PARTICIPANTS

Corporate Participants

Christina Kmetko – Investor Relations Consultant, NACCO Industries, Inc.
J.C. Butler, Jr. – President, Chief Executive Officer & Director, NACCO Industries, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by and welcome to NACCO Industries' Q2 2023 Earnings 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.

Christina Kmetko, Investor Relations, you may begin your conference.

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

Thank you. Good morning, everyone, and welcome to our 2023 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 and Chief Executive Officer; and Elizabeth Loveman, Senior Vice President and Controller.

Yesterday, we published our second quarter 2023 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 to follow, including answers to your questions, contain forward-looking statements. These statements are subject to several 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've described in our earnings release, 10-Q and other SEC filings. We may not update these forward-looking statements until our next quarterly earnings conference call. We'll also 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.

With the formalities out of the way, I'll turn the call over to J.C. 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. Christy will go into more detail about our second quarter earnings and provide an overview of our outlook in a minute. But first, let me provide a few thoughts on the quarter and our future expectations. It's clear that our second quarter 2023 results were much lower than last year, but that was as expected and discussed last quarter, as well as at year-end. So the decline shouldn't come as a surprise. A significant portion of the decrease was because 2022 results included $30.9 million of pre-tax income received from the termination of Falkirk's contract with Great River Energy. The absence of these 2022 termination payments, however, was not the only reason for our earnings decrease. I'll discuss our results business by business.

First, on our North American Mining segment, operating profit increased substantially year-over-year and over the first quarter of 2023. The aggregates mining part of this segment struggled during 2022. I mentioned in the last quarter that we were implementing changes to drive improved future financial results and it's encouraging to see these improvements. That said, we're still early in this process and it is too soon to judge the full effect of these initiatives. But this is a good start. We still want to see profit improvements occurring on a constant basis. But I'm optimistic North American Mining can build upon this momentum.

The decrease in Caddo Creek reclamation income is partly offsetting the improvement in results at North American Mining's aggregates business. We are no longer recognizing reclamation income at Caddo Creek, because we purchased the membership interests at the Marshall Mine in March 2023 where Caddo Creek had been performing mine reclamation work. We are considering development of a utility-scale solar project at this location.

Wrapping up my North American Mining comments, let me quickly mention Sawtooth Mining, which is the exclusive contract miner for Lithium Americas' Thacker Pass lithium project in northern Nevada. Construction at Thacker Pass commenced last quarter and our customer tells us that they expect to begin Phase 1 lithium production in the second half of 2026. We began acquiring equipment for the project earlier this year. We're also currently recognizing income related to this project and expect to continue to recognize moderate income through 2025 with higher levels of income expected when our customer starts production in 2026.

Moving to our Mitigation Resources of North America business, this team continues to advance existing mitigation projects and build on the substantial foundation it has established over the past several years. I'm pleased to report that Mitigation Resources recognized income associated with credit sales this quarter, which contributed to a year-over-year earnings increase of 2.24 – sorry, $2.4 million in the 2023 second quarter. Mitigation Resources results were included within unallocated results.

I'm very pleased with the level of growth Mitigation Resources has achieved in its first five years and I'm very pleased with their prospects. This business is achieving real success and growing faster than we'd expected when we started it just a few years ago.

The increases I just discussed were not large enough to offset the decrease in earnings we experienced in our Coal Mining and Minerals Management segments in the 2023 second quarter compared to 2022. During our last two earnings calls, we've discussed that we expected 2023 results to decrease significantly.

I'll first address the Coal Mining segment. At Mississippi Lignite Mining Company, we're experiencing operational efficiencies as we complete final mining at the existing mine area, and we're also incurring significant costs associated with moving to a new mine area.

MLMC's Red Hills Mine has also had to contend with significant rainfall during the first half of the year, which has impacted production and increased costs. These higher costs and inefficiencies are expected to continue into the third quarter, but then begin to moderate during the fourth quarter when we anticipate being fully operational in the new mine area. You'll recall that we've invested significant capital to open up this new mine area, which is necessary to access coal needed for the remainder of the contract term.

These capital investments have resulted in increased depreciation expense that will continue over the remainder of the contract term. The added depreciation will affect reported operating profit, but those effects are excluded from EBITDA which, we think, is a better way to look at this part of our business since we don't expect MLMC to open additional mine areas through the remaining contract term. Mine development capital expenditures should moderate from 2024 through the end of the contract in 2032.

Shifting to Minerals Management, substantially, lower natural gas and oil prices led to a significant decrease in the second quarter 2023 results, compared with the 2022 second quarter. You'll remember that natural gas and oil prices were very high in 2022. We utilized market forecast for natural gas and oil prices, which project prices to remain below 2022 levels.

Of course, commodity prices are inherently volatile and changes in natural gas and oil prices could result in adjustments to our current forecast.

The team at Catapult Mineral Partners continues to look for opportunities to expand our portfolio through acquisitions of mineral and royalty interests, while also promoting development of our existing mineral and royalty interests. The group is targeting additional investments of up to $20 million in 2023.

On the upside, the development of new wells on existing owned reserves beyond our forecast or new investments could be accretive to future results.

Overall, I expect 2023 to be a year of unfavorable comparisons for the reasons I discussed. Despite this, I'm still very optimistic about our outlook, as we move beyond 2023. I have a lot of confidence in our team and I'm pleased with the way all of these businesses continue to advance their strategies, including efforts to protect our Coal Mining business.

With that, I'll turn the call back over to Christy to cover our results for the quarter and our 2023 outlook in more detail. Christy?

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

Thank you, J.C. I'll start with some high-level comments on our consolidated second quarter financial results and then add detail on our individual segments.

On a consolidated basis, income before tax decreased to $3.3 million from $45.1 million in the prior year. Consolidated net income decreased to $2.5 million or $0.34 per share, compared with net income of $37.2 million or $5.07 per share last year. EBITDA decreased to $9.2 million from $21 million in 2022.

These decreases were primarily due to significantly lower Coal Mining and Minerals Management earnings and, as J.C. discussed, the absence of the 2022 contract termination settlement. These lower results were partly offset by the improvements in Mitigation Resources and North American Mining's earnings, as well as lower unallocated employee-related expenses and higher other investment income.

The Coal Mining's second quarter 2023 operating profit and segment adjusted EBITDA decreased significantly compared with second quarter 2022, primarily due to the substantial decrease in Mississippi Lignite Mining Company results, as well as lower earnings at the unconsolidated operations. These declines were partly offset by lower employee-related costs. A decrease in Mississippi Lignite Mining Company results was driven by a significant increase in the cost per ton sold due to the inefficiencies and additional costs incurred to establish the new mine area J.C. mentioned. A $1.8 million write down of onsite coal inventory to net realizable value also contributed to the significant increase in the cost per ton.

A number of factors contributed to the lower earnings of unconsolidated operations compared with 2022. Coteau earnings decreased due to lower volumes and pricing. Falkirk earnings declined due to lower customer requirements and a decrease in the per ton management fee. And Sabine earnings decreased, because coal deliveries ceased on March 31st and mine reclamation activities commenced on April 1st. These lower earnings were partly offset by improved results at Coyote Creek due to increased customer requirements.

As J.C. already discussed, the primary reason behind the decline in [ph] Mineral Management's (00:11:01) results is significantly lower prices. To put this more in context, current natural gas prices as measured by the Henry Hub Natural Gas Spot Price declined 71% from 2022 and oil prices, as measured by the West Texas Intermediate Average Crude Oil Spot Price, decreased 32% from the prior year.

North American Mining's second quarter 2023 operating profit and segment adjusted EBITDA improved over 76% and 48%, respectively. This improvement was primarily due to an increase in parts sales and lower employee-related expenses. Overall, consolidated results are expected to continue to decrease in the third quarter before improving in the fourth quarter. The improvement in fourth quarter 2023 results will not offset the anticipated third quarter decline. Therefore, earnings in the second half of the year are expected to be lower than both the first half of 2023 and the second half of 2022, primarily driven by the items we've already discussed.

In addition, we expect the earnings of unconsolidated operations to decrease and contribute to the decline in Coal Mining operating profit. This is primarily due to the early retirement of the Pirkey power plant. Sabine is receiving compensation for providing final mine reclamation services, but at a lower rate than during active mining. Funding for Sabine's mine reclamation is the responsibility of the customer. A decrease in earnings at Falkirk and Coteau is also expected to contribute to the lower earnings of unconsolidated operations.

Shifting to North American Mining, we expect a continuation of improved operating results and segment adjusted EBITDA for the remainder of 2023, as well as for the full year compared with the prior-year periods. The second half increase is primarily because the second half of 2022 included an $800,000 charge for a voluntary retirement program. However, these results are expected to decrease from the first half of 2023.

Looking beyond 2023, we continue to remain optimistic about our long-term outlook. The Coal Mining segment expects increased profitability due in part to improvements at Falkirk once their temporary price concessions end and as Mississippi Lignite Mining Company moves to the new mine area.

As J.C. previously mentioned, opportunities for growth remain strong in the Minerals Management and Mitigation Resources businesses. In addition, earnings from the Sawtooth Mining lithium project are also expected to contribute to improved results in 2024 and 2025 and more significantly when production commences at Thacker Pass in 2026.

Lastly, from a liquidity standpoint, we ended the quarter with consolidated cash of $117 million and debt of $24 million. In addition, we had availability of $117 million under our revolving credit facility. For the 2023 full year, we expect cash flow before financing activities to remain positive, but be significantly lower than 2022 because of anticipated high capital expenditures, primarily for Sawtooth.

We will now turn to any questions you may have.

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corrected transcript

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions]

There are currently no questions at this time. I'll turn the call back to Christina Kmetko for closing remarks.

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

Thank you very much. I'll close with just a few reminders. A replay of our call will be available later 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 reach me at the phone number on the press release. I hope you enjoy the rest of your day. And I'll turn the call over to Josh to conclude the call.

Operator: Thank you. A digital recording of this conference will be available for replay in approximately two hours. The recording may be accessed until August 10, 2023, at 11:59 PM Eastern Time. To access the recording, please dial 1800-770-2030, again, that's 1800-770-2030 and enter the conference ID number to join the replay. Thank you very much. This does conclude today's call. You may now disconnect.