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 Kuhn – Director, Focused Compounding Fund LP

MANAGEMENT DISCUSSION SECTION

Operator: Hello everyone and welcome to the NACCO Q2 2022 Earnings Conference Call. My name is Seth and I'll be the operator for your call today. There will be an opportunity to ask questions on the call. [Operator Instructions]

I will now hand the floor over to Christina Kmetko. Please go ahead.

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

Thank you. Good morning, everyone, and welcome to our 2022 second quarter earnings call. Thank you for joining us this morning. I'm Christina Kmetko and I am responsible for investor relations at NACCO Industries. Joining me today are J.C. Butler, President and Chief Executive Officer; and Elizabeth Loveman, Vice President and Controller. Yesterday, we published our second quarter 2022 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, could 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 will discuss our results for the quarter. But first, let me turn the call over to J.C. Butler, our President and CEO, 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. Second quarter 2022 was another very strong quarter for us. As I mentioned during our Q1 call, Rainbow Energy's purchase of the Coal Creek Station power plant in North Dakota from Great River Energy was finalized in early May. As a result, our second quarter coal mining segment earnings benefited from contract termination settlements received from our former customer Great River Energy. We received $14 million in cash and reported income – recorded income of $16.9 million related to our receipt of an office building in Bismarck, North Dakota, and membership units at a private company that produces ethanol. We're excited to have this transaction completed and enthusiastic to have Rainbow Energy as our new customer. As an independent, privately held energy marketers, I think they have a real understanding of the value of the power plant and its potential for the future.

At our coal mining segment, we continue to work diligently to support our existing customers so that they can continue to produce affordable and reliable energy. Although the coal mining industry faces ongoing political and regulatory challenges, we believe the use of coal as a fuel source for electricity in the United States will continue for the foreseeable future. We think there are more reasons to be optimistic about coal fired power generation today than at any other time in the last several years.

Turning back to the quarter, I'm pleased to report that our earnings improved significantly over the second quarter of 2021, even excluding the settlement with GRE, driven primarily by strong results in our Minerals Management segment. This improvement was partly offset by unfavorable changes in the fair value of certain exchange traded equity securities we own and an increase in unallocated employee related expenses. The strong earnings at Minerals Management were mainly due to significantly higher natural gas and oil prices in 2022. This quarter's results also benefited from a $2.4 million gain on sale of land related to legacy operations. We completed a small acquisition in the first quarter and the Catapult Mineral Partners team continues to look for attractive acquisitions of mineral and royalty interests that will allow us to continue to grow and diversify this business, while also promoting development of our existing mineral interests.

Our North American mining segment had an increase in revenues, but lower operating profit in the second quarter of 2022, as employee related costs rose over the prior year. And as I've said before, there's a lot of growth potential in this business, North American Mining continues to review potential new projects.

I'd also like to note that Lithium Americas continues to make progress on its Thacker Pass project. In July of 2022, Lithium Americas provided an update that noted all key state level permits have been issued and feasibility study results are expected in the second half of this year. These steps bring them closer to the start-up of this project. We continue to work closely with them as they advance the Thacker Pass project. The Mitigation Resources of North America team continues to work on existing mitigation projects and development of a number of interesting new projects. During the first half of 2022, Mitigation Resources purchased property to establish a new mitigation bank in Texas and finalized an agreement to provide mitigation services for the Lake Ralph Hall project, which is also in Texas. With these new projects, Mitigation Resources is involved in over 10 mitigation banks and permitting responsible mitigation projects and is making strong progress toward its goal to be a top 10 US provider of stream and wetland mitigation services. I'm very pleased with the way all of these businesses are advancing their strategies.

With that, I will 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 not already covered by J.C. On a consolidated basis, our second quarter operating profit rose significantly, increasing to $29.7 million, from $8.7 million in 2021. Consolidated net income also increased rising to $37.2 million or $5.07 per share from $6.5 million or $0.91 per share last year. As J.C. mentioned these increases were driven primarily by the contract termination settlements received from GRE.

Our second quarter consolidated adjusted EBITDA, which excludes the contract termination settlements, increased to $21 million, up 37% from $15.3 million last year. The increase was driven primarily by improved results in our Minerals Management segment and the add back of higher depreciation depletion and amortization expense.

Moving to the discussion of our segments, excluding the contract termination settlement, operating profit at our coal mining segment decreased moderately due to higher employee related costs and lower earnings at Mississippi Lignite Mining Company, mainly because of the impact of inflation on the cost per ton delivered. An increase in earnings from our unconsolidated mining operations, principally from an increase in contractual price escalation and increased customer requirements at Coteau partly offset these declines.

J.C. already discussed the primary drivers of the Lower North American mining operating profit. So let me focus on our second quarter 2020 segment adjusted EBITDA. Adjusted EBITDA was comparable to the prior year quarter as lower operating profit was fully offset by the add back of higher depreciation expense resulting from the acquisition of additional equipment to support newer contracts.

Finally, Minerals Management segment -- second quarter 2022 operating profit and segment adjusted EBITDA more than doubled from the prior year results. As J.C. said, the significant improvement was driven by higher natural gas and oil prices and the gain on sale of land. Those are the significant factors affecting our results.

Now let me turn to outlook. As we expect that, we expect the coal mining segment operating profit in both the second half and full year of 2022 to decrease significantly from 2021, both including and excluding the contract termination payments received from Bisti last year and GRE this year. We expect results at our consolidated mining operations to decrease significantly in the second half of this year from the prior year second half and the first half of 2022, primarily because of substantially lower earnings at Mississippi Lignite Mining this year.As a result of the anticipated increase in cost per ton, the 2022 full year results are expected to be substantially lower than last year.

Lower anticipated earnings at the unconsolidated coal mining operations is expected to be driven by the agreed to reduction in the per ton management fee at Falkirk from the May 1, 2022 transfer of Coal Creek Station through May 31, 2024, as well as the termination of the Bisti Fuels contract as of September 30, 2021. These are partly offset -- these were partly offset by higher earnings at Coteau.

We also expect an increase in operating expenses, mainly from anticipated higher employee related costs, professional fees and outside services.

Segment adjusted EBITDA, which excludes the contract termination settlement payments, is expected to decrease significantly in 2022 from last year, primarily as a result of the forecasted reduction in operating profit, partially offset by a higher add back of depreciation, depletion and amortization expense.

We expect North American Mining's operating profit to increase in both the second half of 2022 and for the full year over the same prior year period. The increase in the second half is primarily due to expected improved fourth quarter results, principally from a shift in mix of tons delivered to operations with higher margin contracts, partially offset by an anticipated increase in operating expenses.

North American Mining segment adjusted EBIDTA in 2022 is expected to increase significantly over the prior year because of the improved operating profit from higher reclamation income at Caddo Creek in the first half of this year and the add back of higher depreciation expense.

Moving to Minerals Management, excluding settlement income of $3.3 million recognized in last year's third quarter, we expect operating profit and segment adjusted EBITDA in the second half of this year to be comparable to the second half of last year, but decreased significantly compared with the first half of 2022, primarily driven by current expectations for natural gas and oil prices and an anticipated reduction in production volumes.

However, because of the substantial earnings in the first half of this year, we expect a significant increase in Minerals Management's full year 2022 operating profit over 2021.

To summarize, on a consolidated basis for the 2022 full year, excluding the contract termination settlements from GRE this year and Bisti last year, we expect consolidated operating profit and net income to decline moderately from 2021.

Lower operating profit in the coal mining segment is expected to be partially offset by an anticipated significant increase in earnings at the Minerals Management segment.

In addition, income realized in 2021 on owned exchange traded equity securities is not expected to reoccur due to a deterioration in public equity markets during 2022. Finally, we expect our consolidated adjusted EBITDA for this year to be comparable to 2021.

World events have caused volatility in natural gas and oil markets and resulted in an increase in the price of these commodities. While we are not able to speculate future changes in these markets, it is worth noting that continued high natural gas and oil prices could continue to enhance 2022 results in our Minerals Management segment, as well as in our coal segment as higher natural gas prices lead to higher coal dispatch at customer power plants.

Moving away from results expectations, let me briefly provide some cash flow information. We ended the quarter with consolidated cash of $97.1 million and debt of $18.4 million. In addition, we had availability of $119.9 million under our revolving credit facility. For the full year, we expect cash flow before financing activities to be significantly lower than in 2021 because of the anticipated high capital expenditures.

We will now turn to any questions you may have.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from Andrew Kuhn from Focused Compounding. Please go ahead.

<Q – Andrew Kuhn – Focused Compounding Fund LP>: Good morning, everyone. Great quarter.

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

<Q – Andrew Kuhn – Focused Compounding Fund LP>: Thank you. So should we think of the office building and the ethanol company membership unit to receive as being assets you're likely to hold for the long term? Or are these assets you would consider monetizing in some way if conditions were right?

<A – J.C. Butler – NACCO Industries, Inc.>: It's a good question. So the office building in Bismarck is – it's a very nice modern building. We're actually – and it's got a number of tenants in it. We're actually – now that we own it, we're evaluating the possibility of occupying part of that space ourselves. We currently rent space in an office building in North Dakota. But really isn't great space for our needs, although it's perfectly fine. So we are evaluating the possibility of moving our office over to that space. But it's – I would say that's a small amount of the space, the rest of it's rented. And after separate from that, we will continue to look at it as an asset that maybe it makes sense to own it. Maybe it makes sense to sell it. Real estate ownership for things like that's now part of our core business, and we'll just evaluate that as time goes on and see what makes the most sense whether to be the landlord, the building we occupy or rent from somebody else.

The membership interests in the ethanol plant, we actually have had an ownership stake in this ethanol business for a number of years because the ethanol plants are next to power plants where we supply the coal. And it made sense for us to invest in that business while it was developing because it increased the production of coal on the margin. What happens with the future of that is hard to tell. We've owned it for a number of years and we're happy to get additional membership and interest in that and I think but we're still minority owners, we're not a majority owner in the business, and we'll just monitor what happens there as well.

<Q – Andrew Kuhn – Focused Compounding Fund LP>: Got it. Thanks. And as does the shift planned equipment acquisition costs for Thacker Pass from 2022 to 2023 reflect a meaningful change in your expectation for the pace at which that project will proceed, or do you expect Thacker Pass to move ahead at about the schedule you originally expected?

<A – J.C. Butler – NACCO Industries, Inc.>: Well, the project itself. And I think you can see all this by studying Lithium America's announcements on their website. I mean, the project is behind where it was originally expected to be, but I think that's largely because the our customer has done a really thoughtful set of analyses around how they're going to develop the project and how we can work with them to do that. And I think that ultimately is leading to a larger project that's probably going to have a more meaningful impact on their business as well as ours in the future. The change in timing doesn't give me any concern at all. I think it continues to be a very attractive project. And certainly over the last few years, the demand for lithium, particularly domestic lithium, has only increased. So I feel very good about that project.

<Q – Andrew Kuhn – Focused Compounding Fund LP>: Right. And then do you expect that any future value changes in the office building, the private membership unit, the publicly traded equity security and the [indiscernible] (00:17:44) assets will all be recorded in the corporate segment or are some of these items going to be grouped within an actual operating segment?

<A – J.C. Butler – NACCO Industries, Inc.>: Liz, that sounds like a question for you.

<A – Liz Loveman – NACCO Industries, Inc.>: So those are all below operating profit. So they're below our segment results that we report. They're a component of other income.

<Q – Andrew Kuhn – Focused Compounding Fund LP>: So I guess the answer to that is no.

<A – Liz Loveman – NACCO Industries, Inc.>: Correct. Yes, it's below segment. We report segment operating profit and anything below that is reported on a consolidated basis.

<Q – Andrew Kuhn – Focused Compounding Fund LP>: Got it. Got it. All right. Well, thanks a lot. That's all I have for today. And keep up the great work. And I'll hop back in the queue.

<A – J.C. Butler – NACCO Industries, Inc.>: Great. We appreciate your interest.

Operator: [Operator Instructions]

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

That appears to conclude our Q&A session. Let me ask J.C., do you have any closing remarks this morning, we'll also post a transcript on the Investor Relations website, when it becomes available, if you do have any questions, please reach out to me. You can call me at the phone number that is available on the release. I hope you enjoy the rest of your day.

And now I'll turn back to Sam to conclude the call.

Operator: Thank you. This concludes today's conference call. As Christina said, a replay will be available and the replay details are as follows. If you're calling from the US, please call 1-929-458-6194. If you're calling from Canada, please call 1-226-828-7578 and enter the access code 279176. Once again, you're calling from the US, please call 1-929-458-6194. If you're calling from Canada, please use 1-226-828-7578 and the access code is 279176. Thank you. You may now disconnect your lines.