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EDITED TRANSCRIPT

NC - Q2 2015 NACCO Industries Earnings Conference Call

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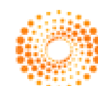

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CONFERENCE CALL PARTICIPANTS

Michael Axon *Moab Capital Partners - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen and welcome to the NACCO Industries, Inc., 2015 first-quarter earnings conference call. (Operator Instructions) As a reminder, this call is being recorded.

I would now like to turn the call over to Christina Kmetko. You may begin.

Christina Kmetko - *Evergreen Consulting & Associates, LLC - IR*

Thank you. Good morning, everyone, and welcome to our 2015 second-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 on today's call are Al Rankin, Chairman, President, and Chief Executive Officer; J.C. Butler, the Senior Vice President Finance, Treasurer, and Chief Administrative Officer of NACCO as well as the President and Chief Executive Officer of North American Coal; and Elizabeth Loveman, NACCO's Vice President and Controller.

Earlier this morning we published our second-quarter 2015 results and filed our 10-Q for the three and six months ended June 30, 2015. Also, copies of our earnings release and 10-Q are available on our website at NACCO.com.

For anyone who is not able to listen to listen to today's entire call, an archived version of this webcast will be on our website later this afternoon and available for approximately 12 months. Before 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 earnings conference call, if at all. Additional information regarding these risks and uncertainties was set forth in our earnings release and in our 10-Q..

Also, certain amounts discussed during today's call are considered non-GAAP. The non-GAAP reconciliations of these amounts are included in our 2015 second-quarter earnings release available on our website.

Now let's discuss the quarter. Of most significance is our news that management recommended and the Board of Directors approved permanently discontinuing operations at North American Coal's Centennial Natural Resources mining operations in Alabama by the end of 2015. This Board action is the culmination of our ongoing monitoring and evaluation of the Centennial business, as we have discussed at length in previous quarters.

With this closure we are substantially insulating North American Coal from exposure to fluctuations in market prices of coal. While this action did not result in any charges during the second quarter, I wanted to mention it first. I will discuss the shutdown plan in more detail shortly; but first let me discuss our operating results.

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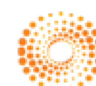

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Results in this quarter improved over last year's second quarter, but much of that improvement is attributable to the non-recurrence of a number of unfavorable items that occurred in the 2014 second quarter. Consolidated revenue was $196.5 million in the second quarter of 2015, down modestly from $200.4 million in 2014. We also reported a net loss of $300,000 or $0.04 per share for the 2015 second quarter, versus a net loss of $3.6 million or $0.47 per share last year.

Here's how our quarterly results break down by business unit, starting with North American Coal. North American Coal's revenues decreased substantially from last year; however the coal business reported higher net income of $4.2 million this quarter, compared with a net loss of $100,000 for the second quarter of 2014.

Included in the prior-year net loss were two large charges that did not reoccur this year. Last year we recognized a $1 million after-tax charge related to a customer defaulting on its contractual payment obligations. We also recorded a charge of $1 million pretax to reimburse a customer for damage to equipment.

The absence of these charges, improved operating results at the Mississippi Lignite Mining Company; and a $700,000 pretax gain on the sale of assets contributed to the improved net income. However, the absence of a $1.4 million discrete tax benefit recorded in the 2014 second quarter and a decrease in royalty income partially offset the improved earnings.

Clearly we were disappointed in Centennial's results this quarter. Results at Centennial continue to be negatively affected at an accelerating rate by worsening conditions in the Alabama and global coal markets.

During the quarter, reduced customer volumes resulted in increased per-unit production costs, while average sales price per unit continued to decline. Accordingly, the improvements in operating results and cash flow before financing we had anticipated for this quarter did not occur.

In addition, Centennial's outlook for the remainder of 2015 and beyond deteriorated further due to the receipt in June 2015 of notification of additional tightening of a customer's thermal coal quality requirement in connection with the implementation of the US Environmental Protection Agency's MATS regulations, which would result in increased coal processing costs and a reduction in tons that could be sold for power generation.

These factors, along with further deterioration of coal prices and declining demand, would have led to more substantial cash loss expectations than previously anticipated had Centennial continued to operate. These were the factors that led to the decision to permanently discontinue operations at Centennial by the end of the year.

Coal production at Centennial's one remaining active mine area will conclude during the second half of 2015. Coal produced and any remaining coal inventory will be sold to satisfy our customer requirements.

Equipment and parts inventory not needed for reclamation activities will be evaluated for sale. The Alabama mineral reserves will also be evaluated and sold as appropriate, taking into account that certain reserves contain substantial un-mined coal tons. We expect to complete the sale of most equipment and reserves as quickly as is reasonable to maximize cash flows.

As a result of the decision to permanently discontinue Centennial's operations, we expect to incur estimated pretax charges of $500,000 to $1 million for severance and other employee benefit costs during the second half of 2015, as we substantially reduce employment levels at Centennial during the remainder of the year. We also expect to recognize up to $15 million for administrative and other costs associated with mine reclamation that otherwise would have been recognized in the future had Centennial continued to produce coal.

These charges are in addition to the existing $16 million mine reclamation liability already accrued as of June 30, 2015. We expect that most of these charges for severance and administrative and other costs associated with reclamation will be recognized in the third quarter and are expected to result in future cash expenditures, with the future cash expenditures related to mine reclamation continuing until final mine reclamation is complete.

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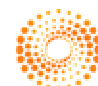

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From a broader strategic perspective, Centennial represents the only operation where we have direct exposure to changes in market prices for coal. The decision to close Centennial substantially insulates us from fluctuations in domestic and international coal pricing.

All of North American Coal's current and in-development mining operations operate under long-term management fee contracts, other than the Mississippi Lignite Mining Company, which operates under a long-term fixed-price coal sales agreement. All of these contracts include contractual escalators utilizing various indices to adjust the applicable management fee or fixed price.

Excluding the Centennial operations, North American Coal's other consolidated mining operations are expected to have strong results, with overall improved operating performance in the second half of the year compared with the same period last year, with the majority of the improvement coming in the fourth quarter. At the Mississippi Lignite Mining Company, tons sold and results from operations are expected to be higher in the remainder of 2015 than in the second half of 2014, when a significant planned outage took place at the customer's power plant. No outages are planned for the remainder of this year.

At the Limerock Mining operations, deliveries in the remainder of 2015 are expected to be lower than the second half of 2014 as a result of reduced customer requirements. We expect operating results at the unconsolidated mining operations to improve moderately due to an expected increase in steam coal tons delivered in the remainder of the year over the same period last year, based on customers' currently planned power plant operating levels and as a result of production increases at the newer mines.

Finally, we also expect a decline in royalty and other income in the second half of the year compared with 2014.

Overall for our core North American Coal operations, excluding the 2014 asset impairment charge of $66.4 million after-tax and the 2014 gains on the sale of assets, as well as the Centennial operations and related shutdown costs, we expect income before income taxes for the second half of 2015 to increase substantially over the second half of 2014. And we expect cash flow before financing activities to be significant as compared with negative cash flow before financing activities realized in the second half of last year.

Planned capital expenditures during the remainder of the year are expected to be $6 million, bringing the full year in at $8.1 million, a decrease from the $24.1 million of capital expenditures projected for 2015 at the end of 2014. The reduction reflects appropriately reduced capital expenditures at Centennial and reduced capital expenditures at Mississippi Lignite Mining Company, resulting from delaying replacement expenditures and developing less capital-intensive mine plans, as part of our continued efforts to manage capital employed at appropriate levels.

Now let me turn to Hamilton Beach. Hamilton Beach's net income was $1.6 million for the second quarter, compared with net income of $1.4 million last year. Included in these results is a full quarter of our recent acquisition, Weston Brands, which Hamilton Beach acquired in December of 2014.

Revenues increased 9% including Weston sales, and 6% excluding Weston. While both operating profit and net income in the current quarter increased over last year, the 2014 results included an environmental charge of $1.8 million after-tax.

Excluding the effect of the prior-year environmental charge, net income and operating profit actually decreased and gross profit declined despite higher volumes, and Hamilton Beach realized unfavorable foreign currency movements of $600,000 pretax as well as higher selling, general, and administrative expenses.

Gross profit declined as a result of increased sales of lower-margin products, an increase in product costs, and an increase in transportation and warehousing costs resulting from the higher volumes, while selling, general, and administrative increased mainly due to higher employee-related expenses pending inclusion of Weston Brands, partially offset by lower advertising.

Improvements are expected in Hamilton Beach in the remainder of 2015. While the economy appears to be improving, Hamilton Beach's target consumer continues to remain under pressure financially. This situation, coupled with weak consumer traffic to retail locations, is creating continued uncertainty about the ongoing growth prospects for the retail market for small appliances.

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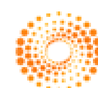

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As a result, sales volumes in the middle-market portion of the US small kitchen appliance market in which Hamilton Beach's core brands participate are projected to grow only moderately in the remainder of 2015. On the other hand, we believe the underlying market conditions in the hunting, gardening, and food enthusiast markets will continue to generate increasing interest and demand in the categories in which Weston Brands participates.

However, the Canadian retail market is expected to experience more difficulty than the US market because the Canadian economy continues to struggle. We also expect other international markets and commercial product markets in which Hamilton Beach participates to grow moderately in the second half of 2015 compared to the second half of 2014.

Despite these market conditions, we expect sales volumes in Hamilton Beach's core small appliance business to grow more favorably than the market in the latter half of 2015, due to increased distribution of its products. In addition, we believe there are a number of existing placements and market opportunities that can be secured for the Weston branded business, although the lower-margin private-label business is expected to experience reduced distribution over time, resulting from fewer placements at a key customer account.

Due to the seasonality of the business, we expect Weston's revenues to be significantly higher in the second half of the year than in the first half. Finally, we anticipate sales volumes of international and commercial products to grow throughout the remainder of 2015 compared with the same period last year as a result of the Company's strategic initiatives.

Overall we expect net income in the second half of this year to be moderately higher than the second half of last year, with a substantial increase in net income expected in the third quarter, partially offset by lower net income in the fourth quarter due to currently projected retailer order patterns. The integration of the Weston Brands acquisition is proceeding smoothly and expected synergies are ahead of schedule.

The anticipated increase in sales volumes attributable to the continued implementation and execution of Hamilton Beach's strategic initiatives, along with a full year of revenue from Weston resulting from the acquisition, are expected to be partially offset by a full year of operating expenses for Weston, including the charges for amortization on acquired intangibles. Costs to implement Hamilton Beach's strategic initiatives, expected increases in employee-related and advertising costs, and the absence of a $1.6 million discrete tax benefit realized in the second half of 2014 are also anticipated to partially offset the benefits from increased sales volumes. In addition, the negative effects of foreign currency fluctuations are currently expected to increase in the second half of this year compared with last year.

Excluding the cash paid for the acquisition of Weston Brands, we expect Hamilton Beach's cash flow before financing activities in 2015 to be higher than 2014. Capital expenditures are expected to be $5.4 million over the remainder of this year.

Finally, our Kitchen Collection business continued to improve significantly in the second quarter despite seasonal weakness. While revenues continued to decline, mainly as a result of the closure of a significant number of stores since the second quarter of 2014, results continued to improve.

Kitchen Collection reported a lower net loss of $1.8 million in the second quarter, a substantial improvement from a net loss of $2.7 million last year. Results improved primarily because of improved operating margins at Kitchen Collection comparable stores due to fewer promotional sales and markdowns, a shift in mix to higher-margin products, and the reduction in store expenses. The closure of unprofitable stores also contributed to the reduced net loss.

Consumer traffic to mall locations continued to decline in the first half of 2015. Despite an economy which is showing signs of improvement, the middle-market consumer remains under pressure, which is expected to continue to limit consumer spending in housewares for Kitchen Collection's target customer. As a result we expect continued market softness throughout the remainder of 2015.

In this context, Kitchen Collection closed 20 stores in the first half of the year, which in large measure completes Kitchen Collection's program of closing underperforming stores to realign the business around a core of Kitchen Collection stores which perform with acceptable profitability. Kitchen Collection plans to maintain a lower number of stores in the remainder of 2015; and as a result, we expect revenues in the second half to increase compared with the second half of 2014.

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Overall we expect a substantial increase in Kitchen Collection's net income for the second half of 2015 compared with the second half of last year, primarily in the fourth quarter. Kitchen Collection expects to close its one remaining Le Gourmet Chef store during the third quarter and focus its growth on its core Kitchen Collection stores, adding stores cautiously through new stores positioned in optimum locations in strong outlet malls.

The net effect of closing stores early in 2015 and the anticipated opening of a small number of new stores during the second half of 2015, as well as the ongoing program to reduce the expense structure and lower store closure expenses in the fourth quarter, are expected to contribute to continued improvements in operating results throughout the second half of this year, ultimately leading to anticipated roughly breakeven results for the full year. As a result of these comprehensive realignment actions, we believe Kitchen Collection's remaining core stores will be well positioned to take advantage of any upturn in consumer traffic.

We expect cash flow before financing activities to be positive again in 2015, but down from the level generated last year. Capital expenditures are expected to be $800,000 for the remainder of 2015.

Before I open up the call for questions I want to note that for the six months ended June 30, 2015, we repurchased $16 million of Class A common stock under our $60 million stock repurchase program. Since the program began in November 2013, we have repurchased approximately 972,900 shares for an aggregate purchase price of $52 million.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Michael Axon, Moab.

Michael Axon - *Moab Capital Partners - Analyst*

I'm trying to get an idea of what your consolidated line operations are going to look like without Centennial, and I just wanted to confirm a few things. Looks like your production ex- Centennial is around 3 million tons per year and that that's all, or essentially all, from Mississippi Lignite. Is that correct?

Al Rankin - *NACCO Industries, Inc. - Chairman, President, CEO*

I'm sorry. Could you say that again? What was your question?

Michael Axon - *Moab Capital Partners - Analyst*

I'm trying to confirm that your consolidated coal production, not including Centennial, is around 3 million tons.

Al Rankin - *NACCO Industries, Inc. - Chairman, President, CEO*

You're talking about the consolidated mines?

Michael Axon - *Moab Capital Partners - Analyst*

Correct.

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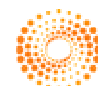

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Al Rankin - *NACCO Industries, Inc. - Chairman, President, CEO*

Not the total Company as a consolidated entity?

Michael Axon - *Moab Capital Partners - Analyst*

Right. The consolidated operations -- yes, the consolidated mines. I'm trying to confirm that's around 3 million tons per year and that that's essentially all Mississippi Lignite.

J.C. Butler - *NACCO Industries, Inc. - SVP Finance, Treasurer, Chief Administrative Officer, North American Coal President & CEO*

That's correct.

Michael Axon - *Moab Capital Partners - Analyst*

Okay. You mentioned that there's a fixed-price contract. Can you talk about the terms of that? The length; if there are any minimum volumes; and given where your costs are, what types of margins per ton you're getting on that contract.

Al Rankin - *NACCO Industries, Inc. - Chairman, President, CEO*

Let's be clear. It's a fixed price with escalators.

Michael Axon - *Moab Capital Partners - Analyst*

Okay.

Al Rankin - *NACCO Industries, Inc. - Chairman, President, CEO*

So the objective is to -- it's a different structure from our other mines, but the objective over time is that inflation is compensated through escalators rather than being a cost-plus contract as many of our others are. So I think that it's not a free-market contract in any sense of the word.

It's basically a mine-mouth coal operation supplying the power plant that is on top of that coal mining reserve operation. So I think you really want to think about it in those terms, and that's the overview comment I would have.

Michael Axon - *Moab Capital Partners - Analyst*

Got it. So, given the fixed cost with escalators -- fixed prices with escalators and where your costs are, what kind of margins per ton does that equate to, just generally?

Al Rankin - *NACCO Industries, Inc. - Chairman, President, CEO*

We don't put information at that level into our public disclosures.

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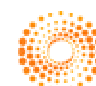

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Michael Axon - *Moab Capital Partners - Analyst*

Okay. How long is the contract for, and are there any minimum volumes?

J.C. Butler - *NACCO Industries, Inc. - SVP Finance, Treasurer, Chief Administrative Officer, North American Coal President & CEO*

There are no minimum volumes, although you should -- as Al mentioned, it is a mine-mouth operation. So 100% of the coal out of that coal mine supplies 100% of the fuel for that power plant.

Al Rankin - *NACCO Industries, Inc. - Chairman, President, CEO*

So that's the important point, is that power plant can only operate with our fuel.

Michael Axon - *Moab Capital Partners - Analyst*

Got it. Okay. So what is the risk for that power plant? Any risk to their requirements either from a slowdown in the plant production or any regulatory risk to that plant, etc.?

Al Rankin - *NACCO Industries, Inc. - Chairman, President, CEO*

The biggest risk is the one that we have had for many years. It's the ups and downs of demand from TVA ultimately. If power demand goes down, if the weather is different from normal patterns you use more or less power; and that plant can have higher or lower demand.

Secondly, there's a risk of outages. I think our point of view is that the current owners of that power plant have really taken some actions that are going to significantly improve the uptime of the power plant and therefore the demand for our coal. So we feel pretty good about that and about the prospects for the near term.

I think the biggest open issue is what happens under the EPA regulations that have been announced. That's very unclear at this point. We'll be looking to determine as best we can the implications.

But in any event nothing really happens to that plant under any circumstances that we can see at the moment prior to 2022. So our expectation and our hope is that, because of the nature of that plant, that it will continue to be required in Mississippi as a key component of the grid network in Mississippi. But we're going to have to look at the regulations and the state is going to have to ultimately develop some kind of plan.

But in the meantime there's going to be an enormous amount of litigation over that, over those EPA regulations, and we'll just have to see. But for the next significant period of time it's going to be simply a matter of supplying the requirements of that power plant, and we believe that the uptime of that plant is going to be better than it has historically been.

But there's always a risk, to your point, of unplanned outages of one kind or another. But that goes with every power plant we have.

Michael Axon - *Moab Capital Partners - Analyst*

Got it. Okay. Then moving over to the unconsolidated mines, it looks like your earnings are around $50 million per year. I think your production is around 26 million tons per year.

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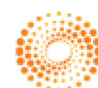

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You talk about a target of increasing your earnings from $45 million by about 50% by 2017, so that would imply $65 million to $70 million of earnings. Can you break out how much of that improvement is going to be an increase of number of tons, versus an increase in your margin per ton due to escalators?

Al Rankin - *NACCO Industries, Inc. - Chairman, President, CEO*

I would encourage you to think differently about the question. We have several new mines that are coming on stream increasingly, J.C., over the next two years or -- two to three years?

J.C. Butler - *NACCO Industries, Inc. - SVP Finance, Treasurer, Chief Administrative Officer, North American Coal President & CEO*

Two to three years.

Al Rankin - *NACCO Industries, Inc. - Chairman, President, CEO*

And the largest portion of that comes from the contracts that underpin those mining operations. Those are all cost-plus mining operations.

Really the margin per ton is not the right -- it's not the metric for thinking about it. It's really the number of tons and the basic profit structure per ton in those mines.

You've got kind of a result for each individual mine. But the point really is that the largest impact comes from the new mines coming onstream. Then secondly, the escalators that are applied to the existing mines --

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J.C. Butler - *NACCO Industries, Inc. - SVP Finance, Treasurer, Chief Administrative Officer, North American Coal President & CEO*

To all of them, all contracts.

Al Rankin - *NACCO Industries, Inc. - Chairman, President, CEO*

-- all of the contracts, will over time increase the earnings from those mines as well. And those two factors account for the entire rationale for laying out the objective of increasing our profits from the unconsolidated mines.

So that's the way I would encourage you to think about it, is to look at the individual new mines that are coming onstream, the timing of those. Those are what are going to determine the profitability and our ability to reach that objective.

J.C. Butler - *NACCO Industries, Inc. - SVP Finance, Treasurer, Chief Administrative Officer, North American Coal President & CEO*

Yes, and I would just add some clarity on the timing. The five new mines have all come online or will come online between 2012 and 2017. Some of those have already come online since 2012, but all five of those come online.

Al Rankin - *NACCO Industries, Inc. - Chairman, President, CEO*

And some of them have a pattern of not achieving their full utilization of the power plant that they're serving or the operation they're serving right away.

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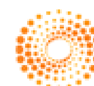

J.C. Butler - *NACCO Industries, Inc. - SVP Finance, Treasurer, Chief Administrative Officer, North American Coal President & CEO*

Right. There's a ramp-up.

Al Rankin - *NACCO Industries, Inc. - Chairman, President, CEO*

The volume builds, there's a ramp-up over time. That is particularly true at the Mississippi mine where there's an extended process of coming up to full volume as all different aspects of that very complex new power plant in Mississippi come online.

J.C. Butler - *NACCO Industries, Inc. - SVP Finance, Treasurer, Chief Administrative Officer, North American Coal President & CEO*

It's the Liberty mine in Mississippi.

Al Rankin - *NACCO Industries, Inc. - Chairman, President, CEO*

Liberty.

Michael Axon - *Moab Capital Partners - Analyst*

Got it. My recollections of the length of those contracts is very long, like 25 years in some cases. Is that the life of the mine? Or do these contracts expire before the expected life of the mine terminates?

J.C. Butler - *NACCO Industries, Inc. - SVP Finance, Treasurer, Chief Administrative Officer, North American Coal President & CEO*

All of these mines were built -- all of the mines that fuel power plants were all built in relationship to the mine. The mine plans are developed and the contracts are developed so that the two operate the same way. The life of the power plant is generally believed to be the life of the coal mine as well.

Al Rankin - *NACCO Industries, Inc. - Chairman, President, CEO*

But it is frequently true that there are more reserves and that the power plant runs longer.

Michael Axon - *Moab Capital Partners - Analyst*

Got it. Similar to your mine in Mississippi, I assume there aren't any minimum volumes. But essentially the plant is going to need to get all the coal from your mines; is that right?

J.C. Butler - *NACCO Industries, Inc. - SVP Finance, Treasurer, Chief Administrative Officer, North American Coal President & CEO*

That's correct.

Michael Axon - *Moab Capital Partners - Analyst*

Okay. Then what's the risk there of the -- those plants either slowing down or competing with alternative fuels, or any environmental changes in regulation that might threaten those power plants? If you can just talk about that qualitatively.

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J.C. Butler - *NACCO Industries, Inc. - SVP Finance, Treasurer, Chief Administrative Officer, North American Coal President & CEO*

I would say the new Clean Power Plan that came out on Monday, I think there's a lot of uncertainty about how that plan would work. It's changed -- at least from what I'm understanding on very early reads of a very complex rule -- there's some pretty significant changes from the draft plan that was circulated a year ago. People are still trying to assess what that means on a state-by-state basis. It's at this point just too early to tell.

Michael Axon - *Moab Capital Partners - Analyst*

Okay. Of the power plants that you supply, are they in your estimation more or less threatened by what may happen on the regulatory front?

J.C. Butler - *NACCO Industries, Inc. - SVP Finance, Treasurer, Chief Administrative Officer, North American Coal President & CEO*

I'd say that the coal-fired power plants that we supply coal to for the most part are -- and this is information that's widely available in the industry if you dig into power plant data -- these are baseload power plants. Historically the United States economy has worked off of power that is dispatched based on cost; and you dispatch the lowest cost first and you work your way up.

Coal-fired baseload power generation, like nuclear power generation, is amongst the lowest-cost, large-scale power generation units you can have. Hydro of course is also cheap. Everything else is more expensive and gets dispatched later.

So for the most part these are baseload power plants that are dispatched based on cost, and they run all the time. They are good, solid, sound plants that our customers have invested in significantly over the last several decades, including very recently.

Al Rankin - *NACCO Industries, Inc. - Chairman, President, CEO*

Yes. I would just emphasize that last point, that in the broad structure of coal-fired power plants that are out there operating today, ours are generally very efficient, are newer than many.

J.C. Butler - *NACCO Industries, Inc. - SVP Finance, Treasurer, Chief Administrative Officer, North American Coal President & CEO*

And larger than many.

Al Rankin - *NACCO Industries, Inc. - Chairman, President, CEO*

And larger than many. So they're very important to the grid, and several of them or at least a couple of them are placed in areas where it's very important in terms of maintaining power availability just from a locational point of view.

So in the general scheme of things we think our power plants are rather well positioned. I mean our customers' power plants are rather well positioned.

And as J.C. said, their fuel really has to be the coal that the power plant is sitting on. There is no alternative fuel to fire those plants unless they were to undertake massive investments, which they have no intention of doing.

Michael Axon - *Moab Capital Partners - Analyst*

What would be the most likely alternative source of power that could displace your customers' power usage? Is it hydro? Is it something else?

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J.C. Butler - *NACCO Industries, Inc. - SVP Finance, Treasurer, Chief Administrative Officer, North American Coal President & CEO*

Well, hydro only exists where there is both the water availability and the geology that provides enough gravity in order to do that. As we all know the EPA also and other government agencies don't like dams, so hydro I think is questionable.

Technologically today I've certainly never heard anyone say that there's any sort of solar or wind technology that can come close to replacing coal-fired generation in the United States. The amount of geography that would be required for that with current technology is just staggering. There's no way that could happen.

So then you really get to natural gas units and nuclear units. As we all know, nuclear units are practically impossible to get permitted today. It literally costs billions of dollars to get one of those just permitted, let alone built, and can take up to 10 years.

So then you really get to natural gas, which in the preliminary EPA Clean Power Plan it appeared that it was a shift from coal to natural gas. Again, reading mostly newspapers, the early read on the most recent plan is that the EPA doesn't want there to be any increase in gas.

So you look at this and say: I honestly don't know how they think power is going to be provided in the United States if we're going to shut down coal and not add a lot of gas. It just doesn't make sense to me. But the courts are going to sort that out.

Al Rankin - *NACCO Industries, Inc. - Chairman, President, CEO*

There's going to be a huge amount of analysis that is done, a lot of assessment of options. The states are meant to be coming together with a plan.

But if you look at the things that are being said politically at the moment, they tend to be that these new power sources aren't going to cost more than the existing power sources. And we find that very, very difficult to believe and think it's just not likely to be true.

And number two, that these regulations will force new technology to emerge which can substitute for coal and natural gas. So they're making big bets that nuclear will be more attractive in the future then it is; they're making big bets that solar and wind and battery development for storage of energy are going to change dramatically.

But experience is these don't happen in the kinds of time frames that this regulation seems to be pointing to. So I think one of the biggest debates will be over the time frame for implementation of these rules.

For example, if you look to the natural end of life of our power plants, and these plants run through their natural life and then they're replaced by something else, you can imagine that by 2035 or 2040 or 2050 that there will be some new technologies available that can be helpful. But by 2022, this is really hard to envision.

So you would like some more specificity. We would like more specificity. And I don't think either of us are going to get it for the time being at this point.

J.C. Butler - *NACCO Industries, Inc. - SVP Finance, Treasurer, Chief Administrative Officer, North American Coal President & CEO*

But just to summarize, I would say as we look across the horizon of this un-yet-digested new rule and how that's actually going to shake out, I feel very good about the fact that we have these mines that we have which produce very low-cost fuel for our customers, who operate very well-maintained, very efficient, very sophisticated coal-fired power plants. I think we are as well positioned as anybody can be given where we are.

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Michael Axon - *Moab Capital Partners - Analyst*

Got it. No, I appreciate all that. How do your customer power plants compare to other coal plants on an emissions standpoint? Do they tend to be on the cleaner side, or the less clean side? How do you characterize that?

J.C. Butler - *NACCO Industries, Inc. - SVP Finance, Treasurer, Chief Administrative Officer, North American Coal President & CEO*

This gets to what we were saying about our customers who have generally been investing in their plants. Each power plant is owned by a customer; in some cases we have a customer that owns multiple power plants. But they've been investing in these plants and from a SOx, NOx, particulate matter, etc., etc., it's outstanding overall.

I would add that the new Kemper County facility that's being built by Mississippi Power, a subsidiary of Southern Company, which our new Liberty mine is going to provide the coal to, is -- we keep calling it a coal-fired power plant. It actually is a gigantic coal refinery, coal gasification facility that produces synthetic natural gas.

And in the process they create all sorts of byproducts that are sold for other uses, including CO2; they capture 65% of the CO2 that's sold for oil recovery. And then it produces a syngas that's used to produce electricity.

That power plant has an outstanding CO2 footprint because of this new technology. Of course it cost $6.2 billion and it's not done yet.

The other thing I would tell you is we -- at our Freedom Mine, Coteau Properties' Freedom Mine in North Dakota, one of our customers there is the Dakota Gas plant, which was built in the 1970s as a diversification away from foreign fuels. That facility uses coal that we provide to produce synthetic natural gas; they also produce a want of byproducts that are sold.

Those are the only two -- I believe -- the only two large-scale gasification facilities in the country today. I think maybe they're going to build another one, but I don't remember the specifics right now. But those are a part of our mix as well that goes beyond just power generation.

Michael Axon - *Moab Capital Partners - Analyst*

Got it. Okay. All right.

Then moving over to your royalty income, it's running $7 million or $8 million a year and it sounds like you expect further declines. Is there a floor on this, or could those royalties eventually go away? How should I think about that?

J.C. Butler - *NACCO Industries, Inc. - SVP Finance, Treasurer, Chief Administrative Officer, North American Coal President & CEO*

Royalty is essentially completely out of our control. These are mineral reserves, whether it's coal, oil, or gas, that we own but we don't actively operate or extract. So it's completely up to others who might be mining that coal, or have paid us an upfront fee to secure a lease. And they either have drilled a well or they may drill a well in the future, and they may or may not decide to extract oil or gas, depending on what the market prices are and the local infrastructure that's available to them.

So the royalty side of our business is virtually impossible for us to predict because it's out of our hands.

Michael Axon - *Moab Capital Partners - Analyst*

Got it. But low oil and gas prices you would expect, I assume, would continue to put pressure on that, on those royalties?

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J.C. Butler - *NACCO Industries, Inc. - SVP Finance, Treasurer, Chief Administrative Officer, North American Coal President & CEO*

It doesn't help it.

Michael Axon - *Moab Capital Partners - Analyst*

Right, right.

Al Rankin - *NACCO Industries, Inc. - Chairman, President, CEO*

I would say too that there have been some sources of royalties that have been very substantial that have been tending to wind down. So we'll continue to see income from royalty, but I don't think it's going to be the dimensions of past years. And that's probably the best way of saying that.

J.C. Butler - *NACCO Industries, Inc. - SVP Finance, Treasurer, Chief Administrative Officer, North American Coal President & CEO*

That's a fair statement.

Michael Axon - *Moab Capital Partners - Analyst*

Okay. How should I think about a maintenance CapEx number for your consolidated mines?

J.C. Butler - *NACCO Industries, Inc. - SVP Finance, Treasurer, Chief Administrative Officer, North American Coal President & CEO*

The consolidated mines essentially are Mississippi Lignite Mining Company, right, is the largest piece of that. A coal mine has significant fixed costs, and much of what your CapEx spending is on are things that are very expensive and they have very long lives. You'll spend several million dollars on a truck, and you'll spend multiples of that on a fleet of trucks, or a large shovel, or something like that.

So the concept of maintenance CapEx isn't something that really exists in this industry, because it is so lumpy. You'll spend a bunch of money; and then you won't have to spend much money for several years.

And then you'll have an asset retirement. You'll need to replace a piece of equipment. Eventually it wears out and you can't repair it any longer.

Al Rankin - *NACCO Industries, Inc. - Chairman, President, CEO*

I think it's important to remember that the way the contract is structured for Mississippi Lignite Mining Company it assumes that there will be capital replacement periodically. Otherwise you would have fully depreciated assets in the business; and a fixed-cost escalation-type contract, you'd have rising profits just because you weren't putting capital back into it.

That's not the right way to think about that mine. It operates at whatever the demand is, and over time you're going to maintain the same kind of cost structure as a result of that.

So these are replacement expenditures for equipment, and they're designed to simply keep the mine operating.

J.C. Butler - *NACCO Industries, Inc. - SVP Finance, Treasurer, Chief Administrative Officer, North American Coal President & CEO*

I would just add to that that you have seen over the course of the last few quarters we have drastically reduced our expected capital spending level for the year. Because of the way our financials work you know that most of that is related to Mississippi Lignite Mining Company.

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As it says in our 10-K, that contract runs to 2032. With the EPA rattling around with their Clean Power Plan, this year we are undertaking -- it is still underway -- a significant relook at our mine plans, our long-term mine plans for that operation. And we are looking at new innovative and creative ways to either spend less on capital overall or defer capital expenditures if we can, by rethinking the way we're going to mine the reserves that are available in that location.

Al Rankin - *NACCO Industries, Inc. - Chairman, President, CEO*

Let me give you an example in that case. Any coal mine of that type moves periodically from one pit area to another pit area. That can be an expensive proposition.

So we're trying to design things in a way which will cause us to defer capital expenditures until we have a lot more clarity over what the implications of the EPA regulations are really going to be. So eventually we will be in a position of having to make the kinds of expenditures over the long term to go through the date that J.C. mentioned, 2035.

J.C. Butler - *NACCO Industries, Inc. - SVP Finance, Treasurer, Chief Administrative Officer, North American Coal President & CEO*

2032.

Al Rankin - *NACCO Industries, Inc. - Chairman, President, CEO*

2032. But there are different ways to do that, different sequences of ways to do that. And that's what we're working on, in order to try to ensure that we have the best view of what's going to happen with the regulations.

Michael Axon - *Moab Capital Partners - Analyst*

So if I look at how much your depreciation is for the consolidated mines, is that likely to be higher than your average CapEx over the longer term? Or might that be a pretty good estimate of what you think you have to spend?

Al Rankin - *NACCO Industries, Inc. - Chairman, President, CEO*

I just think you can't -- because of the lumpiness --

J.C. Butler - *NACCO Industries, Inc. - SVP Finance, Treasurer, Chief Administrative Officer, North American Coal President & CEO*

I don't think you can think about it that way.

Al Rankin - *NACCO Industries, Inc. - Chairman, President, CEO*

Because of the lumpiness that J.C. described, it's very difficult to think about it that way.

Michael Axon - *Moab Capital Partners - Analyst*

Yes. No, I was trying to think of like an average over a period of years; but okay.

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Al Rankin - *NACCO Industries, Inc. - Chairman, President, CEO*

I think we've given you everything we can.

Michael Axon - *Moab Capital Partners - Analyst*

Got it. Once Centennial is shut down, how much is that going to improve your gross margins for your consolidated mines? Any order of magnitude you can give me on that?

J.C. Butler - *NACCO Industries, Inc. - SVP Finance, Treasurer, Chief Administrative Officer, North American Coal President & CEO*

We don't talk about margins with respect to mines.

Al Rankin - *NACCO Industries, Inc. - Chairman, President, CEO*

We have given you some numbers on Centennial and the profitability of Centennial, and I think you can work backwards from those.

Michael Axon - *Moab Capital Partners - Analyst*

Okay; got it. SG&A is running around $30 million. And maybe this is sort of the same question, but SG&A is running around $30 million for the consolidated mines. How much do you think that that can go down once Centennial is removed? Or do you think that will stay about the same?

Al Rankin - *NACCO Industries, Inc. - Chairman, President, CEO*

I think that those costs tend to be related to our mines overall and not to any specific mine. The specific mine costs are associated with the individual mines.

Let me make sure we get to some other questions here. You can always come back and ask some more, if need be.

Michael Axon - *Moab Capital Partners - Analyst*

Okay, absolutely. Thanks for your time.

Operator

(Operator Instructions) I'm showing no further questions at this time. I'd like to turn the call back over to Christina Kmetko for any closing remarks.

Christina Kmetko - *Evergreen Consulting & Associates, LLC - IR*

Thank you for joining us today. We appreciate your interest; and if you do have any additional questions you may contact me at 440-229-5130. Thank you.

Operator

Ladies and gentlemen, this conference will be available for replay after 3:00 PM until August 12, 2015, at 11:59 PM. You may access the replay system at any time by dialing 1-800-585-8367, or 1-855-859-2056, and entering the access code 8387-1883. (Operator Instructions)

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That does conclude our conference for today. You may now disconnect.

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