03-Mar-2022

NACCO Industries, Inc. (NC)

Q4 2021 Earnings Call

CORPORATE PARTICIPANTS

Christina Kmetko
Investor Relations Consultant, NACCO Industries, Inc.

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

Elizabeth I. Loveman
Vice President & Controller, NACCO Industries, Inc.

OTHER PARTICIPANTS

Andrew Kuhn
Director, Focused Compounding Fund LP

Nachy Kanfer
Partner, Donovan Energy

MANAGEMENT DISCUSSION SECTION

Operator: Good day, and thank you for standing by. Welcome to NACCO Industries' Fourth Quarter and Full Year Earnings Call. At this time, all participants are in listen-only-mode. After the speaker 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 your speaker today, Christy Kmetko. Thank you. You may begin.

Christina Kmetko
Investor Relations Consultant, NACCO Industries, Inc.

Good morning, everyone, and welcome to our 2021 fourth quarter and full year earnings call. Thank you for joining us this morning. I am Christina Kmetko, and I am 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 fourth quarter and full year 2021 results and filed our 10-K. 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 that follow, including answers to your questions, could contain 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. These risks include, among others, matters that we have described in our earnings release issued last night and in our 10-K 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 fourth quarter and full year results. 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. Good morning, everyone. As we look back on our fourth quarter and full year 2021 results, I'm really pleased to report that our company delivered strong results, generating much higher operating profit and net income than in 2020. The fourth quarter and, frankly, every other quarter in 2021 was strong for us. Comparisons to the prior year fourth quarter are a little more complex, given the $11.6 million of nonoperational charges we recognized last year. But even excluding the impact of these charges, I'm pleased to report that our earnings improved significantly, driven by our Minerals Management and Coal Mining segments.

Our Minerals Management segment had another outstanding quarter, helped by income from more recently acquired mineral and royalty interest as well as legacy mineral and royalty interest. Higher natural gas and oil prices helped as well. Our team at Catapult Mineral Partners continues to look for opportunities to expand our portfolio of mineral and royalty interests through acquisitions while also promoting development of our own interests.

On our Coal Mining segment, our fourth quarter 2021 operating profit improved significantly over the prior year quarter despite the termination of the Bisti Fuels contract at the end of the third quarter. This increase in operating profit was primarily because of an increase in customer demand at Mississippi Lignite Mining Company. Although the coal mining industry faces increasing political and regulatory challenges, we believe the use of coal as a fuel source for electricity in the United States will continue for the foreseeable future.

The significant increase in natural gas prices in 2021 benefited us on two fronts. It contributed to an increase in dispatch and coal deliveries in our Coal segment as well as contributed to an increase in results at our Minerals Management segment. We continue to work diligently to support our existing customers so that they can continue to produce affordable and reliable energy.

Turning to our North American Mining segment. The fourth quarter financial results for this segment did not meet our expectations. We did grow income from new and existing contracts in 2021, but we added cost by hiring additional experts to bolster our already strong maintenance and operational capabilities. We invested in the future of this business and feel that hiring these people was the right strategic thing to do.

Throughout 2021, this business expanded its geographic footprint by entering into new contract mining services agreements at quarries in Indiana, Texas and Arkansas. North American Mining also entered into a 15-year mining services contract with a new customer, a limestone quarry, in Central Florida. While this contract contributed only modestly to 2021 results, it aligns with our long-term focus and is expected to contribute more significantly once a larger dragline is commissioned in the second half of 2022.

As I've said before, there is a lot of growth potential in this business, and North American Mining continues to have a substantial pipeline of potential new projects in the works. We can leverage decades of experience and a whole company of experts to provide specialized mining services or operate an entire mine or quarry, and we can apply our skills to mine a wide range of minerals.

A great example of this is our work with Lithium Americas, where we are working with them on their Thacker Pass project in Northern Nevada. That project continues to advance. As shown by their recent announcement they have received all final key state permits as of February 25. We continue to provide support to Lithium Americas as they move forward. At maturity, this management fee contract is expected to deliver fee income similar to a mid-sized management fee coal mine.

The mitigation resources of North American team continues to advance development of their existing mitigation projects and is evaluating a number of interesting new projects as well. Early in 2022, Mitigation Resources finalized an agreement to provide mitigation services for the Lake Ralph Hall project in North Texas. We've established a joint venture related to this project with a partner that has expertise in risk and restoration and mitigation solutions. This will be a great project for us, and it's great to have a project that expands mitigation resources into Texas.

More generally and importantly, I should note that the previously announced sale of GRE's Coal Creek Station to Rainbow Energy Center is expected to occur in the second quarter of 2022. Once the sale is complete, we will operate the Falkirk mine to serve Coal Creek Station under a new management fee contract mining agreement with Rainbow Energy. Also, the existing agreements between GRE and Falkirk will terminate. We will receive a $14 million termination payment from GRE, and GRE will transfer ownership of certain other assets to us. We look forward to the completion of this transaction.

Lastly, we are happy to have successfully completed the amendment and extension of our revolving credit agreements during the fourth quarter of 2021.

Looking back on 2021, it was a strong year of performance on our strategies to protect the core and to grow and diversify. We also rebranded the company to better reflect the changing makeup of our businesses. I continue to be very optimistic about our long-term outlook because I have a lot of confidence in our strategies to protect the core and to grow and diversify. I believe that we have strong businesses with strong teams executing on sound business strategies. And I am enthusiastic about the trajectory we are on as we pursue what we see in our tagline, bringing natural resources to life.

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

Christina Kmetko

Investor Relations Consultant, NACCO Industries, Inc.

Thanks, J.C. I'll start with the consolidated quarter results and then provide additional detail at the segment level. On a consolidated basis, our fourth quarter operating profit rose significantly, increasing to $10.8 million from an operating loss of $8 million in 2020. Consolidated net income also increased, rising to $7.8 million or $1.07 per share from a net loss of $5.4 million or a loss of $0.77 per share last year. As J.C. mentioned, included in these results are $11.6 million of charges taken in the prior year fourth quarter that did not reoccur in 2021.

Our fourth quarter consolidated adjusted EBITDA increased to $17.8 million from $4.3 million last year. The increase in adjusted EBITDA was driven by improved results in our Coal Mining and Minerals Management segments.

In our Coal Mining segment, operating profit, excluding $4.6 million of prior year charges, increased significantly as a result of substantially higher earnings at the consolidated mining operations, primarily Mississippi Lignite Mining Company, and the decrease in operating expenses from lower employee-related costs. These improvements were partially offset by a decrease in earnings of unconsolidated operations. Segment adjusted EBITDA increased as a result of the improvement in operating profit as well as an increase in depreciation, depletion and amortization expense at Mississippi Lignite Mining Company.

J.C. already discussed the primary driver of North American Mining's fourth quarter operating loss. So let me focus on North America Mining's fourth quarter 2021 segment adjusted EBITDA. Segment adjusted EBITDA was positive but lower than the prior year fourth quarter as the 2021 operating loss was partially offset by substantially higher depreciation expense resulting from the acquisition of additional equipment to support newer contracts.

Finally, Minerals Management operating profit and segment adjusted EBITDA for this quarter increased significantly over the prior year even after excluding the $6.7 million impairment charge realized in 2020. The improvement was driven by increased production and higher natural gas and oil prices. Those are the significant factors affecting the fourth quarter results.

Now let me turn to outlook. In 2022, we expect the Coal Mining segment operating profit to decrease significantly from 2021. We expect results at our consolidated mining operations to decrease significantly, primarily due to substantially lower earnings at Mississippi Lignite Mining Company, driven by an anticipated reduction in customer demand from 2021 levels, which contributes to an increase in the cost per ton. It is possible that high natural gas prices could lead to increased power plant dispatch, just as it did in 2021, but our forecast isn't assuming that will happen.

A reduction in earnings at the unconsolidated coal mining operations is expected to be mainly driven by lower earnings at Falkirk, resulting in part from a planned power plant outage prior to the expected closure of the Rainbow Energy transaction. In addition to support the transfer of Coal Creek Station, we have agreed to a reduction in the current per ton management fee from the effective date of the new coal sales agreement with Rainbow Energy through May 31, 2024. After May 2024, Falkirk's per ton management fee increases to a higher base in line with current fee levels and thereafter adjusts annually according to an index, which tracks the broad measure of US inflation.

Termination of the Bisti Fuels contract in late 2021 will also contribute to the expected decline in the earnings at the unconsolidated mining operations in 2022. We also expect an increase in operating expenses, mainly from anticipated higher insurance costs and other professional fees.

Segment adjusted EBIDTA, which excludes the termination payments of $10.3 from Bisti Fuels customer in 2021 and the anticipated $14 million contract termination fee from GRE in 2022, is expected to decrease significantly in 2022, primarily as a result of the forecast to reduction in operating profit, partially offset by an increase in depreciation, depletion and the amortization expense.

In 2022, we expect North American Mining's full year operating profit to increase significantly over 2021 due to an anticipated increase in customer requirements and contributions from contracts executed during 2021. Segment adjusted EBITDA from North American Mining is expected to increase significantly over the prior year as a result of the improved operating profit and an increase in depreciation expense.

Moving to Minerals Management. We expect operating profit and segment adjusted EBITDA in 2022 to decrease significantly compared with 2021. These declines are expected to be driven primarily by reduced production from the natural decline curve on wells in Ohio and the absence of $3.6 million of settlement income recognized in 2021. Our current expectation is that oil and gas market prices will moderate in 2022 and stabilize at levels more in line with averages over the second half of 2021.

To summarize on a consolidated basis, in 2022, we expect consolidated net income and consolidated adjusted EBITDA to decrease significantly from 2021. Lower operating profit in the Coal Mining segment and an anticipated reduction in income at the Minerals Management segment are expected to be partially offset by higher operating profit in North American Mining and lower income tax expense. Additionally, we expect to recognize the value of the North Dakota office building and the membership units in Midwest AgEnergy, which are expected to be received as part of the compensation from GRE upon the closing of the transaction with Rainbow Energy.

Obviously, world events are causing increases in natural gas and oil prices at the moment. While we are not able to speculate how all of this might play out, it is worth noting that continued high natural gas and oil prices could enhance 2022 results in our Minerals Management segment as well as in our Coal segment if higher natural gas prices lead to generally higher dispatch of customer power plants.

Moving away from results expectations, let me briefly provide some cash flow information. We ended the quarter with consolidated cash of $86 million and debt of $20.7 million. In addition, we had availability of $116.2 million under our newly refinanced revolving credit facility. As a result of forecasted capital expenditures and the anticipated decrease in net income, cash flow before financing activities is expected to return to a significant use of cash in 2022.

We will turn to any questions you may have.

QUESTION AND ANSWER SECTION

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

Andrew Kuhn
Director, Focused Compounding Fund LP
Q

Good morning, everyone. Great quarter, great year.

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

Good morning, Andrew.

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

Good morning.

Andrew Kuhn
Director, Focused Compounding Fund LP
Q

So my first question relates to your outlook. Would a major move in natural gas prices, say a doubling or being cut in half of the current natural gas price, mean that your 2022 outlook for the Coal segment be way off? Or do you think your coal segment outlook is pretty reliable under a broad range of natural gas prices?

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

No. I mean we saw in 2021 increased dispatch levels. Now do we know exactly what led to the increase in dispatch levels in the Coal segment? There's lots of factors there. It can be outages. It can be of other power plants. It can be transmission congestion issues that focus dispatch. But we think, we believe, that a very significant driver in 2021 was natural gas prices, particularly – I mean, if you think about when we started 2021, right, I mean, it's when everybody was still kind of locked out and the economy not yet come roaring back. And so I think we, as well as a lot of companies, sort of had a conservative view of what might play out during the course of the year. What we saw play out were pretty rapidly increasing natural gas prices during the course of the year, and it continued sort of throughout the year. And we think that, that supported a lot of dispatch decisions amongst a lot of our customers.

You also see in our outlook, you're right, we talked about the fact that we had a assumption about natural gas prices, that they were going to moderate and move back to sort of the average of the last half of 2021. Today's natural gas prices are far above that. I think that that's likely to support dispatch. But exactly how much that will affect dispatch, it's always hard to predict that. But I think that the plan that we put together that's reflected on our outlook has a pretty conservative view of natural gas prices even before the events of the last week or so. I think that's – I think what's going on with the situation in Russia and the Ukraine has sort of got everybody in the energy industry rethinking the way they are forecasting things like energy prices and reliability and dependability and all sorts of things are coming out of that. Was that helpful?

Andrew Kuhn
Director, Focused Compounding Fund LP

Q

Yeah. No, that's actually – that's very helpful. Thank you. And then your initial investments in oil royalties at Catapult were made when oil prices were lower. So if oil prices stayed at today's level, do you think you'd still be able to find oil investments in 2022 that could hit your double-digit unlevered return target?

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

A

Yeah. We think we can. It's a market for buyers and sellers that doesn't necessarily fit into generalities. At any period in time, you might find that there are more buyers that are interested in undeveloped reserves. And at other times, you might find buyers are more interested in near-term cash flow assets. Same thing goes with sellers, right? I mean people might be holding on to one category of assets and selling another one. We also know that there's periods of time when there's a lot of activity in very small transactions or there could be activity and a lot of huge transactions, hundreds of millions of dollars, things that make headlines in the newspaper.

We sort of take a – we're taking sort of an opportunistic view here. We're being rather selective about what we buy. We have not won every bid that we have put in, which I think sort of confirms to me that we've got a pretty disciplined approach. We're not just chasing whatever we can acquire. We're thinking pretty carefully about it. And I think in the current environment, there are still opportunities that we're seeing and are actively bidding on that fit our profile and provide an attractive return opportunity for us. So I think there's still going to be good opportunities in 2022 to make acquisitions.

Andrew Kuhn
Director, Focused Compounding Fund LP

Q

That's great to hear. And then you mentioned you'll recognize some income on the transfer of the North Dakota office building at the Midwest AgEnergy membership interest. Do you expect that income to be material to full year 2022 earnings?

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

Well, the – so we'll recognize the income when it's transferred to us. I just want to be clear about that. It's not that we are going to get it and sell it and they're going to recognize it that way. I think we're going to wait – we're going to get them. Assuming all this closes in May as it should, we will get title to the property and then decide what we do with it.

Liz, I'll let you comment on, is it material?

Elizabeth I. Loveman
Vice President & Controller, NACCO Industries, Inc.
A

We'll look at the appraisal. And it's an office building. It's real estate. We'll get an appraisal. I don't know that it's super material to us, but it's a...

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

Look, it's a one-storey office building sort of on the edge of Bismarck. It's not some major office tower in a major development district.

Elizabeth I. Loveman
Vice President & Controller, NACCO Industries, Inc.
A

And just one other point. It is going to be recognized below operating profit that will be included in our other income.

Andrew Kuhn
Director, Focused Compounding Fund LP
Q

Got it. And then I have one more question, and I'll drop back in the queue. But you said that capital expenditures in 2022 for Mitigation Resources are going to be approximately $9 million. I was wondering if you could kind of explain what that represents. I guess I kind of thought about this segment being more of like a capital-light segment. So if you could expand on that, that would be great. And I'll jump back in the queue.

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

Well, it is generally a pretty capital-light segment, right? But we do – we are acquiring some equipment in that business – it's not a segment, in that business so that we can perform some of the dirt work that's involved in the stream and wetland mitigation business. And we do from time to time acquire property. But generally, I think you can think of this as a pretty asset-light business. Liz, is that fair?

Elizabeth I. Loveman
Vice President & Controller, NACCO Industries, Inc.
A

That's correct.

Operator: [Operator Instructions] Your next question is from Nachy Kanfer with Donovan Energy.

Nachy Kanfer
Partner, Donovan Energy

Q

Hey, everyone. Great quarter. Thanks for the remarks. It's a question on Coal Creek and the expected sale. My understanding is there remains an outstanding application to EPA for a different type of treatment under the CCR rule. And to my knowledge, EPA hasn't ruled on that. EPA hasn't ruled on any of them. Any insider thoughts on if there's a risk there and how that might affect the closure of the sale for operating performance post sale? Thanks.

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

A

So I am not aware of any challenges at present with respect to the – with the transaction. And I think the transaction is headed towards closing as expected. And I don't believe that it's – that anybody has any expectations that this is a real problem for the long-term operation of the facility.

Nachy Kanfer
Partner, Donovan Energy

Q

Okay, great. Thanks. And about Mississippi quickly, there was a question earlier about whether gas prices fundamentally are the major driver behind dispatch decisions, whether increased dispatch or decreased dispatch. And my understanding of your response to that was basically gas prices are a major driver, possibly not the only driver. And for the Red Hills plant, I'm wondering if there are any plant-specific or unique drivers there, given just the big difference between 2020 and 2021 and then the difference you're forecasting between 2021 and 2022 as well?

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

A

Yeah. I mean, look, the big drivers of results for us, right, with respect to coal sales is coal dispatch. Coal dispatch is really made up of two things. One of those is to what extent is the plant dispatch onto the grid, which is largely controlled by TVA. And the other piece of that's mechanical availability at the plant. Those two things work together to ultimately determine how that will play out. I mean if you end up with tremendously high natural gas prices and TVA wanting to dispatch the plant but it's not mechanically available, it's the same but as if TVA is not dispatching the plant and vice versa, right? You can have a plant that's very mechanically available, it's in great mechanical shape, it doesn't have any issues. But if TVA not dispatching the plant, it doesn't get dispatched. When those planets align and it's mechanically available and you get a high dispatch levels, which can be driven by natural gas prices, you end up with a year like 2021. Was that helpful?

Nachy Kanfer
Partner, Donovan Energy

Q

It is. Thank you.

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

A

Thank you.

Operator: And there are no further questions at this time. I will now turn it back over to Christy Kmetko for closing remarks.

Christina Kmetko

Investor Relations Consultant, NACCO Industries, Inc.

Thank you. That will conclude our Q&A session. J.C., do you have any closing remarks?

J.C. Butler, Jr.

President, Chief Executive Officer & Director, NACCO Industries, Inc.

I do not.

Christina Kmetko

Investor Relations Consultant, NACCO Industries, Inc.

All right. We will close with a few 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 earnings release. Hope you enjoy the rest of your day.

And now I'll turn it back to our operator to conclude the call.

Operator: This concludes today's conference call. This call will be available for replay beginning at 11:30 A.M. Eastern Time today through March 10 at midnight. The number to dial for the replay is 1-800-585-8367 or 855-859-2056. You may also dial internationally on 404-537-3406 and enter the conference ID number 8188339. Again, that is 8188339. Thank you for participating. You may now disconnect.