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# NACCO Industries, Inc. (NC)

Q4 2017 Earnings Call

## CORPORATE PARTICIPANTS

Christina Kmetko

*Investor Relations Consultant, NACCO Industries, Inc.*

John C. Butler

*President, Chief Executive Officer & Director, NACCO Industries, Inc.*

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## OTHER PARTICIPANTS

Mitchell Lolley

*Analyst, Goshawk Global Investments LLC*

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Good morning. My name is Lisa, and I will be your conference operator today. At this time, I would like to welcome everyone to the NACCO Industries 2017 Fourth Quarter and Full-Year Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speaker's remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

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

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Christina Kmetko

*Investor Relations Consultant, NACCO Industries, Inc.*

Thank you. Good morning, everyone, and welcome to our 2017 fourth 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 fourth quarter 2017 results and filed our 10-K. Copies of our earnings release and 10-K are available on our website at [nacco.com](http://nacco.com). For anyone who is not able to listen to today's entire call, an archive 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 is set forth in our earnings release and in our 10-K.

Now, that I have the formalities done, let's talk about the quarter. As we discussed on our third quarter call, we successfully completed the tax-free spin-off of our housewares-related businesses of Hamilton Beach Brands and Kitchen Collection on September 29, 2017. As a result of the spin, the 2017 and 2016 financial information in our earnings release and 10-K reflect the housewares business' operating results as discontinued operations.

Today's discussion will exclude the housewares business and focus only on income from continuing operations, as it reflects our post-spin ongoing business. In addition, as I explained last quarter, I will discuss segment results to pre-tax income and then cover taxes and net income at the consolidated level.

Now, let me discuss our results for the fourth quarter. Yesterday, we reported consolidated income from continuing operations of \$9.7 million or \$1.40 per diluted share, which includes the provisional tax benefit of \$4.5 million or \$0.65 per share related to U.S. tax reform. This compares with a consolidated loss from continuing operations of \$4.6 million or a loss of \$0.68 per share last year.

At our North American Coal business, pre-tax income increased in the fourth quarter of 2017 to \$8.2 million from \$1.1 million last year. The improvement was primarily due to higher royalty and other income, an increase in the earnings at our unconsolidated mining operations, and a reduction in lease expense, as well as the non-recurrence of a \$3.3 million charge in 2016 related to the resolution of a Centennial legal matter.

These improvements were partly offset by an increase in operating expenses and substantially lower results in Mississippi Lignite Mining Company. Mississippi Lignite's results declined because fewer tons were delivered and our cost per ton delivered increased.

Our NACCO and Other segment reported a pre-tax loss from continuing operations of \$2.4 million in the fourth quarter of 2017, compared with a loss of \$1.4 million in the prior-year fourth quarter. The loss increased primarily due to revisions of estimated long-term Bellaire mine reclamation expenses, partially offset by lower employee-related costs.

On a consolidated basis, we reported pre-tax income from continuing operations for the quarter of \$5.8 million and an income tax benefit from our continuing operations of \$3.9 million. For the full year, we reported consolidated income before income tax from continuing operations of \$29.1 million and an income tax provision on continuing operations of \$600,000.

As a result of the accounting we had to follow to allocate our full-year income tax expense between continuing and discontinuing operations and the benefit we reported in the fourth quarter as a result of U.S. tax reform, our 2017 effective income tax rate is not meaningful or indicative of our future expectations. Looking forward, we expect the consolidated effective income tax rate in the range of 9% to 12%.

On a consolidated basis, we expect our 2018 pre-tax income to decrease compared with last year as 2017 results included \$4.6 million of gains on sales of assets and a \$2.8 million favorable adjustment to Centennial mine reclamation liability, as well as higher royalty revenue.

Excluding these favorable 2017 items, we expect 2018 pre-tax income to increase compared with 2017, primarily as a result of lower operating expenses, improved income at both the consolidated and unconsolidated mining operations, and reduced interest expense. These improvements are expected to be partially offset by an anticipated substantial decrease in royalty and other income.

At our consolidated mining operations, Mississippi Lignite Mining Company's 2018 full-year results are expected to improve over last year because customer demand is expected to return to historical levels as a result of an anticipated reduction in outage days at our customer's power plant. While the total number of power plant outage days for the full year is expected to decline, a majority of these outage days are expected to occur in the second half of the year.

As a result, Mississippi Lignite Mining Company's pre-tax income in the first half of 2018 is expected to be comparable to the first half of 2017, while pre-tax income in the second half of the year is expected to increase over the second half of 2017.

We expect that income from our unconsolidated mining operations will be modestly higher in 2018 due in part to higher fees at Liberty Fuels and increases at our North American Mining's unconsolidated limerock mining operations.

Our Bisti Fuels' mining operation is expecting a slower start to the year, while the owners of the power plant it serves installed additional environmental controls at the plant. But, overall, Bisti's full-year 2018 pre-tax income is expected to be comparable to last year.

One additional item I'd like to discuss before I wrap up the operating results. As you may have already seen on February 8, 2018, our customer, Mississippi Power, instructed our Liberty Fuels mine to permanently cease all mining and delivery of lignite and to commence mine reclamation. The terms of our contract with Mississippi Power specifies that Mississippi Power is responsible for all mine closure costs and Liberty Fuels is specified as the contractor to complete final mine closures. We will receive compensation for these services. Overall, the customer's decision to close the mine does not negatively impact our 2008 (sic) [2018] earnings outlook for Liberty Fuels, but it does unfavorably affect North American Coal's long-term earnings potential from this mine.

Lastly, regarding our cash and our balance sheet, 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. Overall, we ended the fourth quarter with consolidated cash on hand of \$101.6 million, debt of \$58.1 million, and net cash of \$43.5 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. Our previously authorized share repurchase program expired at the end of 2017.

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. Your line is open.

Mitchell Lolley

*Analyst, Goshawk Global Investments LLC*

Q

Hi. What is the long-term potential of winning contracts in areas outside of the coal industry?

John C. Butler

*President, Chief Executive Officer & Director, NACCO Industries, Inc.*

A

Did you say outside of the coal industry?

Mitchell Lolley

*Analyst, Goshawk Global Investments LLC*

Q

Yes.

John C. Butler

*President, Chief Executive Officer & Director, NACCO Industries, Inc.*

A

Yeah. One of the things that we are focused on is how do we use the skills that we have to expand into other areas. The most significant example of that is our North American Mining business. Historically, that business has been maintaining and operating draglines for limerock producers in Florida. As you can see in our release, one of the customers that we picked up towards the end of last year also included operation of a rope shovel; it's a large piece of excavation equipment.

We think we can operate things other than draglines. We certainly have a lot of experience with a broad range of equipment at our coal mining operations. We're leveraging those skills to see what other services we can provide with respect to the limerock industry. And, quite frankly, there's no reason it has to just be limerock. We could certainly be helpful with the mining part of any other aggregates business as well. And we're in Florida. There's no reason we only have to operate the North American Mining business in Florida; there's a lot of aggregates in other states where we already operate, like Texas.

So your question is, what's the potential. I mean, really, the aggregates industry is huge. We don't want to be in the entire aggregates industry, but we think we've got a lot of relevant skills for the mining part. And then you just really look around the rest of our business and say, well, what pieces and parts of our core skill set could we leverage to provide other services for people. So it's not really an answer of what's the potential, but we think that we've got relevant skills that could be useful to other people as well.

Mitchell Lolley

*Analyst, Goshawk Global Investments LLC*

Q

Okay. And then, how much do you expect royalty income could be down next year?

John C. Butler

*President, Chief Executive Officer & Director, NACCO Industries, Inc.*

A

I don't think we disclose a specific amount. The royalties are related to oil and gas, primarily in Southern Ohio. And there's some coal royalties in there as well, the coal that's mined by third parties mainly in the East. It's incredibly hard to predict those numbers because it's really completely up to how those folks decide to extract oil, gas, or even mine the coal. So it's a tricky number to predict. It was pretty large last year. We think it was unusually large in 2017. But I guess what I hope is that it turn out to be the same or higher this year, but it's very hard for us to predict that number.

Mitchell Lolley

*Analyst, Goshawk Global Investments LLC*

Q

Okay. And then, lastly on CapEx, can you talk about some of the things you guys are spending on and maybe why that number's a little bit higher for 2018 now?

John C. Butler

*President, Chief Executive Officer & Director, NACCO Industries, Inc.*

A

CapEx at the unconsolidated mines, it's really the customer CapEx. So when we talk about CapEx, it's really CapEx only for any of the consolidated operations or something that might be at a corporate level. Our one main consolidated operation is Mississippi Lignite Mining Company. And from time to time, you need to replace pieces of equipment, and you need to replace large coal trucks, or significant parts of a dragline, or other pieces of equipment that generally have pretty long lives. You'll spend several million dollars on it, you'll run it for a very long time, and then ever so often you've got to buy more; you've got to replace those.

We do, from time to time, also have to make investments in land because we're going to move into a new mine area where we need to control the property where we're going to mine. So it's very lumpy and we'll go through periods when it's low and then we'll have some years when it's higher just because of the lumpiness of replacing those significant pieces of equipment.

We also are spending some capital at our North American Mining business that I mentioned earlier, the limerock business. In some instances, those are pieces of equipment that we think can be useful to customers that we either currently have or that we might be able to secure in the future. We also, as we've expanded into Central Florida, have needed to establish a new home base in Central Florida that we can operate out of. I mean, that's really the answer to the CapEx question.

Mitchell Lolley

*Analyst, Goshawk Global Investments LLC*

Q

Okay. Is it fair to say at all that CapEx in 2018 could be maybe slightly elevated versus what it looks like in future years after 2018?

John C. Butler

*President, Chief Executive Officer & Director, NACCO Industries, Inc.*

A

We don't really give outlook into future years. It really is going to depend on what are the ongoing capital needs of the operations that I just mentioned.

Mitchell Lolley

*Analyst, Goshawk Global Investments LLC*

Q

Okay. Thank you.

John C. Butler

*President, Chief Executive Officer & Director, NACCO Industries, Inc.*

A

Thank you.

**Operator:** [Operator Instructions] We have no questions in queue. I'll turn the call back to the presenters.

Christina Kmetko

*Investor Relations Consultant, NACCO Industries, Inc.*

All right. Thank you very much. We don't have any final wrap-up comments here. So we thank you for, all, joining us today. We appreciate your interest. And if you do have any additional questions, I can be reached at 440-229-5130. Have a good day.

**Operator:** Thank you for participating in today's NACCO Industries Fourth Quarter and Full-Year Earnings Conference Call. This call will be available for replay beginning at 11:00 AM Eastern Standard Time today through 11:59 PM Eastern Standard Time on March 15. The conference ID for the replay is 6291859. Again, the conference ID for the replay is 6291859. The number to dial for the replay is 800-585-8367 or 855-859-2056 or internationally on 404-537-3406. This concludes today's conference call. You may now disconnect.

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