02-Nov-2016

NACCO Industries, Inc. (NC)

Q3 2016 Earnings Call

CORPORATE PARTICIPANTS

Christina Kmetko
Investor & Media Relations, NACCO Industries, Inc.

Alfred M. Rankin
Chairman, President & Chief Executive Officer, NACCO Industries, Inc.

John C. Butler
Senior Vice President - Finance, Treasurer & Chief Administrative Officer, NACCO Industries, Inc.

OTHER PARTICIPANTS

Jacob Wagner
Vice President, Oaktree Capital Management LP

Michael Fisherman
Analyst, Zuckerman Investment Group LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Julie and I will be your conference operator today. At this time, I would like to welcome everyone to the Q3 2016 NACCO Industries Earnings Conference Call. [Operator Instructions] Thank you.

Christina Kmetko, you may begin your conference.

Christina Kmetko
Investor & Media Relations, NACCO Industries, Inc.

Thank you. Good morning, everyone, and welcome to our 2016 third 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; and 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. Also joining us is Elizabeth Loveman, NACCO's Vice President and Controller.

Yesterday, we published our third quarter 2016 results and filed our third quarter 10-Q. 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 For anyone who is not able to listen to today's entire call, an archived version of this webcast will be on our website later this afternoon and available for approximately 12 months.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 third quarter earnings release available on our website.

Now, let me discuss our results for the third quarter. Our consolidated revenues were $220.8 million compared with $239.1 million in the third quarter of 2015. Our consolidated revenues declined primarily as a result of the cessation of mining activities at North American Coal's Centennial Natural Resources mining operation during the fourth quarter of 2015, reduced sales volumes at Hamilton Beach and a reduction in the number of stores at Kitchen Collection.

We reported a consolidated net loss of $400,000 or $0.07 per share for the third quarter of 2016 compared with net income of $3.1 million or $0.45 per share last year. The main reason for this quarter's net loss is because North American Coal recognized a $17.4 million pre-tax impairment charge at Centennial to reduce the carrying value of coal land and real estate to zero and assets held for sale to $5 million.

The tax benefit of $4.9 million for this impairment charge is reflected in the consolidated effective tax rate included in our consolidating eliminations. There is no tax effect at the North American Coal subsidiary level because of the mix of North American Coal's earnings, mainly due to the benefit of percentage depletion.

I'd also like to highlight that the consolidated third quarter 2015 net income includes the mine reclamation obligation charge we took last year resulting from the decision to cease mining operations at Centennial. This charge was $7.5 million, or $5.8 million after tax.

We've continued to provide financial results excluding Centennial to allow for a better understanding of the performance of the company's active operations. Excluding Centennial, our third quarter consolidated revenues were $220.7 million compared with $230.2 million in the prior year quarter. Consolidated adjusted income increased to $18.4 million or $2.70 per diluted share from $12.7 million, or $1.83 per diluted share in the third quarter of 2015.

Revenues at North American Coal including Centennial were $32.4 million in the third quarter of 2016 compared with $42.7 million in the prior year. North American Coal reported an operating loss of $10.9 million in 2016 compared with an operating loss of $4 million last year and a net loss of $12.7 million this quarter, compared with a net loss of $5.3 million in 2015. These results include the 2016 asset impairment charge and the 2015 mine reclamation obligation charge.

Let me focus on Centennial for just a minute before I talk about results excluding that operation. Centennial had an operating loss of $19.7 million and nominal revenue in the third quarter of 2016 compared with an operating loss of $15.4 million and revenues of $8.9 million in the prior year. The reduced revenue was a result of the cessation of mining activities during the fourth quarter of 2015.

Excluding the asset impairment and mine reclamation charges, Centennial's operating loss also declined as expected, a substantially lower operating costs were required to conduct the remaining day-to-day operations of selling equipment, maintaining permits and mine reclamation.

Excluding Centennial, North American Coal's revenues declined $1.5 million from the prior year third quarter primarily because of lower royalty and other income. Operating profit excluding Centennial's results also declined $2.6 million compared with the prior year. The decrease was primarily due to lower operating results at the Mississippi Lignite Mining Company and a reduction in royalty and other income, partially offset by an increase in operating profit at the unconsolidated mining operations as new mining operations began or increased production.

Operating results were lower at the Mississippi Lignite Mining Company due to a decrease in revenue and an increase in cost of sales, which includes both production costs and changes in inventory. While production costs were comparable between periods, Mississippi Lignite Mining Company sold more tons than it produced during the third quarter of 2016, resulting in the recognition of a portion of production costs previously capitalized into inventory.

Looking forward, we expect tons sold at North American Coal's mining operations to increase in the fourth quarter of 2016 compared with last year and we expect an increase in income before income taxes and net income, both including and excluding Centennial.

Excluding Centennial, the increase in income is expected to be driven by additional income from the unconsolidated mining operations due to production from Coyote Creek Mining Company, which began producing in 2016, partially offset by a substantial decline in Mississippi Lignite Mining Company results and increased Otter Creek Mine expenses associated with land leases.

The expected decline at Mississippi Lignite Mining Company is due to an increase in production costs because the fourth quarter of 2015 included a benefit from the reversal of an accrual related to a leased asset.

We expect Centennial to incur a moderate loss in the fourth quarter of 2016 as it manages mine reclamation obligations and disposes of certain assets. Although we continue to evaluate strategies to maximize cash flow including through the sale of mineral reserves and equipment. We expect cash flow before financing activities in the fourth quarter and for the full year 2016 to be substantially lower compared with the respective periods in 2015. Capital expenditures are estimated to be $7.9 million for the fourth quarter of 2016 and $15.2 million for the full year.

Rounding out 2016, excluding Centennial, we expect North American Coal's full year 2016 operating profit to decrease compared with 2015. At Centennial, excluding the asset impairment and asset retirement charges, we expect the current year operating losses to be significantly less than in the prior year.

Looking forward to 2017, excluding the effect of the asset impairment charge in 2016, we expect a significant increase in North American Coal's income before income taxes compared with this year. Results in 2017 are expected to benefit from higher income from the unconsolidated mining operations as North American Coal transitions into the contract miner role at Bisti Fuels in early January when the production period begins, and from the realization of a full year of income at its Coyote Creek mine. A lower, more moderate, operating loss at Centennial is also expected to contribute to the improvement. Partially offsetting this improvement is an expected moderate continued decrease in Mississippi Lignite Mining Company results, primarily in the first half of 2017, as well as the anticipated decreases in royalty and other income, and at the limerock mining operations as deliveries from the new limerock mining operations are not expected to offset an anticipated decline in customer requirements at the existing limerock mining operations.

Cash flow before financing activities is expected to increase in 2017 compared with 2016. Capital expenditures are expected to be approximately $14 million in 2017.

Now let me discuss Hamilton Beach. Hamilton Beach's third quarter 2016 revenues, decreased moderately from $163.3 million in 2015 to $157.3 million this quarter. Both operating profit and net income increased substantially over the prior year third quarter.

Revenues declined primarily as a result of reduced sales volumes in the U.S. specialty housewares market and in the Canadian consumer retail market. An improvement in gross profit as a result of reduced product costs and a shift in sales mix to higher priced and higher margin products was the main driver for the improved operating profit.

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, market volumes in the fourth quarter of 2016 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 fourth quarter of 2016, but at a slower pace than in the first part of this year.

In spite of current market conditions, we expect Hamilton Beach's consolidated sales volumes to increase in the fourth quarter of 2016 compared with 2015 as a result of increased placements and promotions of higher priced products in the core small kitchen appliance business for the fourth quarter holiday selling season, as well as anticipated improvements in its other U.S. consumer product lines. 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 the number of new products in the pipeline and the execution of these initiatives both domestically and internationally, we expect an increase in revenues at Hamilton Beach in the 2016 fourth quarter compared with the prior year provided consumer spending is at expected levels.

The fourth quarter revenue increase is also expected to offset the revenue decline in the first part of the year, resulting in full year 2016 revenues comparable to 2015. In addition, we expect Hamilton Beach's fourth quarter net income to increase substantially compared with last year's fourth quarter, resulting in a significant increase in full year 2016 net income compared with 2015. However, the anticipated improvement from increased sales volumes of higher margin products and reduced product costs are expected to partly offset by increased SG&A expense and by higher transportation and warehousing costs from the higher sales volumes.

We expect full year 2016 cash flow before financing activities to be substantially higher than in 2015. Capital expenditures are estimated to be $2.8 million in the fourth quarter of 2016 and $6.1 million for the full year.

In 2017, we expect the consumer retail market for small kitchen appliances to be comparable to this year. The international markets are expected to continue to grow moderately.

Overall, we expect Hamilton Beach's sales volumes and revenues to increase in 2017 compared with 2016 due to enhanced distribution and increased higher margin product placements resulting from the execution of the company's strategic initiatives.

Net income in 2017, is expected to be comparable to 2016. In 2017 cash flow before financing activities is expected to be substantial, but lower than this year and capital expenditures are expected to be approximately $8 million.

Finally, our Kitchen Collection business reported a net loss of approximately $700,000 in the third quarter of 2016, slightly higher than the net loss of approximately $600,000 in 2015 on a moderate decrease in revenues.

We expect changing consumer habits and continued financial pressures to continue to limit Kitchen Collection's target consumers' spending on housewares and small appliances in the remainder of 2016 and in 2017. Given this market environment, Kitchen Collection has continued to reduce the number of stores and to focus on a smaller core number of Kitchen Collection outlet stores. As a result of ongoing market weakness and fewer stores, we expect Kitchen Collection's revenues to decline modestly in the fourth quarter and for the full year of 2016 compared with the respective 2015 periods.

Fourth quarter and full year 2016 results are expected to be comparable to the prior year periods as a result of a lower effective income tax rate. We believe Kitchen Collection's smaller core store portfolio is well positioned to allow it to perform at improved operating levels, take advantage of any future market rebound and optimize its operating performance over time.

Cash flow before financing activities is expected to be positive in 2016, but substantially lower than 2015. Capital expenditures are expected to be approximately $400,000 in the remainder of the year and $1.5 million for the 2016 full year. Kitchen Collection continues to focus on a number of store initiatives to improve the customer experience in products and store profitability.

As a result of these initiatives, we expect Kitchen Collection to achieve near breakeven results in 2017 on lower revenues, provided customer visits are at expected levels. Revenues in 2017 are expected to decrease modestly compared with 2016 as Kitchen Collection continues to prudently close non-performing stores. Cash flow before financing activities is expected to be positive in 2017 but lower than 2016.

Before I open up the call for your questions, I want to note that for the nine months ended September 30, 2016, we have repurchased $6 million of Class A Common Stock under our $50 million stock repurchase program including $2.2 million of stock purchased during this quarter.

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

QUESTION AND ANSWER SECTION

Operator: [Operator instructions] Your first question comes from the line of Jacob Wagner from Oaktree Capital. Your line is open.

Jacob Wagner
Vice President, Oaktree Capital Management LP

Q

Hi, good morning. Congrats on a good quarter. So NACCO is generating a lot of cash flow, but without reinvestment opportunities, you're forced to pay down cheap debt or buy back even more of your limited [indiscernible] (18:18) The company doesn't need the capital markets for financing as you haven't raised public equity or bonds in decades. And at this point, Mr. Rankin even your family control over 80% of the voting rights and nearly 50% of the company's economics.

These facts have created a massive valuation overhang where we think NACCO trades at a discount to Hamilton Beach's competitors without any value ascribed to North American Coal's contracted cash flow. So, Mr. Rankin, in your and the board's opinion, why is keeping NACCO as an independent public company the best path forward for all shareholders?

Alfred M. Rankin
Chairman, President & Chief Executive Officer, NACCO Industries, Inc.

A

Well, obviously any question of that nature would be handled by our board of directors and would be thought about periodically and we look at all of our options over time. I think that at the moment, one of our key concerns is that we have some substantial debt at our coal company and it isn't crystal clear by any means how banks will view coal companies and the amount of debt that we might think is appropriate in the coal company itself as we move forward.

So we're pretty cautious about thinking about cash flow at this point. Our views may change in the future, but at this point, those are really our focuses. We think about returning cash to shareholders through dividends, we think about returning cash to shareholders through our share buyback program. As you know, we have been returning cash in the share buyback program to some degree. Those are the main focuses for us at this point in time.

We are also from time-to-time looking for opportunities to invest in businesses that have a high degree of synergy value with the businesses that we're already in and I think Weston is a good example of that. We felt that it worked well for us, it was highly complementary, it got us in Hamilton Beach and to a new channel, and new products which we could then use to sell additional traditional Hamilton Beach products through Weston's channels and traditional Weston products through Hamilton Beach's channels.

We look at opportunities to take advantage of some of the significant skills we have in our coal business and areas like reclamation and things of that nature. So we continue at this point to look for opportunities to invest in related businesses, but I must say too that in no way, we're willing to overpay for those. And we take a very long-term view about when we might invest in any of those and this upturn in stock market won't last forever and there may be opportunities as we look forward in the future.

So we have a very long-term view of building value for all shareholders, that's our primary concern, we treat them equally as we look forward. J.C., you want to add anything to that?

John C. Butler
Senior Vice President - Finance, Treasurer & Chief Administrative Officer, NACCO Industries, Inc.

A

No, I mean my primary focus is North American Coal and we do have a number of initiatives underway looking at opportunities to grow that business. We mentioned in the earnings release that we signed an additional contract in Florida, it's a very small part of our business, but we think it's a place where we might have growth opportunities.

Alfred M. Rankin
Chairman, President & Chief Executive Officer, NACCO Industries, Inc.

A

That's in the limerock mining business

John C. Butler
Senior Vice President - Finance, Treasurer & Chief Administrative Officer, NACCO Industries, Inc.

A

Right. And that particular project didn't take much capital, but you don't know what might be in the future.

Jacob Wagner
Vice President, Oaktree Capital Management LP

Q

All right. Thank you.

Operator: Your next question comes from the line of Michael Fisherman with Zuckerman. Your line is open.

Michael Fisherman
Analyst, Zuckerman Investment Group LLC

Q

Thank you. Good morning, Al.

Alfred M. Rankin
Chairman, President & Chief Executive Officer, NACCO Industries, Inc.

A

Good morning.

Michael Fisherman
Analyst, Zuckerman Investment Group LLC

Q

My question is very similar to Jacob's. During the quarter, Goldman Sachs took a company Happycall Private for call it 1.4 times revenue or 17 times EBIT. If we apply those multiples to Hamilton Beach trailing 12 month revenue and earnings or EBIT, be it a value about $630 million to $820 million which is greater than the whole company of NACCO. So my question is why don't you explore strategic alternatives for this division?

Alfred M. Rankin
Chairman, President & Chief Executive Officer, NACCO Industries, Inc.

A

I hope you're not suggesting we don't explore strategic alternatives, I've said, obviously – I've tried to say in the answer to the earlier question, we do look at strategic alternatives and with – but primarily, we take a long view about building the value of our individual businesses, trying to build the profits over time to use the capital and it's generated in a wise way and we think that in the long-term that's in the best interest of all of our shareholders and I just wouldn't comment any further than that.

Michael Fisherman
Analyst, Zuckerman Investment Group LLC

Q

Well 10 years ago, or even 13 years ago 2003, Hamilton Beach did $36 million of EBIT, right, [ph] you're going to do, call it (24:25) $36 million, $40 million today, so why do you think Hamilton Beach is best in your hands versus selling it to someone for more value than the total company today and let someone else grow the business that you guys haven't been able to do over 10 year, 15 year period.

Alfred M. Rankin
Chairman, President & Chief Executive Officer, NACCO Industries, Inc.

A

I've already said all I want to say at this point.

Michael Fisherman
Analyst, Zuckerman Investment Group LLC

Q

Okay.

Operator: There are no other questions at this time. I will turn the call back over to the presenters.

Christina Kmetko
Investor & Media Relations, NACCO Industries, Inc.

Al, do you have any further comments?

Alfred M. Rankin
Chairman, President & Chief Executive Officer, NACCO Industries, Inc.

No, I don't have any further comments. At this point I'd just echo the comments that I made earlier and J.C. made about looking for opportunities to use the skills and expand on the capabilities that we have in the businesses that we have. And that remains a primary focus but also with real attention to ensuring that we have the appropriate levels of debt in each of our businesses given the financing conditions as we look forward and I'd close there.

Christina Kmetko
Investor & Media Relations, NACCO Industries, Inc.

Okay. Thank you all for joining us today. We do appreciate your interest and if you have any further questions, you can reach me at 440-229-5130. That ends our call. Thank you.

Operator: Please be advised your on-call playback will be available two hours after the call has ended. Please dial 1-800-585-8367 or 1-855-859-2056 and enter your passcode of 91048890. Again dial 1-800-585-8367 or 1-855-859-2056 and enter your passcode of 91048890. This concludes today's conference call. You may now disconnect.