PARTICIPANTS

Corporate Participants

Christina Kmetko – Owner-Investor Relations Consultant, Evergreen Consulting & Associates, L.L.C.
J.C. Butler, Jr. – President, Chief Executive Officer & Director, NACCO Industries, Inc.

Other Participants

Andrew Kuhn – Director, Focused Compounding Fund LP

MANAGEMENT DISCUSSION SECTION

Operator: Good day, and thank you for standing by. Welcome to NACCO Industries' Q1 2022 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] Thank you.

I would now like to hand the conference over to your speaker today, Christy Kmetko. The floor is yours.

Christina Kmetko, Owner-Investor Relations Consultant, Evergreen Consulting & Associates, L.L.C.

Thank you. Good morning, everyone, and welcome to our 2022 first quarter 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 first quarter 2022 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 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-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.

Before I turn the call over to J.C. for his opening remarks, I want to mention the change we've made in our segment reporting. Effective at the beginning of this year, we changed the composition of our reportable segments to reclassify the results of Caddo Creek and Demery Resources from our Coal Mining segment into the North American Mining segment. The Coal Mining segment now includes only mines that deliver coal for power generation. This segment reporting change has no impact on our consolidated operating results, but all prior periods segment information mentioned in the following discussion follows the new reporting structure. We have also included the reclassified segment financial information for our fourth quarter and full year 2021 at the end of our earnings release. In a moment, I will 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. I'm very glad to be on the call this morning since we have a lot of good news to report. I mentioned in our year-end call that I was optimistic about our long-term outlook because I have a lot of confidence in our strategies to protect the core and grow and diversify.

I'm very excited to start with some great news associated with our protect the core strategy. This past Monday, May 2, Rainbow Energy finalized the purchase of the Coal Creek Station power plant in North Dakota and the adjacent high voltage direct current transmission line.

As a result of this sale, the existing agreements between Great River Energy and Falkirk terminated and the new coal sales agreement between Falkirk and Rainbow Energy became effective. Falkirk will continue supplying all coal requirements of Coal Creek Station. GRE paid us $14 million, transferred ownership of this office building in Bismarck, North Dakota, and conveyed membership units in Midwest AgEnergy to NACCO. This is a great outcome and we are enthusiastic about this new relationship with Rainbow Energy as our new customer. As independent privately held energy marketers, I think they have a real understanding of the value of the power plant and its potential in the future.

In addition to this exciting news, I'm pleased to report strong 2022 first quarter earnings driven primarily by improved results in our Minerals Management segment. Minerals Management had another outstanding quarter mainly due to significant higher natural gas and oil prices, as well as $2.1 million of settlement income recognized this quarter. 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 existing mineral interests. In the first quarter of 2022, we completed a small acquisition of mineral interests in the New Mexico portion of the Permian Basin. Catapult team continues to look for attractive acquisitions of mineral and royalty interests to continue to grow and diversify this business.

Our North American mining segment also contributed to the improvement in earnings, although this was offset by lower earnings in the Coal Mining segment and an increase in unallocated business development and employee related expenses. First quarter earnings in our North American Mining segment increased versus the prior year, as higher reclamation income at Caddo Creek was partly offset by a reduction in earnings of our active operations as a result of higher employee-related costs. As I've said before, there's 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.

During the first quarter of 2022, North American Mining agreed to commission a second dragline at an existing quarry in Florida to secure a contract extension through 2027. This dragline will supplement an existing dragline of this operation, resulting in an expected increase in deliveries and income over the next five years.

At our Coal Mining segment, we continue to work diligently to support our existing customers so that they can continue to produce affordable and reliable energy. Although the coal mining industry faces ongoing 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. We think there are more reasons to be optimistic about coal fired power generation today than at any other time in the last several years.

The Mitigation Resources of North America team continues to advance development of existing mitigation projects, and they are 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 Northern Texas. We've established a joint venture related to this project with a partner that has expertise in restoration and mitigation solutions. This will be a great project for us, and it is great to have a project that expands Mitigation Resources into Texas.

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

Christina Kmetko, Owner-Investor Relations Consultant, Evergreen Consulting & Associates, L.L.C.

Thanks, J.C. I'll start with the consolidated quarter results and then provide additional detail at the segment level not already covered by J.C. On a consolidated basis, our first quarter operating profit rose significantly, increasing to $14.9 million from $8.3 million in 2021. Consolidated net income also increased, rising to $12.6 million, or $1.72 per share, from $9 million, or $1.25 per share, last year.

Our first quarter consolidated EBITDA increased to $21.4 million, up 48% from $14.5 million last year. The increase in EBITDA was driven primarily by the improved results in our Minerals Management and North American Mining segments and higher depreciation, depletion and amortization expense. At our Coal Mining segment, operating profit and segment EBITDA decreased due to reduction in earnings of unconsolidated operations as well as higher operating expenses. The decrease in earnings of unconsolidated operations is primarily the result of the termination of the Bisti Fuels contract on September 30, 2021, a reduction in fees earned at Liberty as the scope of final mine reclamation activities continues to decline and lower customer requirements at Sabine. These decreases were partly offset by an increase in earnings at Coteau resulting from contractual price escalation.

J.C. already discussed the primary drivers of the increase in North American Mining's first quarter operating profit, so let me just focus on North American Mining's first quarter 2022 segment EBIDTA. Segment EBITDA increased significantly as a result of the increase in the operating profit and by substantially higher depreciation expense resulting from the acquisition of additional equipment to support newer contracts.

Finally, Minerals Management's first quarter 2022 operating profit and segment adjusted EBITDA more than doubled from the prior year results. As J.C. has said, the significant improvement was driven by higher natural gas and oil prices and settlement income related to the company's ownership interest in certain mineral rights. Those are the significant factors affecting the first quarter results.

Now let me turn to outlook. In 2022, we expect the Coal Mining segment's operating profit to decrease significantly from 2021, both including and excluding the contract termination fees from Bisti last year and GRE this year. 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 predominantly in the second-half of the year from higher than average levels in 2021. It is possible that continued high natural gas prices could lead to increased power plant dispatch, just as it did in 2021, but our current forecast assumes dispatch levels this year will be below average 2021 dispatch levels.

A reduction in earnings of unconsolidated Coal Mining operations is expected to be driven by the termination of the Bisti Fuels contract as of September 30 and lower earnings at Falkirk, primarily in the second half of 2022 compared with the second half of 2021. Falkirk has agreed to a reduction in the current per ton management fee from May 1, 2022 through May 31st, 2024. After May 31, 2024, Falkirk's per ton management fee increases to a higher base in line with current fee levels and thereafter adjust annually according to an index, which tracks a broad measure of US inflation.

We also expect an increase in operating expenses mainly from anticipated higher outside services and professional fees. Segment EBITDA for the Coal Mining segment which excludes the termination payments of $10.3 million received from the Bisti Fuels' customer in 2021, and the $14 million contract termination fee from GRE received this week, is expected to decrease significantly in 2022 from last year, primarily as a result of the forecast of reduction in operating profit, partly offset by an increase in depreciation, depletion, and amortization expense.

At North American mining, we expect full year 2022 operating profit to increase over last year, primarily in the fourth quarter due to an anticipated increase in customer requirements and contribution from contracts executed during 2021. North America Mining segment EBITDA in 2022 is expected to increase significantly over the prior year as a result of improved operating profit and an increase in depreciation expense.

Moving to Minerals Management, we expect operating profit and segment EBITDA to increase significantly over last year, primarily driven by current expectations for natural gas and oil prices for the remainder of this year, partly offset by an anticipated reduction in production. As a result of substantially higher oil and natural gas prices in the first half of 2022 compared with the respective prior year period, we expect a significant increase in operating profit in the first half of this year. This increase is anticipated to be partly offset by a modest decrease in the second half of this year, as we expect increases in oil and gas prices to moderate, and as a result of the absence of $3.3 million of settlement income recognized in the third quarter of 2021.

To provide a bit more color to Minerals Management earnings outlook and why it increased from what we said in last quarter's release, I wanted to point to some government forecasts for natural gas and oil prices. The United States Energy Information Administration, April 2022 Short Term Energy Outlook projects Henry Hub natural gas prices to average $5.23 per MMBtu for the full year 2022. The EIA's Henry Hub natural gas forecast would result in an increase of $1.32 per MMBtu, or 34%, compared with last year. The EIA April 2022 Short Term Energy Outlook projects West Texas Intermediate crude oil prices to average $98 per barrel this year. The EIA forecast would result in an increase of approximately $30 per barrel, or 44%, compared with last year.

To summarize, on a consolidated basis for the 2022 full year, excluding the settlements associated with the GRE and Rainbow Energy transaction and the Bisti termination fee recognized in 2020-2021, we expect consolidated operating profit, net income and consolidated EBITDA to decrease. Lower operating profit in the coal mining segment is expected to be partly offset by an anticipated significant increase in earnings at the Minerals Management segment and higher operating profit in North American Mining.

In addition, we recognized $3.4 million of gains associated with equity securities in 2021 that are not expected to recur this year. Once we have the final appraisals, we will recognize the value of the North Dakota Office Building and the membership units of Midwest AgEnergy received as part of the settlement with GRE as a component of other income.

World events are causing continued volatility 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 continue to 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 $81.6 million and debt of $25.5 million. In addition, we had availability of $113.9 million under our revolving credit facility.

For the full year, we expect cash flow before financing activities to be significantly lower than in 2021 as a result of anticipated higher capital expenditures.

So I now turn to any questions you may have.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Your first question is from Andrew Kuhn of Focused Compounding. Your line is open.

<Q – Andy Kuhn – Focused Compounding Fund LP>: Good morning, everyone. Great quarter.

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

<Q – Andy Kuhn – Focused Compounding Fund LP>: So I only have one question today and that's that you added a new line in your report saying that sustained higher natural gas prices could continue to result in increased demand for coal and that changes to expectations for customer power plant dispatch could affect the company's outlook for 2022 and over the long term. So, as you sit here today, natural gas is up something like 50% since the end of Q1, and we know that Minerals Management will benefit from this. But I'm curious if you are also now seeing more demand for your coal business, given where natural gas prices are, maybe even since the end of Q1.

<A – J.C. Butler – NACCO Industries, Inc.>: I'll speak generally about the relationship on the energy side, energy gets dispatched, power plants get dispatched, generally based on economics. There's other things that come into play like is the transmission congestion and things like that, it will come into play. But for the most part, it's on economics. And when you see natural gas prices as high as they are and the grid needs base load generation, they're going to turn to lower cost resources. And generally, especially when you look at the relationships that we have with our customer power plants where it's not the typical relationship, is power plants are buying coal on the market. They might contract for a year or two years, and generally the relationship that we have is that they're buying the coal at a contracted price in all instances except one with our customers, it's cost plus a management fee. So it's a very low, predictable and known amount and those are – every one of those is very, very competitive on the grid versus high natural gas prices at this point in time. Does that answer your question?

<Q – Andy Kuhn – Focused Compounding Fund LP>: Sure, got it. Thanks. I'll go back in the queue. Yes, thank you.
<A – J.C. Butler – NACCO Industries, Inc.>: Yeah.

Operator: [Operator Instructions] We have a follow-up question from Andy Kuhn, Focus Compounding. Your line is open.

<Q – Andy Kuhn – Focused Compounding Fund LP>: No, I was just jumping back in the queue. I apologize for that.

Operator: [Operator Instructions]

Christina Kmetko, Owner-Investor Relations Consultant, Evergreen Consulting & Associates, L.L.C.

Well, that appears to conclude our Q&A session for today. So, J.C., did you have any final closing remarks.

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

Thanks to Andrew for the question.

Christina Kmetko, Owner-Investor Relations Consultant, Evergreen Consulting & Associates, L.L.C.

All right. Well, just 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. My phone number is at the top of the press release. I hope you enjoy the rest of your day and I'll turn the call back to the operator to conclude.

Operator: Thank you. As a reminder, this call is recorded and will be available for replay 2 hours after the call has ended until May 13, 2022. You may dial 800-585-8367 or 855-859-2056 and enter the conference ID 7747766 to listen. Thank you. This concludes today's conference call. Thank you all for joining. You may now disconnect.