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

Nachy Kanfer – Partner, Donovan Energy

MANAGEMENT DISCUSSION SECTION

Operator: Good day and thank you for standing by. Welcome to the NACCO Industries Second Quarter 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, Ms. Christina Kmetko. Please go ahead.

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

Thank you. Good morning, everyone, and welcome to our 2021 second 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, Chief Executive Officer; and Elizabeth Loveman, Vice President and Controller.

Yesterday, we published our second 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, 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 second 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. I'm happy to be on the call this morning since we have a lot of good news to report. 2021 continues to be a good year for us, as our second quarter earnings release described new developments that build on a lot of good news from our first quarter. I'll start with some great news for our Coal segment.

In late June, Great River Energy entered into an agreement to sell Coal Creek Station and the adjacent high-voltage direct current transmission line. Once closing conditions are met and the sale of Coal Creek Station is completed, the existing agreements between GRE and our Falkirk Mine will be terminated, and we will receive a $10 million (sic) [$14 million] (00:03:03) termination payment, as well as certain other assets that are described further in our release.

Falkirk will continue to supply all of the core requirements for Coal Creek Station under a management fee agreement, the Coal Creek Station's expected new owner Rainbow Energy. Similarly to our existing management fee contract with GRE, Rainbow will be responsible for funding all mine operating costs and securing all capital required to operate and reclaim the mine. This is very exciting news for everyone involved and I think it really highlights the kinds of things we're trying to accomplish with our Protect the Core strategy.

Turning to North American mining. Our team signed one new contract in the second quarter of 2021 to develop and operate a new aggregates operation in Indiana. This contract is with an existing customer who is a major US producer of construction materials. The team further advanced our growth efforts in late July by signing two contracts with the leading supplier of construction materials in North America to perform all mining operations at two sand and gravel quarries located in Texas and Arkansas. These last two new contracts which are expected to be accretive to earnings expand the range of contract mining services beyond the traditional scope of North American Mining's core, limestone mining business to include responsibility for all mining activities at these quarries and also further advance our expansion outside of Florida.

As I've said before, there's a lot of growth potential in this business and I note that North American Mining's pipeline of potential new projects remains strong. Our team at Catapult Mineral Partners is actively overseeing the performance of our owned royalty and mineral interests and continues to look for opportunities for us to invest. 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 very pleased with the way all of these businesses are advancing their strategies.

I would be remiss however if I don't mention that we were notified in mid-June that the contract mining agreement between our Bisti Fuels Company and the Navajo Transitional Energy Company will be terminated as of September 30 this year. NTEC will assume control and responsibility for operation of the Navajo Mine upon termination of the contract mining agreement. NTEC is responsible for all liabilities including mine reclamation and under the agreement is required to pay us a termination fee which is anticipated to be approximately $10 million. We're very proud of what we've accomplished over the last few years at the Navajo Mine. We did dramatically change and improve the safety culture at the mine and we advanced work on mine reclamation. We also got to know and work with a lot of great people at the mine and in the community. We wish NTEC continued success as they take over mine operations. Finally, I want to talk about our new branding which we announced last Friday.

My letter in the annual report mentioned that we were working on a plan that better describe our company and what we do. The result of that work was announced last week when we launched a new brand identity for our family of companies, which we referred to as NACCO Natural Resources. NACCO Industries is still the name of the public company. We created NACCO Natural Resources to be the unifying brand name for our portfolio of Natural Resources businesses. This new approach unifies our identity and underscores our commitment to all of our businesses while creating a new identity that will help us execute on our two key strategies, which are Protect the Core and Grow and Diversify. The introduction of natural resources honors our strong legacy as a leading 108-year-old mining company and recognizes our success in growing strong and competitive new businesses that leverage our core skills. And NACCO website contains overview information about NACCO Natural Resources and each of our businesses and it also provides investor information for NACCO Industries. We created new logos and websites for each of the operating businesses so that each business now has its own unique identity that can easily be linked back to our umbrella brand. After the call, please take some time to explore the websites and be sure to watch our branding launch video that was on the home page of nacco.com. I am very optimistic about our future 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 advance the ball with our new tagline of bringing natural resources to life.

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

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

Thank you, J.C. I'll start with the consolidated quarter results and then provide additional detail at the segment level. On a consolidated basis, our second quarter operating profit improved significantly, increasing 93.4% to $8.7 million from $4.5 million in 2020. Our consolidated net income also increased rising 7.5% to $6.5 million or $0.91 per share from $6.1 million or $0.86 per share last year and our consolidated adjusted EBITDA increased 39.4% to $15.3 million from $11 million in the prior year second quarter. These increases were primarily driven by improved results in all three of our operating segments, most significantly our Minerals Management segment. The increase in net income was not as significant as the other improvements, because of higher income tax expense as a result of an increase in our estimated annual effective income tax rate in the 2021 second quarter.

At our Coal Mining segment, operating profit and segment EBITDA increased primarily due to a reduction in costs for outside services at Centennial Natural Resources and the income associated with mine reclamation at Caddo Creek, partially offset by a decrease in earnings of unconsolidated operations, primarily from mining contracts that are no longer in place.

North American Mining second quarter 2021 operating profit increased over the prior year, mainly due to favorable changes in the mix of customer requirements. This improvement was partially offset by higher employee related costs, including medical costs and an increase in business development expenses. Segment adjusted EBITDA also increased due to the operating profit improvement and an increase in depreciation expense as a result of more equipment being placed in service to support activities related to newer contracts.

At the Minerals Management segment, second quarter 2021 operating profit and segment adjusted EBITDA increased significantly over 2020, primarily due to increased royalty income generated from newer wells on legacy Ohio mineral interests, as well as royalty income from the new mineral interest acquired in the fourth quarter of last year and in early May 2020 – 2021, I'm sorry. An increase in natural gas and oil prices also contributed to the improvement. Those are the significant factors affecting the second quarter results.

Now let me turn to our outlook. In the Coal Mining segment, we expect operating profit to increase significantly in both periods because of the anticipated cash receipt of approximately $24 million related to the pending termination of the Falkirk and Bisti Fuels customer contracts, which J.C. mentioned.

The fourth quarter of 2020 also included charges totaling $4.6 million that are not expected to reoccur. Excluding these items, we expect our 2021 operating profit to decrease in the second half and full year from 2020 levels. The decrease is primarily attributable to substantially lower earnings expected in the Mississippi Lignite Mining Company from the anticipated decline in profit per ton delivered and reduced earnings at the unconsolidated Coal Mining operations.

Excluding the $24 million termination related payments expected later this year and the $1.1 million asset impairment charge recognized in 2020, segment adjusted EBITDA for the second half of 2021 is expected to decrease from the prior year as a result of the reduction in operating profit. Segment adjusted EBITDA for the full year is expected to be comparable to last year.

At North American Mining, we expect tons delivered, operating profit and segment adjusted EBITDA to increase in the second half of 2021 over last year, primarily as a result of increased production under existing contracts and contributions from new mining contracts, partially offset by an increase in operating expenses mainly from higher employee-related costs as well as anticipated higher business development expenses.

Full year 2021 operating profit is expected to decrease moderately from last year because of the lower first quarter 2021 results. Segment adjusted EBITDA for the full year is expected to increase as the moderate reduction in operating profit will be more than offset by an increase in depreciation expense. The operating profit impact of the contracts that were executed in late July and discussed by J.C. are not included in our discussion of outlook because of the timing of contract execution but are expected to be accretive to earnings.

Finally, our Minerals Management segment operating profit and segment adjusted EBITDA is expected to decrease significantly in the second half of 2021 compared to the prior year second half once you exclude the impact of impairment charges taken in the 2020 fourth quarter. These decreases are primarily the result of the expected natural production decline curve of certain newer wells in Ohio. Royalty income generated from the mineral interests acquired in the fourth quarter of 2020 and in May of 2021 are expected to partly offset the reduced earnings and contribute to the expected increase in the full year operating profit and segment adjusted EBITDA over the last year.

On a consolidated basis, we expect our full year net income to be significantly higher than 2020 with an anticipated effective income tax rate for 2021 of between 13% and 15%, both resulting from the expected termination and release settlements associated with Falkirk and Bisti Fuels in the absence of prior year charges totaling $12.1 million. Excluding these items, we expect significantly lower net income as a result of substantially lower operating profit from lower earnings in the Coal Mining segment and higher unallocated employee-related and business development costs. We expect consolidated adjusted EBITDA to increase moderately over 2020 excluding the termination and relief payments and prior year impairment charges.

Moving away from results expectations, let me briefly provide some cash flow information. We ended the quarter with consolidated cash of $85 million and debt of $32 million, compared with consolidated cash of $79.1 million and debt of $44.4 million at the end of the first quarter. In addition, we had availability of $109.9 million under our revolving credit facility. As a result of the termination and lease payments, we are anticipating positive cash flow before financing activities in the 2021 full year as compared to significant use of cash last year.

Consolidated capital expenditures are now expected to be approximately $61 million for the 2020 full year, higher than we previously anticipated because it now includes amounts to support the expansion of contract mining services beyond North American Mining's historical dragline oriented model as well as expenditures related to moving to a new mine area at Mississippi Lignite Mining Company which we have previously discussed.

Now let me open up the call for your questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions]

<A – Christy Kmetko – NACCO Industries, Inc.>: Zenith, we have...

Operator: Your first question...

<A – Christy Kmetko – NACCO Industries, Inc.>: Go ahead.

Operator: Your first question comes from the line of Nachy Kanfer of Donovan Energy.

<Q – Nachy Kanfer – Donovan Energy>: Hi, folks. Can you hear me, okay?

<A – Christy Kmetko – NACCO Industries, Inc.>: Yes, we can.

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

<Q – Nachy Kanfer – Donovan Energy>: Thanks so much. Thanks for the informative presentation. Nachy Kanfer with Donovan Energy, just hoping you can give us a little bit more color on Mississippi Lignite, pretty thin profit margin and long term contract. How should we be thinking about forward-looking profitability for Mississippi Lignite as it relates to the 2032 end date on the contract? Thanks.

<A – J.C. Butler – NACCO Industries, Inc.>: Well the – so the way that contents – thanks for the question by the way. So, that the Mississippi Lignite contract, it's all requirements. It's mine-mouth operation. It is the one operation where we pay all the costs and we pay all the capital. We clearly over the last few years including this year have been investing quite a bit of capital, which we just had to do, because we were moving from one mine area to another one. You just have to advance this as you need additional coal requirements to fulfill the contract. The CapEx is adding pretty substantially to our forecast depreciation going forward, not surprisingly. And that is going to – as we've disclosed, that's going to adversely affect the operating profit margins out of that business. But because if you think about the capital, right, and we've said this we're going to spend a lot of capital in the last few years and this year. And then, there's really not a lot of capital going forward. So, I think in that business EBITDA probably – in that part of the business EBITDA becomes better representation of what's really going on because you don't have to replace your depreciation with additional CapEx.

So, I think operating profit is not going to be great, but I think EBITDA is going to show you really the kind of the cash on cash returns that are coming out of that business going forward. The price that we sell the lignite to our customer that is set it up – it's a formula price, it's not a market price that moves in line with a basket of indices, widely published indices that sort of reflect general inflation. So, as you look in – everybody's got their own views on where we're headed in inflation. Even if you just assume a moderate level of inflation, the price will continue to go up. We understand what our costs are. And then, you just have to factor in this depreciation piece. Is that helpful?

<Q – Nachy Kanfer – Donovan Energy>: Yeah. Thanks so much. And just one quick follow-up, any views on the underlying credit worthiness of your customer at Mississippi Lignite?

<A – J.C. Butler – NACCO Industries, Inc.>: No, no, I don't have any concerns.

<Q – Nachy Kanfer – Donovan Energy>: Thanks so much.

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

Operator: [Operator Instructions]

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

It appears we don't have any further questions, Zenith. J.C. do you have...

Operator: Yes. There are...

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

J.C. do you have any wrap up comments?

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

No, I do not. Thanks, Christy.

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

All right. Thank you everyone for participating. We do appreciate your interest. And if you do have any follow-up questions, my information is available on the earnings release and on the website. Thanks so much and have a fantastic day.

Operator: The replay of this call will be available two to four hours from now. Participants may dial 800-585-8367 or 855-859-2056 or internationally on 404-537-3406 and enter the conference ID number to listen. This concludes today's conference call. Thank you for participating. You may now disconnect.