PARTICIPANTS

Corporate Participants

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

Other Participants

Andrew Kuhn – Director, Focused Compounding Fund LP
Nachy Kanfer – Analyst, Donovan Energy, LLC

MANAGEMENT DISCUSSION SECTION

Operator: Hello, and welcome to the NACCO Industries Third Quarter Earnings Call. My name is Elliot and I will be coordinating your call today. [Operator Instructions]

I'll now hand over to our host, Christina Kmetko. Christina, please go ahead when you're ready.

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

Thank you. Good morning, everyone, and welcome to our 2021 third 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 third quarter 2021 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.

In a moment, I'll discuss our third 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 & Director, NACCO Industries, Inc.

Thank you, Christy, and good morning, everyone. The third quarter of 2021 was another very strong quarter for us. Our third quarter earnings benefited from a $10.3 million payment as a result of NTEC's decision to self-perform. As of October 1, NTEC has assumed control and responsibility for operation and all required reclamation of the Navajo Mine. I'd just add that I am very thankful that we have the opportunity to work with the people and leaders of the Navajo Nation. They were great partners and I am proud of the work that we did while we operated the mine.

By applying our own unique and proven approach to managing and operating surface coal mines, we're able to quickly improve safety for everyone who works at the mine, improve the quality of the environmental work being done at the mine and improve the level of service and support for the power plant. These things are at the core of what we do and I am proud that we were able to bring value to the Navajo Mine, to our customers at NTEC and to the Navajo people through our work.

Turning back to our quarter, I'm pleased to report that our earnings improved significantly, even excluding the Bisti termination payment. Earnings increased at all of our segments. In particular, our Minerals Management segment had an outstanding quarter helped in part by settlement income, higher natural gas and oil prices and income from newly acquired mineral interests. Our team at Catapult Mineral Partners continues to look for opportunities to expand our portfolio of mineral interests while they actively oversee the performance of our owned royalty and mineral interests.

In the Coal Mining segment, third quarter 2021 Coal Mining operating profit improved over the prior year quarter, mainly due to the Bisti termination payment as well as an increase in earnings of unconsolidated operations resulting from contractual price escalation and strong demand. As more and more baseload power generation facilities are shut down and natural gas prices increase, power generation companies are increasingly relying on coal to provide low cost and dependable electricity.

Turning to North American Mining, we began deliveries at two new sand and gravel quarries located in Texas and Arkansas in the third quarter, as we delivered on our goal to expand North American Mining's scope of work and geographic footprint. We are conducting all mining operations of these two quarries, just as we do in our Coal Mining operations and we'll do at the lithium mine in Nevada. As I've said before, there's a lot of growth potential in this business, and North American Mining's pipeline of new projects remains strong. 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.

I'd also like to note that Lithium Americas, our customer at the Thacker Pass mine, issued an update on the Thacker Pass project in early October. At that time, they noted that final permitting decisions are expected to be received in the first quarter of 2022 and early-works construction is expected to begin in the first half of 2022. We continue to provide support as they move forward with this project. 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 America team continues to advance development of their existing mitigation projects and is evaluating a number of interesting new projects as well. I'm really very pleased with the way all of these businesses are advancing their strategies.

Lastly, I should note that the previously announced sale of GRE's Coal Creek Station to Rainbow Energy Center has not yet closed. Presently, closing is expected to occur in the first quarter of 2022. Once the sale is complete, 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.

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'm enthusiastic about how we can continue to grow our business by bringing natural resources to life.

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

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 third quarter operating profit improved significantly, increasing to $27.6 million from $9.4 million in 2020. Consolidated net income also increased, rising to $24.8 million or $3.47 per share from $8 million or $1.14 per share last year. A large driver of the increase in operating profit and net income was the $10.3 million termination fee J.C. discussed.

Consolidated adjusted EBITDA, which excludes the termination fee, increased 55.3% to $23.3 million from $15 million in the prior year third quarter. As J.C. mentioned, excluding the contract fee, these increases were driven primarily by improved results in all three operating segments, most significantly our Minerals Management segment.

In our Coal Mining segment, operating profit, excluding the termination payment, increased primarily due to improved earnings at our unconsolidated operations partially offset by higher operating expenses. Segment EBITDA increased as a result of the improvement in operating profit as well as an increase in depreciation, depletion and the amortization expense at Mississippi Lignite Mining Company.

North American Mining's third quarter 2021 segment adjusted EBITDA increased significantly over the prior year primarily due to an increase in depreciation expense resulting from the acquisition of additional equipment to support newer contracts.

As J.C. already discussed, Minerals Management's operating profit and segment adjusted EBITDA for this quarter increased significantly over the prior year. These improvements were driven by $3.3 million of settlement income recognized in the current quarter and higher royalty income driven by increased production and higher natural gas and oil prices.

Royalty income from the Permian Basin and Eagle Ford shale mineral interests acquired as part of our strategy to extend Minerals Management's geographic footprint also contributed to the improvement in earnings. Those are the significant factors affecting the third quarter results.

Now let me turn to our outlook. I will provide some insight on our expectations for the 2021 fourth quarter and full-year as well as provide a high level overview of our current expectations for 2022. While we are providing this first look at 2022, more color will be provided with the fourth quarter and full-year 2021 earnings release once we have finalized our 2022 annual operating plan.

In the Coal Mining segment, we expect fourth quarter operating profit to increase significantly over the prior year operating loss because the prior year included charges totaling $4.6 million to write down Mississippi Lignite Mining Company's coal inventory and cost associated with the voluntary separation program and an asset impairment.

Excluding the impact of these 2020 items, operating profit is expected to decrease from the prior year fourth quarter as a result of significantly reduced earnings at the unconsolidated coal mining operations and at Mississippi Lignite Mining Company. These anticipated decreases are expected to be partly offset by lower operating expenses in the absence of wind down costs recognized in 2020 related to Camino Real Fuels.

For the 2021 full year, we expect coal deliveries to be moderately lower than 2020. Despite fewer deliveries, operating profit is expected to increase even after excluding the impact of the $10.3 million termination payment and the various 2020 charges, mainly as a result of income associated with performing mine reclamation at Caddo Creek, a reduction in expenses at Centennial, and the absence of cost associated with the closure of Camino Real Fuels.

Excluding the termination payment received this year and the fixed asset impairment charge recognized last year, we expect segment adjusted EBITDA for the fourth quarter and full year to increase over the respective prior year periods as a result of operating profit improvements and an increase in depreciation, depletion and amortization expense.

Looking into 2022, we anticipate coal deliveries to decrease from 2021 levels as a result of the Bisti Fuels contract termination and current expectations of customer requirements. Excluding the Bisti Fuels and anticipated GRE termination payments, we expect Coal Mining operating profit to decrease significantly from 2021 because of expected significant reductions in earnings at the consolidated and unconsolidated coal mining operations, as well as an anticipated increase in operating expenses.

The reduction in earnings at the unconsolidated Coal Mining operations is expected to be mainly driven by lower earnings at Falkirk, as we have agreed to a reduction in the per ton management fee from the effective date of the new Coal Sales Agreement through May 31, 2024.

After May of 2024, the 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 a broad measure of US inflation. Termination of the Bisti Fuels contract will also contribute to the expected decline in the earnings at the unconsolidated mining operations next year.

Segment adjusted EBITDA, excluding the termination payment received from NTEC, and the anticipated $14 million payment from GRE, is expected to decrease significantly in 2022 from 2021, primarily because of the forecasted reduction in operating profit.

At North American Mining, we expect tons delivered and operating profit to increase in the fourth quarter and full year over the respective prior-year periods, primarily because of increased production, partially offset by higher operating expenses. In 2022, North American Mining expects full-year operating profit to increase significantly over this year due to contributions from contracts entered into during 2021 and an expected increase in other customer requirements.

Segment adjusted EBITDA for North American Mining in the fourth quarter 2021 and full year, as well as in 2022, is expected to increase significantly compared with the respective prior-year periods as a result of the improved operating profit and increases in depreciation expense.

Moving to Minerals Management, last year, this segment recorded impairment charges totaling $7.3 million, of which $6.7 million were taken in the fourth quarter. Excluding the 2020 fourth quarter charge, we expect Minerals Management's operating profit and segment adjusted EBITDA to decrease in the fourth quarter, primarily due to the natural production decline curve of certain newer wells in Ohio.

We expect full-year 2021 operating profit and segment adjusted EBITDA to increase over last year, including and excluding the prior year impairment charges as a result of the addition of royalty income generated from recently acquired mineral interests and higher oil and gas market prices.

In 2022, we expect operating profit and segment adjusted EBITDA to decrease significantly from this year. These declines are expected to be driven primarily by reduced production from the natural decline curve on wells in Ohio, expectations for lower natural gas and oil prices and the absence of $3.3 million of settlement income recognized in 2021. Our current expectation is that oil and gas market prices moderate in 2022 and stabilize at levels consistent with the expected full year 2021 averages.

To summarize, on a consolidated basis, we anticipate a significant increase in consolidated operating profit, net income and consolidated adjusted EBITDA in the fourth quarter over last year, primarily because of the absence of prior year charges totaling $11.6 million.

Excluding those charges, fourth quarter 2021 consolidated operating profit is expected to decrease from the prior year, primarily because of anticipated lower results in our Coal Mining and Minerals Management segments, partially offset by an increase in the North American Mining segment.

For the full year, we expect net income to be significantly higher than last year as a result of the Bisti Fuels termination payment and the absence of prior year charges totaling $12.1 million. Excluding all of these items, we still expect significantly higher 2021 net income and consolidated adjusted EBITDA because of the strong results in the first nine months of this year.

In 2022, we expect consolidated net income to decrease significantly from 2021. Lower earnings in the Coal Mining segment and an anticipated reduction in earnings in the Minerals Management segment are expected to be partially offset by lower income tax expense.

Moving away from results expectations, let me briefly provide some cash flow information. We ended the quarter with consolidated cash of $87.5 million and debt of $17 million, compared with consolidated cash of $85 million and debt of $32 million at the end of the second quarter. In addition, we had availability of $124.9 million under our revolving credit facility. We are in the process of refinancing our revolving credit agreement. Based on the current status, we believe it is probable that the refinancing will be complete by the end of this year. We are also anticipating significant cash flow before financing activities in the 2021 full year as compared to a substantial use of cash in 2020. However, in 2022, we expect to return to a significant use of cash due to substantial capital expenditures and the forecasted reduction in earnings.

We will now turn to any questions you may have.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from Andrew Kuhn from Focused Compounding Capital Management. Andrew, your line is now open.

<Q – Andrew Kuhn – Focused Compounding Fund LP>: Thank you, and good morning.

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

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

<Q – Andrew Kuhn – Focused Compounding Fund LP>: So my first question is, I was curious, I mean, would you say natural gas is the commodity price earnings you are most sensitive to because it affects both royalties at minerals management and dispatch at coal power plants? And how do you decide on what natural gas price to assume when giving guidance?

<A – J.C. Butler – NACCO Industries, Inc.>: Thanks for the question. I mean, your question was very specific about is it the thing that is we're most sensitive to. There are a number of things that drive our business, including the timing of planned and unplanned power plant outages and other things.

But if you want to talk specifically about natural gas, I mean, yes, it does certainly affect the way utilities think about dispatching their fleet of resources. I think that high natural gas prices have contributed pretty significantly to the increased demand that we have seen for coal from our customers. And it also has benefited our oil and gas business. A majority of our legacy assets in the Minerals segment are tied to natural gas reserves in Southeastern Ohio.

Your second part of your question is what do we look to when we're making assumptions? I think in the release, we said that what our assumption is that prices are going to moderate and sort of return to an average for 2021. We tend to take a pretty conservative view of forecasting in general. I think it's probably appropriate in an industry like ours because we'd rather be conservative as we think about how we're going to operate and manage going forward, so that we don't become overconfident and take risks that we probably shouldn't be taking.

So, I think we've taken a pretty conservative view of natural gas prices as we look into the future. And certainly if they stay at the current spot prices, which are much higher than the average for 2021, at least so far, I think we should see better results for the rest of the year and into next year. But I'll go back to the beginning and say that, of course, on the coal side, it depends on what happens with the individual power plants related to, I guess primarily unplanned outages − planned outages we know about. Does that answer your question?

<Q – Andrew Kuhn – Focused Compounding Fund LP>: Yeah. No. That does. Thanks a lot. And then I just have a couple more. I'm curious, are you expecting any changes in credit availability due to new fossil fuel lending policies at banks? Maybe you could speak to if it's becoming more difficult for coal companies to borrow?

<A – J.C. Butler – NACCO Industries, Inc.>: Well, it certainly isn't any easier for coal companies to borrow. And we all see, gosh, all the time you see banks that decide that they're going to get out of fossil fuels or they're going to steer away from energy and they've all got their own reasons for doing that. Some, I think are politically driven. I think some are driven by possibly troubled credits that they've had in the past. So, the mix of banks that we work with have certainly changed over time and they continue to change.

As for terms, it is certainly possible to borrow. We're working on a refinancing right now expected to be completed during this quarter, before the end of the year. And I'm pleased with the terms that we were able to − at least so far the team − the terms that we're able to work out with lenders. So, I think that's probably what I would have to say about the status of the lending markets as it relates to us.

<Q – Andrew Kuhn – Focused Compounding Fund LP>: Got it. And then can you talk a little bit about the $2 million in CapEx at Mitigation Resources? What kind of things will CapEx in this business usually be for? And then I'm going to jump back in the queue.

<A – J.C. Butler – NACCO Industries, Inc.>: Yeah. Good question. So the accounting for mitigation resources is sort of an interesting thing. As we acquire a piece of property and spend money to develop the mitigation bank on that property, it actually is treated more like work in process inventory. So investments that we're making in Mitigation Resources on actual mitigation banking credits are not really thought of as CapEx. It's really building inventory.

The CapEx that we're mentioning here is actually for some equipment that we intend to acquire that will be used by us to do the dirt work on mitigation banks. Dirt work is a core part of our skills. It's what we do at our Coal Mining operation. It's directly related to what we do at North American Mining. And we're just taking those skills and expanding them into mitigation resources to enhance the financial returns from that business. So the $2 million that we referenced there is related to equipment. It's a very good question. Thank you.

Operator: [Operator Instructions] Our next question comes from [ph] Nachy (23:02) Kanfer from Donovan Energy. [ph] Nachy (23:05), your line is now open.

<Q – Nachy Kanfer – Donovan Energy, LLC>: Thanks. Hey, guys, great quarter. Just a couple of specific questions. Can you – great news about the new Coal Sales Agreement at Falkirk. Can you provide a little color on the risk of early termination of that contract [ph] meant that we (23:19) had an early termination. Earlier, under the former management of Coal Creek, what's the – how should we think about the potential for that plant just closing again in a few years?

<A – J.C. Butler – NACCO Industries, Inc.>: Well, it's a good question. The new owners, Rainbow Energy Center they're in the business, the parent company and all the leaders of that business are involved in the marketing and sale of electricity in capacity and things like that. They're very different than a utility or in particular a coop in the way that they think about how they would operate that plant.

They're viewing, at least in the conversations we've had with them, they're viewing this plant very much like a manufacturing company would view a factory. And their intent is to run that thing like you would a factory at high capacities which produce – particularly at that plant produces very low cost electricity and an increasingly valuable capacity. Revenues were available from that plant. And they're making a bet that they can do that successfully into the future.

Now there are business plan risks. There are regulatory risks. There are political risks that we all sort of read about in the newspaper every day. So my ability to really think about what are the specific risks for that plant I don't know that that's something that I could really call out because we're really dependent upon their plans for their business model. But I will tell you, I think the conversations that we've had with them, it's very exciting to see how they're approaching this business and how they're thinking about running a plant like this in the current energy environment what we see going forward. I'd add of course, this hasn't closed yet. This transaction...

<Q – Nachy Kanfer – Donovan Energy, LLC>: Sure.

<A – J.C. Butler – NACCO Industries, Inc.>: ...is going through the final regulatory steps and we expect it to close in the first part of next year. And we're looking forward to the point when that transition happens. I think it will be – I think it'll be a great thing for the plant and for the community and certainly for the coal mine.

<Q – Nachy Kanfer – Donovan Energy, LLC>: Sure, thanks. And so do I understand in effect that NACCO is partially subsidizing the early years of this new arrangement with a lower management fee and subsidizing is, probably the wrong word but contributing some value to it and is that – how should we think about that? Is that a below cost arrangement? Is that an at cost arrangement?

<A – J.C. Butler – NACCO Industries, Inc.>: Okay. So two parts to that question and I'll address the second one first. You said is it below cost. Remember that this is a management fee contract today as well as after the transition, which means the customer pays 100% of the costs and provides all the capital. And we receive a fee for the work that we do. And what we described in our earnings release, I think we've done for a couple of quarters now is that what we have agreed to is a reduction in our fee. So the concept of it being below cost doesn't really apply in this equation because all we earn from operating any of these management fee coal mines is our fee.

<Q – Nachy Kanfer – Donovan Energy, LLC>: Got it.

<A – J.C. Butler – NACCO Industries, Inc.>: We don't have any other costs. My first reaction when you said subsidy is okay, well, I wouldn't think about this as a subsidy and you ultimately pointed that out and it's probably not the right word. I would say as is true in many transactions in order to get a deal done, many parties to the transaction need to participate in getting a deal done. And that was one of the ways that we were able to help get a deal done. In evaluating that decision, we, of course, thought a lot about what is the potential for the future as -and what were we giving up given that it's a management fee, it's not like we're in a losing situation. It's just we're going to make less for a period of time. We view that as 100% okay with us. And in fact, we were pleased to be able to support the completion of a transaction. Like I said, it's great for the power plant, it's great for the community. It's great for consumers. It certainly is good for our employees and we were happy to do that.

<Q – Nachy Kanfer – Donovan Energy, LLC>: Thanks. That's really helpful. One more question and appreciate your patience, switching over to Mississippi for a minute. Trying to reconcile the broad optimism I'm hearing around gas prices and base load retirements and the uplift that provides to NACCO's contracts with the persistently lower capacity factors and demand from Mississippi looking at mining' customer. And help me understand how to think about that, how to reconcile that and what's the – is there a worst case scenario? Are we in the worst case scenario right now in Mississippi or could it go lower?

<A – J.C. Butler – NACCO Industries, Inc.>: I mean, it's hard to think about worst case scenarios, right, because what exactly are those? Certainly I believe that increased natural gas prices have supported the high-level of dispatch out of that plant so far this year, the Red Hills Power Plant. It is proving to be an important resource in the mix of generation that's serving that part of TVA. Certainly increased natural gas prices will help with that dispatch, I believe, and the plant has been running well, and historically it's had some mechanical issues. But it's been running well.

I think it benefits power plants in general, including that plant. These plants are built to run at a high level. So having higher natural gas prices allows these plants to run at a higher dispatch level. There's less cycling them, which means ramping them up, ramping them down, because that causes issues that can affect mechanical availability. So having a plant running at a higher level during the year has been helpful, and I think it would be in the future.

Your question about worst-case scenario, I mean, I guess worst-case scenario is that there developed some kind of regulation that shuts the whole plant down, but I don't see that happening right now. I think it would – I think TVA views this as a power purchase agreement, not as an operated asset, which is – it is a power purchase agreement. And so it's kind of an independent contractual arrangement that runs through 2032. So I think it's likely to continue to operate as part of the fleet, at least through that period of time. Does that answer your question?

<Q – Nachy Kanfer – Donovan Energy, LLC>: Very well. Thank you so much for all the additional detail. Appreciate it.

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

Operator: We have no further questions. I will now hand back to the management team for any closing remarks.

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

Thank you very much. J.C., did you have anything you wanted...

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

Nothing else, Christy. Thanks.

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

All right. Thanks, J.C. We'll close with a few final reminders. A replay of our call will be available online later this morning. We'll also post the 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 available on the press release. I hope you have a great day. And I will turn it back over to Elliot to conclude the call.

Operator: Thank you. This concludes today's conference. The audio recording will be available two hours after the conclusion of this call. You may access it by dialing 1-866-813-9403 and by using 392853. Playback will be available until Thursday, the 11 of November 2021.