PARTICIPANTS

Corporate Participants

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

Other Participants

Mitchell Lolley – Analyst, Goshawk Global Investments LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Kelly and I'll be your conference operator today. At this time, I would like to welcome everyone to the NACCO Industries First Quarter 2018 Earnings Analyst Conference 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.

I would now like to turn the conference over to Christina Kmetko. Please go ahead.

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

Thank you. Good morning, everyone, and welcome to our 2018 first 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 first quarter 2018 results and filed our 10-Q. Copies of our earnings release and 10-Q are available on our website at nacco.com. For anyone who is not able to listen to today's entire call, an archived version of this webcast will be on our website later this afternoon and available for approximately 12 months.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 was set forth in our earnings release and in our 10-Q.

Now that I have the formalities done, let's talk about the quarter. Yesterday, we reported consolidated income from continuing operations of $8.2 million, or $1.18 per share for the first quarter of 2018. This compares to consolidated income from continuing operations of $8.2 million, or $1.20 per share for last year's first quarter. Our effective income tax rate for the quarter was 9%, within the range we provided at year-end.

At our North American Coal business, coal deliveries decreased to 9.2 million tons in the first quarter of 2018 from 9.9 million tons last year, primarily at our unconsolidated operations. However, limestone deliveries at our North American Mining division increased to 9.3 million yards from 7.8 million yards in the first quarter of 2017, primarily at the unconsolidated limestone operations.

Operating profit was comparable between years at $11.3 million. We recorded a $1 million favorable adjustment to Centennial's mine reclamation liability, and the earnings at the unconsolidated operations increased 4% over the prior year, despite a decrease in results at our unconsolidated Bisti mining operations as a result of fewer tons delivered.

The increase in the earnings at the unconsolidated mines was the result of several factors; one, the increase in limestone deliveries I mentioned previously; two, higher compensation at Liberty Fuels during the mine reclamation period; and, three, moderately increased earnings at other unconsolidated operations. These favorable items were fully offset by higher operating expenses because of higher employee-related expenses and costs and an increase in professional fees. We also had a decrease in earnings at Mississippi Lignite Mining Company resulting from an increase in cost per ton delivered.

While North American Coal's first quarter 2018 operating profit was comparable to 2017, its first quarter 2018 pre-tax income increased to $10.9 million from $10.6 million last year, primarily because of lower interest expense. NACCO and other operating results were comparable between periods.

Looking forward, we continue to expect a consolidated effective income tax rate in the range of 9% to 12%. We expect our 2018 consolidated pre-tax income to decrease modestly compared with last year [audio gap] (00:04:16) 2017 included $5.1 million of gains on sales of assets. Excluding these gains, we expect 2018 pre-tax income to increase compared with 2017 primarily as a result of a reduction in full-year operating expenses, improved income at our unconsolidated operations and reduced interest expense.

These improvements are expected to be partly offset by an anticipated substantial decrease in royalty and other income and a decrease in income at Mississippi Lignite Mining Company. Income from the unconsolidated operations is expected to be modestly higher in 2018 due in part to higher compensation at Liberty Fuels and increases at North American Mining's unconsolidated limestone operations as a result of new contracts signed in 2017 and increased customer demand.

Our Bisti Fuels unconsolidated operation is experiencing a slower start to the year, while the owners of the power plant it serves installed additional environmental controls at the plant. Overall, we expect Bisti's full-year 2018 pre-tax income to be comparable to last year, as an increase in income in the second half is expected to offset the decrease in the income from the first half. At the consolidated operations, Mississippi Lignite Mining Company's pre-tax income in the first half of 2018 is expected to decrease substantially from the first half of last year, primarily as a result of an increase in the cost per ton delivered.

To better explain, cost per ton delivered is lowest when the power plant requires a consistently high level of coal deliveries because we are then spreading the cost over more tons. Historically, periods of reduced or fluctuating deliveries have adversely affected Mississippi Lignite's tons delivered, resulting in an increase in cost per ton delivered and reduced profitability. We are expecting pre-tax income in the second half of the year to improve compared with the second half of 2017, but this improvement is not expected to fully offset the decrease from the first half.

As a result, we expect Mississippi Lignite Mining Company's full-year income to decrease compared with the prior year. Customer demand in the second half of 2018 is expected to return to higher levels due to reduced plant outage days, but if demand remains low, it could continue to unfavorably affect 2018 and future earnings significantly.

Before I wrap up, let me provide you with some cash flow and balance sheet information. We expect cash flow before financing activities to decrease substantially in 2018, due in part to an increase in capital expenditures at North American Coal. We ended the first quarter with consolidated cash on hand of $83.4 million and debt of $50.8 million, resulting in a net cash position of $32.6 million. Also, in February 2018, our board of directors authorized a stock buyback program to purchase up to $25 million of our outstanding Class A common stock. This program will expire on December 31, 2019. We did not purchase any shares during the first quarter of 2018.

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from the line of Mitchell Lolley from Goshawk Global Investments. Please go ahead.

<Q – Mitchell Lolley – Goshawk Global Investments LLC>: Hi there.

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

<Q – Mitchell Lolley – Goshawk Global Investments LLC>: Can you talk about one of the mining contracts that I believe is coming up for renewal this year?

<A – J.C. Butler – NACCO Industries, Inc.>: You must be talking about the Camino Real contract?

<Q – Mitchell Lolley – Goshawk Global Investments LLC>: Yes, that's the one.

<A – J.C. Butler – NACCO Industries, Inc.>: Yes. So, that contract is with a customer. We mine coal for them. It's a management fee arrangement. It's their coal that we're mining for them and they sell that coal on to use in a power plant. So, we're selling to them and they're selling on to somebody else that runs the power plant. Our contract will be extended when and if their contract is extended with their customer. That's really in their hands. It's not a negotiation that we're part of. We're operating the mine today as if it's going to continue to operate into the future. But we don't – I mean, because it's our customer's negotiation with their customers, it's not really something we can comment on further.

<Q – Mitchell Lolley – Goshawk Global Investments LLC>: Okay. The North American Mining limestone business was kind of a bright spot in the quarter and I was wondering is the margin profile on limestone operations similar to the margin you get on the coal side of your business.

<A – J.C. Butler – NACCO Industries, Inc.>: Well, margin is a concept in our business that's not like other businesses – other mining companies because you typically think of them – they mine coal at a cost and then they sell it at a price and they collect the margin that's between the two. We really are a service business. We collect fees for services provided and the business in Florida operates the same way.

At our traditional coal mining business, we're operating the whole mine, soup to nuts, everything from land acquisition through permitting, mine development, mining reclamation, the whole bit. At our operation, our North American Mining operation, we maintain and operate draglines and recently we added one shovel. So, it's a much narrower scope of services that we're providing in that business.

<Q – Mitchell Lolley – Goshawk Global Investments LLC>: Okay. But when I look at the unconsolidated financial statements – and I understand you don't have price exposure, but when I just look at pre-tax profit, for example, as a percentage of revenue in that business, it's about 8% pretty consistently. Does it kind of net out the same way in the limestone business?

<A – Elizabeth Loveman – NACCO Industries, Inc.>: Are you talking about the unconsolidated financial statements we filed as part of the 10-K, is that what you're looking at?

<Q – Mitchell Lolley – Goshawk Global Investments LLC>: Yes. Yes.

<A – J.C. Butler – NACCO Industries, Inc.>: Yeah. I mean, again, you can't really look at that because amongst – so the customer pays 100% of the cost. Revenues on the unconsolidated mines are – the revenues on those financial statements are equal to 100% of the costs that are incurred at those mining operations, plus our fee.

<Q – Mitchell Lolley – Goshawk Global Investments LLC>: Okay. Okay.

<A – J.C. Butler – NACCO Industries, Inc.>: And at the limerock operations, they're really just paying us a fee. I mean, they are paying our costs, like for our people and the cost of the parts for repairs and maintenance items. But we're just collecting – in both instances, we're collecting a fee. Although at the coal mining operations, it's a much larger scale operation, where the limerock business in North American Mining, we're doing something that's very specific. We're just maintaining and operating a dragline. You really can't look at – said another way, you really can't look at this 8% margin and have that mean anything to you.

<Q – Mitchell Lolley – Goshawk Global Investments LLC>: Okay. I guess what I'm trying to get at is it seems like [indiscernible] (00:12:00) could already be especially now versus a few years ago more of a material aspect of your business. And I was just wondering if you expect kind of that to continue where growth is more on the limestone and other side.

<A – J.C. Butler – NACCO Industries, Inc.>: Well, I mean, I will tell you as I certainly put in the Annual Report letter. We've been very successful. It's a wonderful thing. Over the last seven, eight years, we've been incredibly successful growing our coal business. We've built five new coal mines where – we took over operation of a sixth coal mine in New Mexico and we've grown the [ph] business (00:12:45) pretty substantially. So, I will tell you that we're working pretty hard on growth in lots of areas.

And I mean, this is I guess something out of your industry, past performance is no indication of future performance, but we feel like we've done pretty well in the last several years. So, we're continuing to work on those. I will tell you most recently, I mean, this is obvious from reading our statements, we've grown the limerock business pretty quickly. We've added a lot of new quarries, a lot of new customers in the last couple of years in that business. Certainly helps that the economy's booming, there's lots of construction and infrastructure business going on. So, limerock businesses are looking for ways to expand their operations. So, we think there's potential there as well.

But we provide a very specific service inside the limerock industry. If you think about that business, you start with the reserves, you mine the reserves, and then the limerock producers crush them, size them, sort them, wash it, and [ph] sell them (00:13:58). Really what we are doing is the back end part of their business. And really just right now in Florida where it's Florida limerock that we're mining, we're doing the mining part of their business and then they're doing the value-added parts of crushing, sorting, sizing, washing and selling.

<Q – Mitchell Lolley – Goshawk Global Investments LLC>: Got you. If we could move to the balance sheet for a second, you're obviously sitting in a very strong net cash position. How do you plan on using your cash in the future?

<A – J.C. Butler – NACCO Industries, Inc.>: I know this is in our investor presentation. Maybe I think it was in the Annual Report letter as well. Our priorities are, of course, to invest in our existing businesses as is required. We think we have a very strong business model. We want to make sure we do everything we can to preserve that. We're investing in growth.

You certainly saw in the earnings release that one of the reasons operating expenses were up is because of business development. We're investing money in our business development activities. And if we have opportunities to prudently invest, we will. I mean beyond that, we intend to maintain very conservative leverage.

We like the fact that we don't have a lot of debt, and we've been returning cash to shareholders. We've paid dividends for a very, very, very long time at North American Coal before NACCO Industries and then NACCO Industries since 1986. And we've – for the last – jeez, I've been around for 22 years, we've had a number of programs in place to buy shares back. Most recently, we announced one in February. So, I mean, those are really our priorities in order.

<Q – Mitchell Lolley – Goshawk Global Investments LLC>: Okay. And given the steadiness of your business model, I guess I'm wondering why you don't choose to pay a large dividend because it looks like you could easily support even a mid-single-digit dividend yield on the current stock price and still have plenty of headroom for growth initiatives.

<A – J.C. Butler – NACCO Industries, Inc.>: Well, we want to be prudent. We want to think about what dry powder might we need for something in the future. We don't – it's impossible to predict what might come up in the future. We certainly have seen other mining companies – albeit with a different business model, we've seen other mining companies have issues and we want to make sure we're prepared for those.

I mean we signed a 40-year contract to build the Liberty Mine which was going to supply the Kemper County facility that Southern operated, and we expected that to be in place till I think it was 2055. Well, you know what, their plan didn't work out and they shut down that facility. I mean we expected to generate a lot of income and cash from that over the years to come and that didn't pan out. So, we just want to be cautious about how we think about our business.

We think one of our advantages as we look at growth is the fact that we're very stable. People don't have to worry about whether we're going to be here next year or not. When you're signing a 15, 20, 25, 30, 40-year contract, people want to know that you're pretty stable.

<Q – Mitchell Lolley – Goshawk Global Investments LLC>: Does what you just said imply at all that you could be retaining capital for something like making an acquisition even?

<A – J.C. Butler – NACCO Industries, Inc.>: Yeah. I mean it's – like I said, it's impossible to predict the future. You just – who knows.

<Q – Mitchell Lolley – Goshawk Global Investments LLC>: Okay. Thank you very much. I appreciate it.

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

<A – Christina Kmetko – NACCO Industries, Inc.>: Thank you.

Operator: [Operator Instructions] And there are no further questions at this time. I will now turn the call back over to Christina Kmetko for closing remarks.

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

All right. Well, thank you for joining us today. Do you have anything you want to add?

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

No. Thank you.

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

All right. Thank you very much. If you do have any further questions, you can reach me, my number is on the earnings release. Thanks so much and have a great day.

Operator: Thank you for joining. If you would like to access the [audio gap] (00:18:22), please dial 855-859-2056, and it will be available at 11:30 AM Eastern Standard Time. This concludes today's conference call. You may now disconnect.