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NACCO Industries, Inc. (NC)

Q2 2019 Earnings Call

CORPORATE PARTICIPANTS

Christina Kmetko

Investor Relations Consultant, NACCO Industries, Inc.

John C. Butler

President, Chief Executive Officer & Director and President & Chief Executive Officer – The North American Coal Corporation, NACCO Industries, Inc.

OTHER PARTICIPANTS

Mitchell Lolley

Analyst, Nixon Capital LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Emily, and I'll be your conference operator today. At this time, I would like to welcome everyone to the NACCO Industries' Second Quarter Earnings Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions]

Thank you, Christina Kmetko. You may begin your conference.

Christina Kmetko

Investor Relations Consultant, NACCO Industries, Inc.

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

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 For anyone who is not able to listen to today's entire call, an archived version of this webcast will be on our website later this afternoon and available for approximately 12 months.

As we begin, I would like to remind participants that this conference call may contain certain forward-looking statements. These statements are subject to a number of risks and uncertainties that could cause actual results to differ materially from those expressed in the forward-looking statements made here today in either our prepared remarks or during the following question-and-answer session.

We disclaim any obligation to update these forward-looking statements, which may not be updated until our next quarterly conference call, if at all. Additional information regarding these risks and uncertainties were set forth in our earnings release and in our 10-Q.

Now let me discuss our 2019 second quarter. I will cover our consolidated results first and then provide the highlights for each segment. On a consolidated basis our operating profit increased 17.4% to \$9.2 million from \$7.8 million in the prior year second quarter. Our consolidated net income increased to \$8 million or \$1.14 per share up from \$6.4 million or \$0.92 per share last year. For the year-to-date period our effective income tax rates were 15.2% compared with 12% in 2018.

A significant increase in operating profit at our Minerals Management segment was the biggest driver of the higher net income. Operating profit in the Minerals Management segment increased because lessees operated more wells in our Ohio mineral reserves, which increased the amount of royalty income we received. This favorability was partially offset by lower operating profit at both the Coal Mining and North American Mining segments.

At our Coal Mining segment operating profit decreased mainly due to higher employee-related costs and a decrease in earnings of the unconsolidated operations. The decrease in the unconsolidated operations earnings was primarily because of fewer coal tonnes delivered as a result of customer plant outages. However, an improvement at our consolidated coal operations resulting from both an increase in customer requirements, as well as the reduction in cost per tonne sold at Mississippi Lignite Mining Company helped partly offset the decline at the unconsolidated coal operations.

We mentioned in our release that we were able to transfer certain Centennial Mine permits to third parties, which resulted in a \$400,000 loss. While this loss is not significant, we [ph] called it out (00:03:39) because the transactions that generate the loss allowed us to reduce the Centennial Mine reclamation liability on our balance sheet by \$5.4 million and will result in a reduction of future cash outlay.

At our North American Mining segment, we reported an operating loss this quarter compared with modest operating profit in last year's second quarter. The second quarter loss included higher employee-related and business development costs as well as an increase in supplies and repairs and maintenance expenses. These higher costs were partially offset by incremental earnings attributable to a new customer contract. Those are the significant factors affecting the second quarter results.

Now let me turn to our outlook. At the Coal Mining segment, we expect overall deliveries to decrease in the second half of this year and for the 2019 full-year from both prior year periods. This decrease is the result of anticipated changes in customer requirements, including the timing and duration of power plant outages as well as comparisons to historically high delivery levels experienced last year at certain of the unconsolidated operations.

I would like to note that in the second half of last year, we received a \$3 million contractual settlement and we recognized \$1.8 million in favorable adjustments to mine reclamation liabilities.

Excluding these favorable prior years items, we expect the operating profit in the second half of 2019 to increase because of a reduction in operating expenses and improved results at our consolidated operations. However, lower income at the unconsolidated Coal Mining operations resulting from the reduction in tonnes delivered is expected to partially offset the operating profit improvement.

For the 2019 full-year and excluding the favorable 2018 items, operating profit at the Coal Mining segment is expected to decrease modestly as lower income at the unconsolidated operations is expected to be partially offset by improved results to consolidated operations. Full-year 2019 operating expenses are expected to be comparable to 2018 despite the increase in the first half of the year.

At our North American Mining segment, we expect operating profit in the second half of this year to improve over the first half and be comparable with second half of last year. Operating profit for the remainder of 2019 is expected to benefit from an increase in earnings associated with new contracts by continued spending on business development activities and increased employee-related expenses are forecasted to partly offset the new contract benefits. As a result of the operating loss in the first half of 2019, North American Mining expects full-year 2019 operating profit to be significantly lower than 2018.

With regard to business development, North American Mining entered into two new contracts during the second quarter of 2019. These new contracts, which should commence in the third quarter will have a modest impact on earnings in the second half of this year, and will contribute moderately beginning in 2020.

Finally, as I mentioned previously our Minerals Management segment's operating profit increased significantly during the first half of the year. For the remainder of 2019, we expect royalty income to increase substantially over the comparable 2018 period, but at a significantly lower rate than we realized during the first half of 2019.

Also, as we mentioned in the earnings release, it is important to note these expectations for royalty income are dependent on a number of factors outside of our control.

Overall, we expect our consolidated 2019 net income to increase significantly compared with last year as a result of the increase in net income experienced in the first half of the year, and an anticipated improvement in the remainder of the year. The increase is significant whether or not you include or exclude the previously mentioned favorable 2018 items. We are forecasting an effective income tax rate excluding discrete items of approximately 15%.

Lastly, we expect our consolidated cash flow before financing activities to increase over last year, and we expect capital expenditures to be approximately \$28 million for the 2019 full-year.

Before I open up the call for questions, let me provide some balance sheet information. We ended the second quarter with consolidated cash on hand of \$98.4 million and debt of \$12 million. That concludes my prepared remarks. I will now open up the call for your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from the line of Mitchell Lolley with Nixon Capital. Your line is open.

Mitchell Lolley

Analyst, Nixon Capital LLC

Q

Good morning.

Christina Kmetko

Investor Relations Consultant, NACCO Industries, Inc.

A

Good morning.

John C. Butler

President, Chief Executive Officer & Director and President & Chief Executive Officer – The North American Coal Corporation, NACCO Industries, Inc.

A

Good morning.

Mitchell Lolley

Analyst, Nixon Capital LLC

Q

It looks like momentum at North American Mining continues with two new contract wins in the second quarter. And first question I had about that was, are these new contracts in Florida or are they in other states?

John C. Butler

President, Chief Executive Officer & Director and President & Chief Executive Officer – The North American Coal Corporation, NACCO Industries, Inc.

A

They're in Florida.

Mitchell Lolley

Analyst, Nixon Capital LLC

Q

Okay and are they limestone-related or do they pertain to sand or some other mineral?

John C. Butler

President, Chief Executive Officer & Director and President & Chief Executive Officer – The North American Coal Corporation, NACCO Industries, Inc.

A

Aggregates.

Mitchell Lolley

Analyst, Nixon Capital LLC

Q

Okay.

John C. Butler

President, Chief Executive Officer & Director and President & Chief Executive Officer – The North American Coal Corporation, NACCO Industries, Inc.

A

Look a vast majority of the aggregates in Florida are limestone. But from time-to-time these guys also produce some other products out of the material that's mined.

Mitchell Lolley

Analyst, Nixon Capital LLC

Q

I see. Would you be willing to share if they are with existing customers or entirely new ones?

John C. Butler

President, Chief Executive Officer & Director and President & Chief Executive Officer – The North American Coal Corporation, NACCO Industries, Inc.

A

Yeah so these are two new customers and I'll just add one of them is a three-year contract with a customer. And another one is a 20-year contract with a customer. Quite pleased to see a 20-year contract in this business.

Mitchell Lolley

Analyst, Nixon Capital LLC

Q

And J.C. just for fun I'll ask the same question I do every quarter. You have almost a \$100 million of cash now sitting on the balance sheet continues to pile-up. What do you guys want to do with it?

John C. Butler

President, Chief Executive Officer & Director and President & Chief Executive Officer – The North American Coal Corporation, NACCO Industries, Inc.

A

Well I will give you the same answer that I've given before, but it's worth talking about it again. And I guess is really obvious by looking at our balance sheet. We think it's important to maintain a conservative balance sheet. We run a business with a long-term perspective. We like to sign up 20-year and 30-year and 40-year contracts and in order to do that you need to be able to make long-term decisions and people with a lot of debt get forced into making short-term decisions, and we don't think that's the place we want to be.

But where do we use the resources that we have, we support our growth initiatives in the North American Mining business. I know you've studied it long enough to see that we from time to time buy draglines that we use to secure new contracts. That is actually is the case in one of these contracts that we just recently signed. We're going to continue to support growth at North American Mining. You saw it in the release that we're spending money on business development and adding people and systems and infrastructure to support the growth of that business. So money is going there.

Of course, we have to fund CapEx at any of the locations where we're responsible for CapEx that's primarily at our consolidated coal mining operations. And we continue to pay a dividend, which I think we've paid a dividend since 1956, certainly since 1961 when we're listed on the New York Stock Exchange. We've historically increased it except in those instances where we've had a spin off or something else has happened that causes us to re-evaluate it and we've – when appropriate we've got share repurchase programs in place.

Mitchell Lolley

Analyst, Nixon Capital LLC

Q

All right. And lastly just given that this is a purely public forum, are you willing to disclose how many acres you have in the Utica?

John C. Butler

President, Chief Executive Officer & Director and President & Chief Executive Officer – The North American Coal Corporation, NACCO Industries, Inc.

A

We have not disclosed that. I will tell you, it's something that we have talked about and we are thinking about, but we've not disclosed that.

Mitchell Lolley

Analyst, Nixon Capital LLC

Okay, well thank you as usual.

Q

John C. Butler

President, Chief Executive Officer & Director and President & Chief Executive Officer – The North American Coal Corporation, NACCO Industries, Inc.

All right, thank you. We continue to appreciate your interest and your questions.

A

Christina Kmetko

Investor Relations Consultant, NACCO Industries, Inc.

Thanks Mitchell.

A

Mitchell Lolley

Analyst, Nixon Capital LLC

Thank you.

Q

Operator: [Operator Instructions] There are no further questions at this time. I'll turn the call back to the presenters.

Christina Kmetko

Investor Relations Consultant, NACCO Industries, Inc.

Great. Thank you very much for joining us today. We do appreciate the interest and if you have any additional questions, please feel free to give me a call my number is available on the earnings release. Thanks so much. Have a great day.

Operator: Thank you for participating in today's NACCO Industries Second Quarter Earnings Conference Call. The call will be available for replay beginning at 11:30 AM Eastern today through 11:59 Eastern on August 8. The conference ID number for the replay is 7883671. Again, the conference ID is 7883671. The number to dial for the replay is 800-585-8367. This concludes today's conference call and you may now disconnect.

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