PARTICIPANTS

Corporate Participants

Christina Kmetko – Investor Relations Consultant, NACCO Industries, Inc.
J.C. Butler, Jr. – President & Chief Executive Officer, NACCO Industries, Inc.
Elizabeth I. Loveman – Vice President & Controller, NACCO Industries, Inc.

Other Participants

Andrew Kuhn – Analyst, Focused Compounding Capital Management, LLC

MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, welcome to the NACCO Industries First Quarter Earnings Call. My name is Katie, and I'll be coordinating your call today. [Operator Instructions]

I will now hand you over to our host, Christina Kmetko, to begin. Christina, please go ahead.

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

Thank you. Good morning, everyone, and welcome to our 2021 first quarter earnings call. I'm Christina Kmetko and I'm responsible for Investor Relations at NACCO Industries. Thank you for joining us this morning.

Joining me today are J.C. Butler, President, Chief Executive Officer of both NACCO and North American Coal; and Elizabeth Loveman, NACCO's Vice President and Controller.

Yesterday, we published our first quarter 2021 results and filed our 10-Q. This information is available on our website. If anyone is not able to listen to today's entire call, an archived version of this webcast will be on our website later this afternoon and available for approximately 12 months.

Our remarks that follow, including answers to your questions, 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.

In a moment, I'll discuss our first quarter 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, 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 future, because I had a lot of confidence in our strategies to grow and diversify. In the first four months of this year, we've already delivered some very positive developments.

[ph] North American Mining (00:02:32) entered into a 15-year mining services contract with a new customer at a limestone quarry in Central Florida. We'll operate a smaller dragline at this quarry until a larger dragline that will increase production capacity is relocated and commissioned.

We expect deliveries to be approximately 1.5 million tons annually once mining commences with the larger dragline in 2023. North American Mining also amended a contract with an existing customer to operate an additional dragline at an existing limestone quarry in Florida.

And in April, North American Mining entered into a new mining services contract with an existing customer for a greenfield sand and gravel quarry in Indiana. This customer is hopeful the quarry will operate for multiple years providing aggregates for a multi-year transportation infrastructure project near Indianapolis. We expect deliveries from this quarry to be between 600,000 and 1 million tons per year. All of these new or revised contracts are expected to be accretive to our 2021 earnings. As I've said before, there is a lot of growth potential in this business, and I'd note that North American Mining's pipeline of potential new projects is bigger and better than ever.

Our Minerals Management segment is also showing continued success in its efforts to grow and diversify. Catapult Mineral Partners, which is our business that manages the oil and gas part of our Minerals Management segment, completed a small acquisition in the Delaware Basin for a purchase price of $300,000 and a larger acquisition in the Eagle Ford Basin. The Eagle Ford acquisition includes just over 14,000 gross acres and 1,700 net royalty acres for a preliminary purchase price of $4.7 million.

Mitigation Resources of North America is actively working on opportunities in some very attractive growth areas in the southeast part of the country, as well as continuing to develop existing mitigation banks. We're finding a lot of opportunities to grow and diversify in this part of the business as well.

Finally, our Coal Mining segment also had some very positive news during the quarter. GRE, the owner of Coal Creek Station and our customer for the Falkirk Mine, announced that it is in exclusive negotiations with a third-party to sell Coal Creek Station. If GRE's efforts to sell a power plant are successful, we expect to continue to operate the Falkirk Mine under a new mining services agreement. While this is a positive development for us, this is GRE's deal, so we can't add anything further to the information they've already shared.

I would also like to add that since our last earnings call, we have issued our 2020 annual report and investor presentation. These documents provide a thorough description of our key strategies to protect the core and grow and diversify, as well as the operating and financial objectives for each of our growth businesses.

We've also included a description of what I think of as our core values. We've titled this piece Corporate Responsibility. In short, it describes how we strive to always do the right things to maintain a safe workplace, to take care of our employees, to be good stewards for the environment, and to be a good corporate citizen in the communities where we operate. We are quite proud of our culture and our legacy and believe that it's one of the keys to our long-term success.

Our annual report and investor presentation are available on our website at nacco.com. I encourage any interested party to read these documents.

With that, I will 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.

Thank you, J.C. I'll start with the consolidated quarter results and then provide additional detail at the segment level. On a consolidated basis, our first quarter operating profit improved 9.9% to $8.3 million, up from $7.6 million in 2020, driven by substantially higher earnings at our Coal Mining segment. This improvement was partly offset by lower earnings at our North American Mining segment and an increase in unallocated employee-related expenses. Our consolidated net income also increased significantly, up 45.3% to $9 million, or $1.25 per share from $6.2 million, or $0.88 per share last year. The improved operating profit as well as favorable changes in the market value of equity securities, which are reported in other income, drove the significant improvement in net income.

Before I discuss the segments, I wanted to mentioned that in addition to reporting consolidated EBITDA, we started reporting and discussing segment EBITDA this quarter, given the significant impact of depreciation expense in our results, we thought providing the consolidated EBITDA and segment EBITDA would help everyone better understand the underlying results from the business operations.

At our Coal Mining segment, operating profit and segment EBITDA increased primarily because of substantially higher results at Mississippi Lignite Mining Company due to an increase in customer demand. This increase in demand contributed to a reduction in the cost per ton of coal and an overall increase in the profit per ton delivered. The improvement in the Coal Mining segment's operating profit was partly offset by a decrease in earnings of unconsolidated operations and higher operating expenses, primarily an increase in insurance expense, partially offset by lower employee-related costs.

And North American Mining's first quarter 2021 operating profit decreased from the prior year, primarily as a result of higher employee-related costs and lower earnings related to the Thacker Pass Project. Segment EBITDA also decreased but to a lesser extent than operating profit as depreciation expense increased over the prior year first quarter, due to more equipment being placed in service to support activities related to newer contracts.

At the Minerals Management segment, operating profit and segment EBITDA were generally comparable to the prior year as the increase in revenue was offset by higher employee-related expenses. Those are the significant factors affecting the first quarter results.Now let me turn to our outlook.

In the Coal Mining segment, we expect 2021 coal deliveries to be comparable to 2020 based on current expectations of customer requirements. However, operating profit in 2021 is expected to decrease compared with the prior year when you exclude prior year charges of $4.6 million related to an asset impairment, an inventory write-down, and our voluntary separation program. The decrease in operating profit is primarily attributable to substantially lower full year earnings expected at Mississippi Lignite Mining Company and reduced earnings at the unconsolidated Coal Mining operations. A decrease in employee-related costs resulting from lower head count primarily from our 2020 voluntary separation program is expected to be partially offset by higher insurance expense. In addition, our Coal Mining segment EBITDA is expected to increase moderately over the prior year, excluding the $1.1 million asset impairment charge recognized in 2020.

At North American Mining, we expect an increase in tons delivered, operating profit and segment EBITDA for the 2021 full year over last year as a result of increased production under existing contracts and contributions from new mining contracts. The increase in operating profit is expected to be partially offset by an increase in operating expenses, primarily due to higher employee-related costs.

At our Minerals Management segment, we expect full-year operating profit and segment EBITDA to decrease moderately from 2020, excluding the impact of $7.3 million of impairment charges taken last year and an income – and any income related to asset acquisitions made after March 31, 2021, including the ones J.C. discussed. An anticipated reduction in royalty income from existing Ohio mineral and royalty assets is expected to be partially offset by royalty income generated from the Permian Basin mineral interests acquired in 2020. Taking into account the transactions entered into early in the second quarter, Minerals Management is targeting an additional $5 million of investments in mineral and royalty interests during the remainder of 2021.

On a consolidated basis, excluding the prior year charges previously mentioned, as well as the favorable impact of additional business development activity, we expect substantially lower net income as a result of lower operating profit, an anticipated increase in interest expense, and a reduction in interest income. Consolidated EBITDA in 2021 is expected to increase moderately over 2020, adjusted for prior year asset impairment charges. We also expect a tax benefit rate between 3% and 5% this year.

Moving away from results expectations, let me briefly [ph] provide some (00:11:44) cash flow information. We ended the quarter with consolidated cash of $79.1 million and debt of $44.4 million compared with consolidated cash of $88.5 million and debt of $46.5 million at the end of the year. In addition, we had availability of $119 million under our $150 million revolving credit facility. We believe that a conservative capital structure and adequate liquidity are important, given evolving trends in energy markets and our strategic initiatives to grow and diversify. Last year, our cash flow before financing activities included a significant use of cash. In 2021, we are anticipating positive cash flow before financing activities.

Now, let me open up the call for your questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from Andrew Kuhn from Focused Compounding Capital Management. Andrew, please go ahead.

<Q – Andrew Kuhn – Focused Compounding Capital Management, LLC>: Hey, team. Good morning. Great quarter.

<A – Christy Kmetko – NACCO Industries, Inc.>: Good morning.

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

<Q – Andrew Kuhn – Focused Compounding Capital Management, LLC>: So first question, long term, do [ph] you be (00:13:14) more involved in aggregates? And I'm curious if they can increase in federal infrastructure spending would have any effect and whether owners of quarries would be interested in your contract mining services?

<A – J.C. Butler – NACCO Industries, Inc.>: I mean that's kind of the – that is historically the core part of that business. North American Mining has been in existence really since 1995 focused on mining limerock, limestone in Florida for aggregates producers and a lot of their – a lot of that product goes into infrastructure. I mean, it also goes into cement plants that are used for all sorts of other products. But the aggregates industry overall is – it's kind of an infrastructure type of industry. There is a lot of research publicly available about where aggregates go.

So North American Mining is focused on mining all sorts of things that are not coal, aggregates is a key part of it. And yeah, we expect to do a lot more of that in the future. Now, we also – we're going to be mining lithium. There are lots of other things that we can mine as well, but aggregates, certainly, are a sweet spot for us. We think we've got a lot to bring to the table with the aggregates producers across the country.

As far as infrastructure spending, yeah, I mean, it took – it really determines dexterity of aggregates consumption quite a bit, because as we all know, right, you build highways, you build roads and that leads to more commercial development or real estate development, which takes more aggregates as well. So I think it all feeds into the industry overall, and I think it's positive. I think more infrastructure spending is a positive factor for that industry.

<Q – Andrew Kuhn – Focused Compounding Capital Management, LLC>: Got it. Can you talk about inflation protection? Like, are your contracts indexed to general price levels, to wages, to fuel costs? I mean, I'm curious if you think meaningful higher inflation would have a noticeable impact on NACCO's financial results?

<A – J.C. Butler – NACCO Industries, Inc.>: Well, so at our management fee contracts, which is where a majority of our income comes from in our coal segment, all of those fees are tied to some sort of measurement of inflation, whether it's GDP or some CPI metrics, all of those fee levels are tied to inflation. When you look at the Red Hills Mine at MLMC, that is a fixed price contract, but these things that make up that fixed price are all tied to a basket of indices that are all in one shape or another related to inflation. It's really kind of more so the components as opposed to a single aggregate index like CPI. It's more a component-based comp formula.

North American Mining has got a combination of contracts, some are management fee similarly structured. They also have some fixed price agreements that are similarly structured as well. Mitigation Resources and Minerals Management, those have completely different business models that aren't tied to any kind of inflation index, but inflation certainly affects those businesses as well from a cost and revenue standpoint.

Did I answer your question?

<Q – Andrew Kuhn – Focused Compounding Capital Management, LLC>: No, no, it does. Yeah, I was wondering if you could help shareholders understand how much do decreases in total tons demanded by customers decrease your profit per ton at that mine? So for example, if a customer decides to operate a plant seasonally or to operate at a lower average dispatch level, does that change the per ton profitability of that mine in a big way?

<A – J.C. Butler – NACCO Industries, Inc.>: I mean, we don't disclose the individual fee levels at any of the mines. I think you can sort of look in general – I think you're talking about the coal segment, so I'll describe that. We don't disclose the individual fee levels. I think you can look at that segment in total and kind of get an idea what it is on average. Some of the contracts do have tiers in them, where lower levels of production and deliveries have a higher fee and at a higher level, it's a lower fee. And I think that is good as I can do for you on the management-fee mines.

At Red Hills, we do – at MLMC, sorry, we do run – everything there runs through a stockpile, we sell coal off the stockpile. The more – obviously, the more volume that we produce, it reduces our costs, which reduces the costs in our inventory, which improves our profit, you saw that in the first quarter. That is really [ph] lot for (00:19:21) regular manufacturing business where you kind of factor at a higher level [ph] and end up (00:19:26) with lower average costs.

<Q – Andrew Kuhn – Focused Compounding Capital Management, LLC>: Got it. And then, what criteria does management look at for when Mitigation Resources of America will become its own reporting segment? I'm just curious, I mean, is there like a hard set percentage of revenue hurdle that gets you to your level of revenue, operating profit, breakeven? I'm just kind of curious how management thinks about that. And then, I'll also hop back in the queue.

<A – J.C. Butler – NACCO Industries, Inc.>: Okay. I'm going to give you my take and then I'm going to hand it over to Liz to give you a more technical analysis. The business right now is really – it's a very young business, in a development stage. It's growing really nicely. We've got a terrific team developing that business and they seem to have carved out a pretty attractive niche in that industry that we think is going to be pretty successful. It right now is too small to have its results be anything that's really meaningful to the understanding of our business, which is why it's tucked inside unconsolidated.

I would anticipate, though, at some point in the future, it's going to be big enough that it can turn into its own segment. And we'll, obviously, be providing more reporting information on that. When that happens, I mean, it's hard to tell. I would say that the earlier conversation we had about infrastructure also relates to that business, because anytime there's highway construction or any kind of commercial development. It can – depending on what part of the country you're in and what the local topography is like, it can affect the demand for mitigation credits and so that can be good for that business as well.

But with that more general statement, I'll hand it over to Liz.

<A – Liz Loveman – NACCO Industries, Inc.>: We do evaluate our segments that leaps annually and more often things change, but we look at revenue, operating profit, total assets from a GAAP perspective and so – and how management views the business and how we want to – so when it reaches a level where it's material, we would reconsider how do we want to tell the story in our MD&A disclosures related to changing of any segment's reporting.

<Q – Andrew Kuhn – Focused Compounding Capital Management, LLC>: Got it. Cool. Thanks a lot. Great quarter.

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

<Q – Andrew Kuhn – Focused Compounding Capital Management, LLC>: And thank you for the color that you provided in the annual report. If shareholders haven't read it yet, I encourage you to read it.

<A – J.C. Butler – NACCO Industries, Inc.>: Thanks for your questions, and thanks for the endorsement of the annual report and investor presentation.

Operator: [Operator Instructions].

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

It appears we don't have any further questions. Is that correct, Katie?

Operator: I can confirm, we currently have no questions.

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

Okay. Thank you, again, very – thank you for joining us today. If you do have any follow-up questions, my information is available on the press release, please reach out. Have a wonderful day.

Operator: If you have missed any part of this call or would like to hear it again, a recording will be ready shortly. To access the telephone replay, please call 1-929-458-6194 followed by the access code 160053. Thank you for joining today's call and have a lovely day.