industries, Inc.**

Okay. Thank you very much for joining us. If you do have any further questions, you can reach out to me. Thanks so much and have a great day.

Operator: Thank you for participating in today's NACCO Industries' Q4 and full year 2019 earnings conference call. This call will be available for replay beginning at 12:00 Eastern today through until 11:59 PM Eastern Time on March 12, 2020. The Conference ID number for the replay is 7753979. Again, the Conference ID number for the replay is 7753979. The number to dial for the replay is 1-800-585-8365. This concludes today's conference call. You may now disconnect.