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NACCO Industries, Inc. (NC)

Q2 2020 Earnings Call

CORPORATE PARTICIPANTS

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President and Chief Executive Officer, NACCO Industries, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by, and welcome to the NACCO Industries Second Quarter 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] Please be advised that today's conference is being recorded. [Operator Instructions]

I would now like to hand the call over to your speaker today, Christina Kmetko. Ma'am please go ahead.

Christina Kmetko

Investor Relations Consultant, NACCO Industries, Inc.

Thank you. Good morning, everyone, and welcome to our 2020 second quarter earnings call. I am Christina Kmetko, and I'm responsible for Investor Relations at NACCO Industries. Thank you for joining us this morning. I hope you and your families are continuing to remain healthy and safe. I'll 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 2020 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 For anyone who is not able to listen to today's entire call, an archived version of this webcast will be on our website later this afternoon and available for approximately 12 months.

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.

Let me start by saying that we sincerely thank those who continue to work to keep us safe particularly those in the healthcare community and first responders. We would also like to recognize our employees who are ensuring we can continue to deliver coal and limestone, both critical infrastructure industries, to our customers.

We truly appreciate everyone's commitment to supporting our customers while also working diligently to keep one another safe. The majority of our employees have been reporting to work since the pandemic began. We've implemented safeguards in accordance with regulatory requirements and guidance from health authorities to

protect those at work and limit their exposure to COVID-19. Other employees who are able to continue to work-from-home.

Now, let me discuss our 2020 second quarter. I will cover our consolidated results first and then provide the highlights for each segment.

On a consolidated basis, our second quarter consolidated net income decreased to \$6.1 million or \$0.86 per share from \$8 million or \$1.14 per share last year. The largest driver of the decrease was a significant reduction in the earnings of the Minerals Management segment as the prior year benefited from a large number of new gas wells put into commission during 2018 and early 2019. This was expected because new wells have high initial production rates and follow a natural decline before settling into relatively stable, long-term production.

Earnings in the second quarter of 2020 were substantially lower than the second quarter of 2019. The reduced earnings in Minerals Management were partly offset by improved earnings in both the North American Mining and Coal Mining segments as well as lower unallocated employee-related expenses, and a favorable change in taxes. Despite a reduction in tons delivered, North American Mining's operating profit improved significantly primarily due to new operations since last year and favorable changes in the mix of customer requirements.

The Coal Mining segment's operating profit increased modestly over the prior year driven by improved earnings at Mississippi Lignite Mining Company and lower operating expenses in the Coal Mining segment, partially offset by reduced earnings of unconsolidated operations.

Effective July 1st, the contract mining agreement between Camino Real Fuels and its customer, Dos Republicas, was terminated as a result of the unexpected termination of the coal supply contract between an affiliate of Dos Republicas and its customer. This contract termination eliminated Dos Republicas' need for coal from Camino Real Fuels' Eagle Pass Mine, and will result in mine closure.

Camino Real Fuels has no legal obligation to perform mine reclamation, but it is in negotiations with Dos Republicas to potentially perform mine reclamation activities under a new contractual arrangement. The contract mining agreement between Camino Real Fuels and Dos Republicas was previously expected to terminate in 2021.

Now, let me discuss income taxes. Similar to last quarter, we had a negative effective income tax rate, which resulted in a tax benefit on income in both the second quarter and first half of 2020 as a result of the CARES Act enacted in response to the COVID-19 pandemic, compared with tax expense in the comparable prior year period.

The CARES Act includes temporary changes regarding the utilization of tax basis net operating losses. For the full-year, we anticipate that the effective tax rate will be negative and result in the benefit within the range of 7% to 10% excluding discrete items. Those are the significant factors affecting second quarter results.

Now, I'll turn to our outlook. In the Coal Mining segment, we expect the second half and full-year 2020 coal deliveries and operating profit to decrease from the respective prior-year periods. Excluding a \$2 million unfavorable adjustment to mine reclamation liabilities at Centennial Natural Resources in the 2019 fourth quarter, operating profit in the second half of 2020 is expected to decrease substantially from the prior year as a result of an anticipated decrease in earnings at the unconsolidated mining operations due to reduced customer requirements and an expected increase in operating expenses mainly as a result of higher professional fees.

Excluding the unfavorable 2019 mine reclamation adjustments, operating profit for the 2020 full-year is expected to decrease from the prior year due to a reduction in earnings at the unconsolidated mining operations and the expected increase in operating expenses. Operating expenses are expected to be moderately higher for the full-year of 2020.

North American Mining expect limestone deliveries in the second half and for the full-year of 2020 to increase modestly from the prior year period. Operating profit in the second half of 2020 is expected to improve over the prior year, a decrease significantly from the first half of 2020 mainly as a result of the timing of new limestone mining contracts and favorable changes in the mix of customer requirements. As a result of the significant increase in the first half of 2020 compared to the first half of 2019, full-year 2020 operating profit is expected to increase significantly over 2019.

As I noted previously, last year's results included significant royalty income, particularly, in the first half of the year, generated by a large number of new gas wells put into commission during 2018 and early in 2019. Given expected lower natural gas prices, fewer expected new wells, and the natural production climate decline occurred earlier in the life of a well, full-year 2020 royalty income is expected to decrease and be substantially lower than 2019 levels.

While royalty income is expected to decline in the second half of 2020 compared with the second half of 2019, we believe the rate of decrease will be substantially lower than the decrease in the first half of this year because prior year incomes significantly decreased between the first and the second half of 2019. The Minerals Management segment is actively engaged in reviewing opportunities to diversify its mineral interests to complement its legacy owned gas interests in Ohio.

On a consolidated basis, we expect a significant decline in full-year 2020 consolidated net income compared with 2019 primarily due to the substantial decrease in operating profit at Minerals Management as well as a reduction in operating profit at the Coal Mining segment. These items are expected to be partially offset by the recognition of a 2020 tax benefit as a result of the CARES Act and an improvement in earnings at the North American Mining segment.

Before I open up the call for questions, let me quickly provide some cash flow information. We ended the second quarter with consolidated cash of \$95.5 million and debt of \$28.4 million, which is an improvement from consolidated cash of \$93.7 million and debt of \$34.6 million at the end of the first quarter.

In addition, at the end of the 2020 second quarter, we had availability of \$133 million under our \$150 million revolving credit facility. We believe that a conservative capital structure and liquidity are important given our strategic initiatives to grow and diversify and changing trends in energy markets.

We expect cash flow before financing activities in 2020 to be a use of cash due the significant capital expenditures and payments made in the first half of the year related to deferred compensation and other payroll liabilities.

That concludes my prepared remarks. I will now open up the call for your questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions]

Christina Kmetko

Investor Relations Consultant, NACCO Industries, Inc.

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While we're waiting if anybody does have any follow-up questions, you are more than welcome to reach out to me. My name and my phone number are all on the earnings release.

Brian, it appears we don't have any questions today.

Operator: That is correct. We don't have any questions at this time.

Christina Kmetko

Investor Relations Consultant, NACCO Industries, Inc.

Okay. I will turn the call over to J.C. Butler for some final comments.

J.C. Butler, Jr.

President and Chief Executive Officer, NACCO Industries, Inc.

Thanks, Christy. I will provide a response to one question that you shared with me that you received by email. It's a question we had before, so I will respond to it as well.

The question was with regard to the differences between our Coal Mining segment and our North American Mining segment, in both of those businesses, we operate predominantly with management fee, business arrangements, contractual arrangements with our customers whereby the customers provide paid costs through operations and we receive a fee for every unit of delivery. And the question was with regards to why when our Coal segment and our North American Mining segment seem to deliver similar volumes, why is the profitability so different to the profits earned between these two segments are different?

The answer to that question is because the scope of services that we provide, are just drastically different between the two. At a typical Coal Mining operation, we operate the entire mine, everything from acquiring and permitting the [ph] raw land (00:12:57) through permitting, pre-strip, mining, reclamation and all the activities that are involved in the operation at a large mine, there will be hundreds of employees at a large coal mine.

In the North American Mining segment, we really at this point of primarily focused on operating draglines of customer queries. So all we're doing is operating and maintaining the dragline, which only requires a very few employees. So it's the difference in the fees per unit of deliveries, I guess you would look at it. The difference is really just regard to the scope of services provided between those two segments. So hopefully that answers the question.

Christy, I'll hand it back to you.

Christina Kmetko

Investor Relations Consultant, NACCO Industries, Inc.

Okay, great. Well, thank you, everyone, for joining us today. And again, if you do have any additional questions, please feel free to give me a call. Have a great day.

Operator: This does conclude today's conference call. You may now disconnect.

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