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NACCO Industries, Inc. (NC)

Q2 2016 Earnings Call

CORPORATE PARTICIPANTS

Christina Kmetko
Investor Relations

Alfred M. Rankin
Chairman, President & Chief Executive Officer

OTHER PARTICIPANTS

Michael Fisherman
Zuckerman Investment Group LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Tracy, and I will be your conference operator today. At this time, I would like to welcome everyone to the NACCO Industries, Inc. 2016 Second Quarter Earnings Conference Call. [Operator Instructions] Thank you.

Ms. Christina Kmetko, you may begin your conference.

Christina Kmetko
Investor Relations

Thank you. Good morning, everyone, and welcome to our 2016 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, our Senior Vice President Finance, Treasurer, and Chief Administrative Officer; as well as the President and Chief Executive Officer of our North American Coal subsidiary; and Elizabeth Loveman, NACCO's Vice President and Controller.

Yesterday, we published our second quarter 2016 results and filed our 10-Q for the quarter ended June 30, 2016. 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 For anyone who is not able to listen to today's entire call, an archived version of this webcast will be on our website later this afternoon and available for approximately 12 months.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. Also, certain amounts discussed during today's call are considered non-GAAP. The non-GAAP reconciliations of these amounts are included in our 2016 second quarter earnings release available on our website.

Now, let me discuss our results for the second quarter. Our consolidated revenues were $178 million compared with $196.5 million in the second quarter of 2015. Our consolidated revenues declined as a result of the cessation of mining activities at Centennial Natural Resources and lower revenues at the Mississippi Lignite Mining Company, along with reduced sales volumes at Hamilton Beach and as a result of fewer customer visits at Kitchen Collection.

Consolidated net income, on the other hand, increased to $3.1 million or $0.45 per share in the second quarter 2016 from a consolidated net loss of $300,000 or a loss of $0.04 per share last year. The improvement in net income was primarily the result of Centennial incurring a lower operating loss in the 2016 second quarter than it did in the prior year and an improvement in Hamilton Beach's gross profit. We have continued to provide financial results excluding Centennial to allow for a better understanding of the performance of the company's active operations.

On an adjusted basis, our second quarter consolidated revenues were $177.7 million, compared with $184.6 million in the prior year quarter. Consolidated adjusted income increased to $4.3 million or $0.63 per share from $3.8 million or $0.54 per share in the second quarter of 2015.

Revenues at North American Coal, including Centennial, were $23.1 million in the second quarter compared with $37.9 million in the prior year. Operating profit was $4.8 million in 2016 compared with $2.4 million last year, and net income was $3.3 million this quarter compared with $4.2 million in 2015.

Let me focus on Centennial for just a minute before I talk about results excluding Centennial. Centennial had an operating loss of $1.9 million and revenues of $300,000 in the second quarter of 2016 compared with an operating loss of $6.5 million and revenues of $11.9 million in the prior year. A significantly reduced number of tons were sold during the current quarter, as a result of the cessation of mining activities on December 31.

As expected, Centennial's operating loss also declined as substantially lower operating costs were required to conduct the remaining day to day operations, which includes selling equipment, maintaining permits and completing mine reclamation. Centennial also continues to sell-off certain assets. In the current quarter, Centennial had a net loss on the sale of assets compared with a net gain on the sale of assets in the prior year. If you exclude Centennial, North American Coal's revenues declined $3.2 million from the prior year second quarter, primarily because of a reduction in both tons sold and the selling price per ton at the Mississippi Lignite Mining Company in the second quarter of 2016 compared with 2015.

An increase in outage days at the customer's power plant led to the reduction in tons sold and the decline in diesel prices during 2015 and 2016 resulted in a lower index-based coal sales price. The decline in revenues at the Mississippi Lignite Mining Company was partially offset by higher revenues at our limerock mining operations due to a substantial increase in limerock yards delivered.

Operating profit, excluding Centennial's results, also declined $2.2 million compared with the prior year. The decrease was primarily due to higher SG&A expenses and a reduction in both royalty and other income and operating results of the Mississippi Lignite Mining Company, all partially offset by improved results at the limerock dragline mining operations and an increase in operating profit at the unconsolidated mining operation as newer mines began or increased production.

Operating results declined at the Mississippi Lignite Mining Company due to the decrease in revenue, partially offset by a reduction in cost of sales which includes both production cost and changes in inventory. The reduction in cost of sales was the result of a decrease in total production costs, as well as the capitalization of production costs into coal inventory in the second quarter of 2016 compared with 2015.

Returning to GAAP for results below operating profit, North American Coal reported an income tax benefit of $1.6 million on income before income taxes of $1.7 million, resulting in net income of $3.3 million in the second quarter of 2016. The income tax benefit was due to the reversal of a $2.3 million uncertain tax position which more than offset income tax expense associated with current period earnings. The company also reversed a corresponding indemnification receivable related to the uncertain tax position that resulted in $2.2 million of other expense in the second quarter of 2016.

Looking forward, we expect tons sold at North American Coal's coal mining operations to increase in the second half of 2016 compared with 2015. Despite this overall increase in tons and excluding Centennial's results in both 2016 and 2015, we expect a decrease in income before income taxes in the second half of the year primarily because of an expected decrease in income at Mississippi Lignite Mining Company, a decrease in royalty and other income and a decrease in the limerock mining operations. Additional income from the unconsolidated mining operations is anticipated to partly offset these decreases.

Coyote Creek Mining Company began delivering coal in the second quarter of 2016 and Liberty Fuels began delivering coal to its customer in July 2016 for facility testing and commissioning. Bisti Fuels is still in its transition period prior to becoming the contract miner at the Navajo Mine. The production period is scheduled to begin when Bisti's customer completes a pending commercial transaction with the existing contract miner, which is expected to occur before year-end.

Finally, North American Coal's cash flow before financing activities in the second half of 2016 is expected to be comparable to the same period in 2015. In the remainder of the year, we expect Centennial to incur moderate, but substantially lower losses than in 2015, excluding the effect of any potential future asset sale as it manages mine reclamation obligations and disposes of certain assets.

We will continue to evaluate strategies to maximize cash flow from Centennial, including through the sale of mineral reserves, equipment and parts inventory. Cash expenditures, related to mine reclamation will continue until reclamation is complete or ownership of the mine is transferred.

Now, let me discuss Hamilton Beach. Hamilton Beach's second quarter 2016 revenues decreased moderately from $129.5 million in 2015 to $127.1 million in 2016, but operating profit and net income increased substantially over the prior year second quarter. Revenues declined primarily as a result of unfavorable currency movements and reduced sales volumes in the U.S. consumer retail market.

Nonetheless, an increase in gross profit primarily as a result of the shift in sales mix to higher priced, higher margin products and low SG&A expenses were the main drivers for the improvement in net income from $1.6 million in the second quarter of 2015 to $2.9 million in the second quarter of 2016.

Looking forward, we believe overall consumer confidence and financial pressures experienced by the middle market consumer continue to create uncertainty about the overall growth prospects for the U.S. retail market for small appliances, including growth prospects for both in-store and Internet sales. As a result, volumes in the second half of 2016 in the market in which our core Hamilton Beach brands participate are projected to be comparable or down slightly compared with 2015.

We also expect the Canadian retail market to be difficult as the Canadian economy continues to struggle. However, the international and commercial markets in which Hamilton Beach participates are expected to grow moderately in the second half of 2016, but at a slower pace than in the first half of the year.

In spite of current market conditions, we expect Hamilton Beach's consolidated sales volumes in the second half of 2016 to increase moderately compared with 2015 due to the increased placements of higher-priced products in the core small kitchen appliance business. We also expect international and commercial product sales volumes to increase as a result of the continued execution of Hamilton Beach's strategic initiatives.

With a number of new products in the pipeline, new distribution channels and execution of these initiatives, both domestically and internationally, we expect an increase in revenues at Hamilton Beach in the second half of 2016 compared with the second half of 2015, provided consumer spending is at the expected levels.

In addition, we expect Hamilton Beach's net income in the second half of this year to increase substantially. However, the anticipated improvement from increased sales volumes and revenues are expected to be partly offset by higher SG&A expenses. We expect cash flow before financing activities for the second half of 2016 to be lower than in the prior year.

Finally, our Kitchen Collection business reported a net loss of $2 million in the second quarter of 2016, slightly higher than the net loss of $1.8 million in 2015 on a moderate decrease in revenues. Despite benefits realized from the closure of unprofitable stores and lower SG&A expenses, Kitchen Collection's net loss increased primarily due to fewer sales transactions and reduced gross margins, as well as the lower effective income tax rate that resulted in a lower tax benefit on Kitchen Collection's pre-tax loss.

Changing consumer habits have led to declining consumer traffic to physical retail locations because consumers are buying more over the Internet or utilizing the Internet for comparison shopping. Financial pressures have also adversely affected sales trends in housewares and small appliances over the last few years, while the recent strengthening of the U.S. dollar has adversely affected sales trends at retail locations near the Mexican and Canadian borders, as well as at stores in areas with higher international tourism.

In the context of this market environment, we expect Kitchen Collection's revenue and results in the second half of 2016 to decline slightly from 2015. We believe Kitchen Collection's smaller core store portfolio is well positioned to perform at improved operating levels and to take advantage of any future market rebounds. We expect cash flow before financing activities to be positive this year, but substantially lower than last year.

Before I open up the call for questions, I want to note that for the three months ended June 30, 2016, we repurchased $3.8 million of Class A common stock under our $50 million stock repurchase program which our Board of Directors approved in May 2016.

That concludes my prepared remarks. I want to open up the call for your questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Michael Fisherman with Zuckerman Investment. Your line is open.

Michael Fisherman
Zuckerman Investment Group LLC

Q

Good morning Christy. Good morning, Al. How are you?

Christina Kmetko
Investor Relations

A

Good morning.

Alfred M. Rankin
Chairman, President & Chief Executive Officer

A

Fine. Thanks.

Michael Fisherman
Zuckerman Investment Group LLC

Q

So on the first quarter press release for Hamilton Beach, the company talked about net income for 2016 increasing year-over-year. First half was up 18% and now you're guiding to up substantially in the second half. Is it fair to assume that you're raising your expectations for this segment for the full year?

Alfred M. Rankin
Chairman, President & Chief Executive Officer

A

I think that's what we've said, yes.

Michael Fisherman
Zuckerman Investment Group LLC

Q

Can you elaborate on just what's different versus your expectations today versus three months ago?

Alfred M. Rankin
Chairman, President & Chief Executive Officer

A

We had more sales volume.

Michael Fisherman
Zuckerman Investment Group LLC

Q

Okay. Thank you.

Operator: [Operator Instructions] There are no further questions at this time. Ms. Kmetko, I'd turn the call over to you.

Christina Kmetko
Investor Relations

Okay. Al, did you have anything?

Alfred M. Rankin
Chairman, President & Chief Executive Officer

No. I don't have any closing comments.

Christina Kmetko
Investor Relations

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

Operator: ONCALL replay will be available two hours after the call has ended. Please dial 800-585-8367 or 855-859-2056, or internationally on 404-537-3406 and enter the passcode 28584079 to listen. ONCALL will be available until August 10, 2016 end of day. This concludes today's conference call. You may now disconnect.