PARTICIPANTS

Corporate Participants

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

Other Participants

Mitchell Lolley – Analyst, Nixon Capital LLC

MANAGEMENT DISCUSSION SECTION

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

I would now like to turn the call over to Christina Kmetko. Please go ahead.

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

Good morning, everyone, and welcome to our 2018 earnings conference 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 outlets, 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 second quarter 2018 results and filed our 10-Q. Copies of our earnings release and Q are available on our website at nacco.com. For anyone who is not able to listen to today's entire call, an archived version of this webcast will be on our website later this afternoon and available for approximately 12 months.

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 was set forth in our earnings release and in our 10-Q.

Now that I have the formalities done, let's talk about the quarter. Yesterday, we reported consolidated

income from continuing operations of $6.4 million or $0.92 per share for the second quarter of 2018. This compares to consolidated income from continuing operations to $7.2 million or $1.06 per share for last year's second quarter. Our year-to-date effective income tax rate was 12%, within the range we provided previously.

As the majority of our consolidated results are derived from our North American Coal business, I'll explain the results by explaining what happened at that business.

At North American Coal, coal deliveries increased to 8.8 million tons in the second quarter of 2018 from 8.2 million tons last year. Limestone deliveries at our North American Coal Mining division also increased to 8.4 million yards from 7.9 million yards in the second quarter of 2017. The increased deliveries of both coal and limestone occurred predominantly at the unconsolidated operation.

Pre-tax income decreased to $9.4 million from $10.3 million last year at North American Coal. This decrease was mainly because of the absence of $2.6 million from gains on sales of assets in the second quarter of 2017. Excluding the effect of the gains, pre-tax income at North American Coal increased primarily as a result of an increase in earnings at the unconsolidated operations.

These improvements were partly offset by a decrease in income at Mississippi Lignite Mining Company resulting from an increase in the cost per ton of coal delivered, which was driven principally by higher repairs and maintenance cost during the quarter. In addition, North American Coal realized an increase in operating expenses due to higher professional fees. At NACCO and Other, pre-tax income from continuing operations was comparable between periods.

Looking forward in the second half of 2018, we expect our consolidated pre-tax income to increase substantially compared with the second half of 2017 even though the second half of 2017 included $2.1 million of gains on sales of assets that are not expected to be repeated this year.

The combination of a modestly stronger than expected second quarter and the anticipated improvement in the second half of 2018 are expected to result in an overall moderate increase in our 2018 full year pre-tax income. We continue to expect a consolidated effective income tax rate in the range of 9% to 12% for the full year. However, because of the anticipated increase in the 2018 effective income tax rate compared with 2017's 2.2%, we expect consolidated income from continuing operations in the second half of 2018 to be comparable to the prior year period and be down modestly for the full year.

We expect improvement in the second half of this year as a result of improved income at our consolidated operations, lower operating expenses mainly related to lower employee-related costs, and reduced interest expense on substantially lower borrowings outstanding. We expect these improvements to be partially offset by a decrease in royalty and other income during the second half of the year.

At our consolidated operations, Mississippi Lignite Mining Company's pre-tax income in the second half of 2018 is expected to increase substantially over the second half of last year and the first half of this year primarily as a result of a reduction in the cost per ton of coal delivered because customer demand in the second half of 2018 is expected to return to higher levels.

Much of this improved second half income is anticipated in the third quarter and we expect this improvement to offset the lower income in the first half of 2018, resulting in full year 2018 income at Mississippi Lignite Mining Company to be comparable to 2017.

If customer demand does not improve as expected, it could unfavorably affect North American Coal's 2018 earnings significantly. Earnings at our unconsolidated operations in the second half of 2018 are expected to be comparable to last year. We are pleased to note that during the second quarter of 2018, North American Mining signed two new contracts with limestone customers. Operations under one contract are expected to commence in the fourth quarter of 2018 while operations under the second contract are expected to commence in early 2019.

Before I wrap up, let me provide you with some cash flow and balance sheet information. We expect cash flow before financing activities to decrease substantially in the second half of the year compared with the second half of 2017, resulting in an overall decrease in cash flow before financing activities for the full year. This decrease is due in part to an increase in planned capital expenditures at North American Coal.

We ended the second quarter with consolidated cash on hand of $80 million and debt of $28 million. This compares to consolidated cash on hand of $101.6 million and debt of $58.1 million last year or at the end of 2017. The decrease in cash was tied to the reduction in debt.

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. We did not repurchase any shares during the first quarter of the program but we did repurchase approximately 1,700 shares during the second quarter for an aggregate purchase price of approximately $100,000. This program runs through December 31, 2019.

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 Nixon Capital. Please go ahead.

<Q – Mitchell Lolley – Nixon Capital LLC>: Hi. Could you disclose who the new limestone contracts are with and what quarries they pertain to?

<A – J.C. Butler – NACCO Industries, Inc.>: That's not something that we have typically talked about. I can tell you they're both in Florida. I mean, that's not something we really ever talked about before.

<Q – Mitchell Lolley – Nixon Capital LLC>: What about how much volume maybe they have in terms of anticipated cubic yards of limerock per year or something like that, just so I have something to compare it to versus your existing operations?

<A – J.C. Butler – NACCO Industries, Inc.>: That's not something we'd just disclose either, although you're bringing up an interesting question about whether we should think about that in the future.

<Q – Mitchell Lolley – Nixon Capital LLC>: Okay. And maybe you could just entertain me for a second on this, and I know this is also something you probably won't disclose, but I kind of tried to estimate the size of your limerock operations and I've estimated that it could be today maybe 13 or more percent of your total company pre-tax profit. Is that ballpark correct or does it make sense to you that it would be that high?

<A – J.C. Butler – NACCO Industries, Inc.>: Well, that's not something – actually, I've never looked at that pie chart, to tell you the truth. I can tell you that it's – I mean, you know this, right? This is a business that has been growing pretty rapidly both because of just the economy is doing very well including in Florida where a lot of this limerock is consumed. So existing customers are taking a lot of limerock and we're doing a pretty good job of signing up a lot of new customers, a lot of new quarries over the last couple of years.

This is a major push for us to grow this business. We think that's a skill set that we have. We're essentially operating the mining operations for these limerock quarries and let them focus on what they do best which is crushing, sizing, processing the limerock and selling it, marketing and selling. So, it is a real growth area for us. And you're asking some interesting questions that we'll think about for future disclosure.

<Q – Mitchell Lolley – Nixon Capital LLC>: And what about the – is there a way to size maybe like the pipeline of opportunities for new contract wins in other areas? I mean, I know you're on a pretty good pace right now. You've got the rope shovel contract last quarter. You announced two this quarter. But is that a reasonable pace going forward to think about?

<A – J.C. Butler – NACCO Industries, Inc.>: I mean, that'd be great. But – so, let me just say one thing about the rope shovel. So, that was a contract at a quarry that included a dragline and a rope shovel. It was our first real success in adding equipment beyond draglines in that business. The growth opportunity -- we still think there's growth opportunities in Florida, kind of with the core businesses we've been operating in. If you look around the United States, I mean, I don't know how often you travel across the U.S., but there are aggregate operations everywhere. So, it's generally a relatively low value product that's used in virtually everything. It's kind of a fundamental building block of roads and bridges and construction and asphalt and cement block and everything. So there are little quarries there, big quarries everywhere. And we think that there's opportunities to grow outside of Florida, outside of the basic limerock business that was -- we do it now, and certainly, we can operate lots of other kinds of equipment other than just draglines and rope shovels.

<Q – Mitchell Lolley – Nixon Capital LLC>: All right. And then lastly, I saw that you purchased that small amount of shares in the quarter. And I was just wondering how you're thinking about using that buyback program going forward, if at all.

<A – J.C. Butler – NACCO Industries, Inc.>: I would – I guess my best answer for that is to say just go back and look at history of our share buyback programs. It is a strategy and a mechanism that we have used for many years now and I think pretty successfully like a lot of other companies.

<Q – Mitchell Lolley – Nixon Capital LLC>: All right. Thank you very much.

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

Operator: [Operator Instructions] We do have a question from Mitchell Lolley from Nixon Capital. Please go ahead.

<Q – Mitchell Lolley – Nixon Capital LLC>: I'm sorry. I had one thing I forgot to ask and that was how long do these limerock contracts take to ramp up before they reach full capacity and how does that compare to, say, a new win on the coal side of your business?

<A – J.C. Butler – NACCO Industries, Inc.>: It varies, although – I mean, if you think about our history in coal, since 2009 to 2010, we have built five new coal mines from scratch. When you build one from scratch, it takes a long time to get ramped up. When you take over a new – take over an existing operation from an existing miner like we did at Bisti, it kind of turns on immediately. Now, the power plant for Bisti fuels now the whole mine has been doing some environmental upgrades so that's affecting deliveries but it turns on kind of immediately.

All these quarries are existing operating quarries and it really doesn't take very long to transition us into an operating role of those quarries in general. In some instances, we've got to do some repairs to a dragline or maybe bringing in a different dragline or our customer's bringing in a different dragline. So, the ramp up typically is very quick because it's already an operating quarry and we can step in as soon as we're allowed to and have the equipment in a position and a situation that we can operate.

<Q – Mitchell Lolley – Nixon Capital LLC>: Thanks.

<A – J.C. Butler – NACCO Industries, Inc.>: Yeah, thank you. Appreciate your interest.

Operator: And there are no further questions at this time. I will now turn the call back over to Ms. Christina Kmetko for closing remarks.

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

Okay. Thank you for joining us today. We do appreciate your interest. And if you have any questions, you can reach me at 440-229-5130. Thanks and have a great day.

Operator: Thank you for joining. This call will be available for replays beginning at 11:30 Eastern Standard Time today through 11:59 Eastern Standard Time on August 9, 2018. The conference ID number for the replay is 1976359. The number for the replay to dial is 800-585-8367. You may now disconnect.

