PARTICIPANTS

Corporate Participants

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

Other Participants

Andrew M. Kuhn – Analyst, Focused Compounding Capital Management
Trey Henniger – Analyst, DIY Investing

MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by and welcome to the NACCO Industries Q1 2020 Earnings 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 conference over to your speaker today, Christina Kmetko. Thank you. Please begin.

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

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 For anyone who is not able to listen to today's entire call, an archived version of this webcast will be on our website later this afternoon and available for approximately 12 months.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

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.& Director; President & Chief Executive Officer-The North American Coal Corporation

Thank you, Christy, and good morning, everyone. To start off, we'd like to extend our sympathies to everyone that's been affected by this global pandemic, and we want to sincerely thank all of those who are keeping us safe, particularly those in the healthcare community and first responders. Just what an incredible job they are doing, really deserve all of our appreciation. We would also recognize – like to recognize our employees who are continuing to deliver coal and limestone to our customers. We couldn't be more pleased with how well our workforce and supervisors are managing through this unprecedented situation and adapting to their changed work environment.

We truly appreciate our employees' commitment to supporting our customers while also working diligently to keep everyone safe. As you can imagine, keeping everyone safe and reducing the spread of the coronavirus has been our highest priority, but we also have a responsibility to continue to supply our customers with coal and limestone since both are critical infrastructure industries. A majority of our employees have been reporting to work these last several weeks. 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.

We're adjusting shift schedules to promote social distancing; we're enhancing cleaning and sanitation of equipment, work areas and common areas; and we're promoting recommended hygiene practices and limiting workplace access. Of course, any of our employees who can work from home are doing so, and we made sure that they have the resources and support to be productive. The investments we've made over the last several years to upgrade our systems and processes largely through IT investments are paying huge dividends for us.

We made a lot of these investments to make our systems and processes more scalable to support our growth, and we are finding that these tools have been invaluable as we have shifted to performing work remotely. I'm incredibly pleased with how all of this is working. From a business standpoint, I think we're very fortunate that we've not been materially affected by the pandemic. Customer demand has not been affected in a material way, and we have not, thus far, had issues with suppliers or vendors. Of course, the extent to which COVID-19 impacts the company going forward will depend on a lot of factors, both present and future, that none of us can predict.

Before Christy reviews our first quarter 2020 results, I'd like to take a moment to discuss yesterday's announcement by Great River Energy that it intends to retire the Coal Creek Station power plant in the second half of 2020 (sic) [2022] (00:05:01). Our Falkirk Mine is the sole supplier of lignite to Coal Creek Station and is our second largest coal mine. As we noted in the release, Falkirk contributed approximately $16 million to our operating profit in 2019. While we are clearly disappointed in GRE's decision, we believe that Coal Creek Station is an efficient, economic and attractive generation asset.

The continued long-term operation of that facility is in the best interest of our employees and certainly for the local and state economy as well. Great River Energy's announcement indicated a willingness to consider opportunities to sell Coal Creek Station, and we are actively engaged in exploration of options that could, if successful, allow for transfer of ownership of the power plant to one or more third parties. I want to be clear that we don't have a solution here and I can't make any guarantees that we will. But I can assure you that we are committed to working with all stakeholders to try to find a solution. GRE's statement says they don't plan to close the plant until the second half of 2022, which gives us time to pursue options to keep the power plant and the mine open.

Now, let me turn the call back over to Christy to cover our results for the quarter. Christy?

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

Thanks, J.C. On a consolidated basis, our first quarter consolidated net income decreased to $6.2 million or $0.88 per share from $15 million or $2.15 per share last year. The largest driver of the decrease was a significant reduction in the earnings of the Minerals Management segment, as 2019 benefited from a large number of new gas wells put into commission during 2018 and early 2019. Because new wells have high initial production rates and follow a natural decline before settling into relatively stable long-term production, earnings in the first quarter of 2020 were substantially lower than the first quarter of 2019.

Our Coal segment also contributed to the decline in net income. The Coal Mining segment's operating profit was substantially lower than in the prior year first quarter primarily due to a decrease in results at Mississippi Lignite Mining Company, driven by an increase in the cost per ton delivered, a reduction in tons delivered at the unconsolidated operations as a result of changes in customer demand and an increase in operating expenses. A significant improvement in operating profit at North American Mining, primarily due to new mining contracts and an increase in tons delivered to existing customers, partly offset the reduced operating profit in Coal and Minerals Management.

Now, let me explain what is happening with income taxes. The CARES Act, enacted in response to the COVID-19 pandemic, contains temporary changes regarding the utilization of net operating losses. The estimated annual effective income tax rate for 2020 includes the benefit of utilizing provisions of the CARES Act and resulted in a tax benefit for the 2020 first quarter, despite having pre-tax income. For the full-year, we anticipate that the effective tax will approximate zero.

Those are the significant factors affecting first quarter results. Now, let me turn to our outlook. In the Coal Mining segment, we anticipate coal deliveries and operating profit to be comparable to 2019. Excluding a $2.5 million unfavorable adjustment to mine reclamation liabilities last year at Centennial Natural Resources, 2020 operating profit is expected to decrease from the prior year as a result of the lower first quarter results and an expected increase in operating expenses.

The decrease in operating profit is expected to be partly offset by an anticipated improvement in Mississippi Lignite Mining Company results. However, the evolving COVID-19 pandemic, historically low natural gas prices and the continued increase in renewable generation, particularly wind, could reduce customer demand, which would unfavorably affect the 2020 outlook for this business.

North American Mining expects limestone deliveries to increase and full-year operating results to improve significantly over 2019, primarily from earnings generated by new limestone mining contracts.

As I noted previously, 2019 results included significant royalty income generated by a large number of new gas wells put into commission during 2018 and early in 2019. Because new wells have high initial production rates and follow this natural decline curve before settling into stable long-term production, royalty income in 2020 is expected to decrease and be substantially lower than prior year levels, with a significant portion of this decrease expected in the first half of 2020, as comparisons are made to historically high income levels in the first half of 2019.

Before I open up the call for questions, let me quickly provide some balance sheet and cash flow information. We ended the quarter with consolidated cash of $93.7 million and debt of $34.6 million. Due to the uncertainty surrounding the COVID-19 pandemic, we suspended our share repurchase activity in March. We expect cash flow before financing activities in 2020 to be a use of cash due to a significant increase in capital expenditures and payments made in the first quarter related to deferred compensation and other payroll liabilities.

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of [ph] Andrew Kuhn (00:10:56). Your line is open.

<Q – Andrew Kuhn – Focused Compounding Capital Management>: Hello, everyone. Good morning. Thanks a lot for allowing me to drop by and ask the questions.

<A – J.C. Butler – NACCO Industries, Inc.>: Great to have you. Good morning.

<Q – Andrew Kuhn – Focused Compounding Capital Management >: Good morning. So, you said in your earning release that Coal Creek Station – and you reiterated at the beginning of the call – is an efficient, economic and attractive generation asset. And however, the CEO of Great River Energy in an interview, he had said that we're not talking about selling Coal Creek for a material price. All of our discussion have been basically giving the plant to somebody and we've had no takers. So, I'm just kind of curious about that. And if you really believe Coal Creek can be economically viable in some other owner's hands, and if so, why do you think Great River Energy is convinced based from its statement that it's effectively worthless?

<A – J.C. Butler – NACCO Industries, Inc.>: I don't want to get into a public disagreement with a customer. So, let me think about this. I believe – we believe that it is a very efficient power plant. This power plant has, over the last several years, been dispatched at above 90% of its capacity level, which is an extremely high dispatch rate for a power plant. In order to do so, a plant's got to be pretty competitive and pretty economic in order to dispatch at that level. So, we think there's some past evidence of its ability to compete. I think there's also differing views – and if you do some research, you can read about this. There are differing views in the industry – in the utility industry about carbon risk, and there are differing views with respect to the need for owned dispatchable generation.

Renewables are intermittent. Things like coal, nuclear and combined-cycle natural gas are considered dispatchable generation, because you can turn them on and off as you choose. And so, there are differing views in the industry with respect to the importance of having dispatchable – the need to have dispatchable generation available. And those views can vary widely between utilities. And those are among the reasons that I think drive differing views about the importance of having a power plant like this in your fleet. The other thing I'd add is there are also differing views with regards to the value of capacity. In energy markets – look, I got to point out I'm not an energy guy, right. We're miners. But we spend a lot of time trying to learn as much as we can.

In the electricity market, there is both energy and capacity. Generators are required to have at least some sort of access to capacity and it needs to be in excess of peak demand. So, there are markets for selling energy and there are markets for selling capacity. There are, I think, growing views that the market for capacity is increasing in value and will continue to increase in value as more and more dispatchable generation is taken off-load – or taken offline, right, closing dispatchable power plants. And you see some of the operators like MISO or SPP and others, you're starting to see them talking about the fact that they're going to award – give less credit for capacity to renewables and more credit to dispatchable energy, because they're growing concerned about the decreasing amount of dispatchable capacity available in the market. So, that's sort of driving differing views between utilities about the future value or future cost of buying capacity on the open market. Does that address your question?

<Q – Andrew Kuhn – Focused Compounding Capital Management>: Got it. Yeah. Yeah, sure. Yeah. Thank you for answering that. And then, the next [ph] – I really have (00:15:55) two more, and one of them is in the March investor presentation, you have a slide in there that was showing that NACCO owns 44,860 gross acres of oil and gas interests, and I'm just kind of curious what was behind your decision to disclose the exact number of acres.

<A – J.C. Butler – NACCO Industries, Inc.>: It's a growing part of our business, as I'm sure you've seen. It's a question that we have received from a number of people, and we just decided – we've spent some time studying other companies' disclosures for companies that actually actively – their sole business is owning royalty interests and mineral interest. And we decided that it made sense to put a number out there, so people could get some sort of indication of what it is that we own. I'd point out that that's a gross acre number. That doesn't necessarily represent our net mineral acres, which is a different number based on what sort of royalty percentage we get and other things. But the decision to put it out there was really responding to inquiries about the size of our reserve base.

<Q – Andrew Kuhn – Focused Compounding Capital Management >: Got it. And then, my final question is on Catapult Mineral Partners. I'm kind of curious who actually makes the decision to buy stock at Catapult. Is this decision made at the Catapult level or is the final buy decision made at the parent company level? And then, how do you think we should think about a stock investment made by Catapult? Do you think of purchases of stocks in the energy industry as being just another buy-and-hold sort of way of diversifying NACCO over time, like will it be long-term, almost permanent stakes or will someone at Catapult be actively managing a stock portfolio on like a quarter-by-quarter basis?

<A – J.C. Butler – NACCO Industries, Inc.>: We are not setting up a trading floor, absolutely not. Your question about where are decisions made, and you're – and differentiating between Catapult or parent company, I want to make sure you know that we have an incredibly flat organization structure, just as flat as you can possibly imagine, and any kind of decisions like that are made jointly. So, I was very actively involved in that decision. It's a new – this Catapult piece of our Minerals Management business is a new thing for us. Their primary focus, as we've described, is going to be with respect to buying mineral interests – managing the mineral interests that we own, first, and then we think that there's really a viable business here to expand that business through owning additional minerals, diversifying into other basins, diversifying the mix of oil and gas and doing so, and really the primary focus is acquiring a diverse portfolio of mineral interests, not stocks.

Your question about short-term, long-term, I said we're not going to have a trading floor. If you – I think it's pretty consistent when you read our information that we are long-term folks. We made this investment, and it is a small immaterial investment in a public company, because we're at a sort of a unique – I think we're at somewhat of a unique period in time when the values of some of these companies have just been crushed. Yet, if you look at what they own, they own exactly what Catapult is trying to do, is develop a diverse portfolio of mineral interests. And so, buying a small interest in a public company really just allowed us to accelerate the diversification of Catapult by making this small acquisition.

It allowed us to get sort of one step removed, I'll admit, but diversification into a lot more basins and diversify our oil and gas mix in a single acquisition as opposed to buying those mineral interests ourselves. So, we view – we spent a lot of time studying the company. We think they've got a similar approach that we do, in that they have a pretty conservative view at capital structure. They take a very long-term view of their business, and they – from what we can tell, they've got a pretty disciplined approach to overhead. All of those things fit pretty well with us, and we decided – this was not something that we had on our radar screen until we saw what was happening in the market, decided this was a good way to have a different kind of diversification in Catapult, but really the same thing, just diversifying our basins and our mix of oil and gas. Does that answer your question?

<Q – Andrew Kuhn – Focused Compounding Capital Management >: Yes, it absolutely does. Thank you so much for answering my questions.

<A – J.C. Butler – NACCO Industries, Inc.>: No problem.

Operator: Your next question comes from the line of [ph] Trey Henninger (00:22:05). Your line is open.

<Q – Trey Henniger – DIY Investing >: Hello. Thank you for taking this question for me today. Good morning.

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

<Q– Trey Henniger – DIY Investing>: I just wanted to ask first about draglines. A lot of the expansion in the limestone business is regarding the acquisition of draglines. So, are you willing to provide some detail about the cost per dragline on average and the expected life of each dragline that you acquire?

<A – J.C. Butler – NACCO Industries, Inc.>: Sure. So, the business inside North American Mining right now is one where we have developed really kind of industry-leading and somewhat unique expertise in operating draglines to mine limerock under water. The dragline, to be clear, is not under water. The limerock is. Now, the size of a dragline – draglines are very – there are some very small draglines that have a bucket that can pick up maybe 5 cubic yards, and we operate draglines in our Coal business that have buckets that can pick up 125 cubic yards. So, the concept of an average price of a dragline is from a few million dollars to in excess of $100 million. Now, the largest ones don't really get used in the limerock business. And in fact, a majority of the draglines that are used are sort of in that 5 to 35 cubic yard bucket range. So, they're at the lower end.

I will tell you that in a number of instances, we don't own the draglines. There are plenty of quarries that we operate where the customer owns the dragline. We have some contracts where there's a management fee, where we collect just a fee for the work that's done, and there's some where we get a fixed fee, and we then pay all the costs and make profits in a more traditional way. And in either of those, the customer could own the dragline or we could own the dragline. So, not in every instance do we own the dragline. We have found success in recent years expanding that business by having draglines available either in our direct ownership or maybe have an option on a dragline or maybe have just a lead on a dragline that would be a good fit for a customer's application. We do from time-to-time acquire them and sort of put them in inventory, because we've got a good sense that we're going to be able to turn that into a new contract.

In every instance, these draglines are used for – we're buying a dragline with an eye towards putting it into contract and turning it into a profitable venture that delivers an attractive return on the capital, any capital that we might have invested, and deliver a nice profit margin as well. So, the average cost of a dragline, I'm going to say it would go from $3 million to $10 million to $20 million for the kind of what we're talking. For the larger draglines though, in the range that I just described, a $20 million cost might be a very inexpensive dragline. And then, you spend a significant amount of money taking it apart and transporting it to the quarry and then reassembling it and updating the technology and all that stuff. So, when you think about cost of a dragline, it's – maybe the dragline is cheap and the relocation is expensive. For the smaller ones, it's not that expensive to relocate them and rebuild them. Is that helpful or could I – you want me to elaborate in another way?

<Q – Trey Henniger – DIY Investing >: No, that's very helpful. So, I think the piece that I'm trying to get at is when we're thinking about the limestone business, you talk a lot about how long-term focused you are, and I was just trying to have an idea for – that's great information on the cost – have an idea about...

<A – J.C. Butler – NACCO Industries, Inc.>: [indiscernible] (00:26:47).

<Q– Trey Henniger – DIY Investing >: How quickly do we have to replace them? Are these 20-year draglines?

<A – J.C. Butler – NACCO Industries, Inc.>: So, we operate some draglines that we have been operating for 40 years. A dragline – and that's in our Coal business, right, where we've obviously been operating longer than we have in the limerock business. We have a philosophy that any tool that you use, whether it's a dragline, a truck, piece of excavation equipment or the hand tools that you use in a mechanic shop, they're tools, they're important parts of our factory, if you want to think of it that way. And so, we are absolutely meticulous about maintenance, quite obsessive about our maintenance practices and methods. So, a piece of equipment – it's expensive, it should be taken care of with the proper preventative maintenance, do the proper repairs when they're needed, be watchful of anything that might look like a weakness.

It's no different than, on an automobile, if you hear the brakes start to squeak, you probably should replace them and not just run them until they're shot. So, a dragline – draglines can run for decades. The concept of replacing a dragline is typically done more so with respect – and especially in the limerock business, it's done more so with respect to wanting a larger dragline to better meet your capacity needs. A larger dragline can support a larger bucket, which means you can produce more per hour. It's really more about changing draglines to change capacity than it is because they wear out. They don't – if you maintain them, they don't wear out. If you don't maintain them, it's much more expensive and you're going to end up replacing it. And in some instances, we have brought in draglines to replace draglines that had just been worn out. Did that address your question?

<Q – Trey Henniger – DIY Investing>: Yes. That's been very helpful. So, yeah, that's very helpful. One other question, would you be willing to give additional detail on the – what appears to be $30 million-ish spending in cash flow on the long-term incentive comp and the payroll liabilities? I was able to trace the $13.4 million of long-term incentive comp, but I'm missing the outstanding around $17 million when I was tracing the 10-Qs back to about 2019 Q1. So, I was just wondering if you could give additional detail on maybe what that accounts payable liability was focused on. Is that just normal employee compensation, executive comp? Is that pension liability, something along those lines? Thanks.

<A – J.C. Butler – NACCO Industries, Inc.>: Yeah. If you don't mind, I'm going to hand that off to Liz. We typically are all sitting at the same table for these calls, but we're in Ohio which is still remote work. So, we're not together. So, I'm going to hand that off to Liz.

<A – Liz Loveman – NACCO Industries, Inc.>: Thanks, J.C. So, I think your question, as you can see, the deferred comp, that was $13.5 million approximately that we paid out. And you can also see if you look at the balance sheet, the payment of the accrued payroll went from $19.6 million in December to $6.5 million today. And so, the remainder was just a normal movement of cash flow. There's really nothing else material to talk about. Is that what you're looking for or did you have another – am I not answering your question.

<Q – Trey Henniger – DIY Investing >: I think really the reason for the question is wondering if this is an expense that we should expect on an annual basis in terms of cash flow or is this a cash flow expense that is more one-time, or does it repeat on a five-year basis or something along those lines?

<A – Liz Loveman – NACCO Industries, Inc.>: No, that would be a more one-time. So, the deferred comp was expensed several years ago and that was just a settlement of that liability.

<Q – Trey Henniger – DIY Investing>: Understood.

[indiscernible] (00:31:14)

<A – Liz Loveman – NACCO Industries, Inc.>: Yeah, same thing, it was the long-term pay – it was the payout of a long-term plan. So, we do – a piece of that was our current. So, there will always be some current piece, but the majority of this was more of a one-time nature item.

<Q – Trey Henniger – DIY Investing>: Okay. So, it's just based on you had some cash available, so is it the time to offset that cash payment or it [ph] just came due for (00:31:38) the cash payment?

<A – Liz Loveman – NACCO Industries, Inc.>: [ph] It came due with the (00:31:41) cash payment, correct.

<A – J.C. Butler – NACCO Industries, Inc.>: Yeah. And it wasn't because we had – I think what I've heard you say is we decided to do this because we had cash sitting around and decided to pay it out. It is not. We terminated some deferred comp plans about the time that we did the Hamilton Beach spin-off and created new long-term incentive plans. And this was – some of this was related to the payout of those plans as per their terms. This wasn't something that we decided, oh gee, end of 2019, beginning of 2020, let's pay these out. This was sort of as per the termination of plans, we paid these out.

<A – Liz Loveman – NACCO Industries, Inc.>: And if you look back, you can see we moved that from long-term to current about 12 months before it was due. So, it was planned – it was a planned payment.

<Q – Trey Henniger – DIY Investing>: Okay. Yeah, I've been able to trace that show up in the current, but just missed the transfer. Thank you for answering. I'll step back into the queue.

<A – J.C. Butler – NACCO Industries, Inc.>: Great, thank you.

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

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

Thank you very much. We do appreciate everybody joining us today. J.C., did you want to make any final comments before we sign off?

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

No, Christy. Just to thank the callers for their questions.

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

Yes. Again, thank you. If you do have any follow-up questions, you can reach me at the number that is on our earnings release. Thank you and have a great day and stay safe.

Operator: Ladies and gentlemen, a replay of today's event will be available later today by dialing 855-859-2056 and entering conference ID number 7535388. This replay will be available until midnight May 15, 2020. Ladies and gentlemen, this concludes today's conference call. You may now disconnect.