Corrected Transcript

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NACCO Industries, Inc. (NC)

Q2 2017 Earnings Call

CORPORATE PARTICIPANTS

Christina Kmetko
Investor Relations Consultant, NACCO Industries, Inc.

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

MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Casey and I will be your conference operator today. At this time, I would like to welcome everyone to the Q2 2017 NACCO Industries Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

Christy Kmetko, you may begin your conference.

Christina Kmetko
Investor Relations Consultant, NACCO Industries, Inc.

Thank you. Good morning everyone and welcome to our 2017 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 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 Greg Trepp, the Chief Executive Officer of both our Hamilton Beach and Kitchen Collection subsidiaries

. Also joining us is Elizabeth Loveman, NACCO's Vice President and Controller.

Yesterday, we published our second quarter 2017 results and filed our 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 For anyone who is not able to listen to today's entire call, an archived version of this webcast will be on our website later this afternoon and available for approximately 12 months.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 earnings release available on our website.

Before I discuss our results, I want to talk a bit about North American Coal's Liberty Fuels Mine, one of our unconsolidated mines. As many of you know, in 2016, Liberty began delivering coal to its customer, Mississippi Power Company. This coal was for facility testing and commissioning at Mississippi Power's Kemper County energy facility. On June 28, Southern Company and its subsidiary, Mississippi Power, issued a press release announcing they were immediately suspending start-up and operations activities involving the coal gasifier portion of the Kemper County energy facility as a result of Mississippi regulators ordering Mississippi Power to enter into a settlement not permitting the use of synthesis gas for power generation.

Our Liberty Mine is the sole supplier of coal to fuel this gasifier. While the final decision has not yet been made, the future of the Kemper County Coal gasification facility is uncertain and therefore the future of our Liberty Mine is also uncertain.

We continue to operate under our existing contract with Mississippi Power and will support them pending a final decision on the continued operation of the gasifier and the Liberty Mine. To be clear, the terms of our cost-plus contract with Mississippi Power specify that Mississippi Power is responsible for all mine closure costs, should that be required.

In addition, the Liberty Mine is specified as the contractor to complete final mine closure, including reclamation work. Should the decision to suspend operations of the gasifier and mine become permanent, it will unfavorably affect North American Coal's long-term earnings under its contract with Mississippi Power. Those are the basic facts about the Liberty situation. I will discuss more when I cover the North American Coal outlook.

Now, let me discuss our results for the second quarter. Our consolidated revenues were $181.1 million compared with $178 million in last year's second quarter and our consolidated net income increased to $6.8 million, or $0.99 per share, this quarter from $3.1 million, or $0.45 per share, last year.The increases in both our consolidated revenues and consolidated net income were driven principally by our North American Coal subsidiary.

We continue to provide financial results, excluding North American Coal's Centennial mining operation to allow for a better understanding of the performance of the company's active operations.

Excluding Centennial, our second quarter consolidated adjusted income increased to $5.9 million, or $0.86 per diluted share, from $4.3 million, or $0.63 per diluted share, in the second quarter of 2016.

This quarter, Centennial reported income before tax of $1.4 million, primarily as a result of a $2.3 million gain on the sale of a dragline. Because of this, the consolidated adjusted income and North American Coal's adjusted income are lower than actual net income this quarter.

Revenues at North American Coal were $28.1 million in the second quarter of 2017 compared with $23.1 million last year and net income including Centennial was $8.4 million compared with net income of $3.3 million last year. The increase in revenues was driven primarily by higher customer requirements at Mississippi Lignite Mining Company and an increase in royalty and other income.

Excluding Centennial, North American Coal's 2017 adjusted income of $7.6 million increased over last year's second quarter adjusted income of $4.5 million, mainly because of an increase in royalty and other income.

Looking forward, we expect an increase in tons sold in the second half of 2017 compared with the same period in 2016 and we expect a moderate increase over the first half of this year. We also expect North American Coal's income before income tax to decrease in the remainder of the year compared with last year, resulting in a substantial increase in full year 2017 income before income tax.

Lower leasehold related and employee related expenses are expected to contribute to this increase in income before tax, but are anticipated to be partially offset by a substantial decrease in Mississippi Lignite's second half 2017 results compared with both the prior year and first half of 2017, primarily as a result of reduced customer requirements. We also expect lower results from North American Mining's consolidated limerock mining operations.

Centennial's second half operating loss is anticipated to be comparable to the loss realized in the second half of 2016, excluding special charges recognized last year.

Income before income tax for the second half of 2017 is expected to benefit from an increase in earnings from the unconsolidated mining operations due to the start of production at Bisti Fuels on January 1 of this year. In addition, at North American Mining Company's unconsolidated operations, mining commenced last year at additional limerock quarries for an existing customer and for a new customer. And in June 2017, North American Mining signed a new contract with a new limerock customer for operations that commenced in July. All of these new North American Mining operations are also expected to contribute to the increase in income from the unconsolidated mining operations.

North American Coal's previously communicated longer term goal was to increase the earnings of its unconsolidated operations by approximately 50% from the 2012 level of $42.5 million. As I mentioned previously, should the decision to suspend operations of the Kemper County energy facility gasifier and Liberty Mine become permanent, this will unfavorably affect North American Coal's long-term earnings. This reduction in earnings would unfavorably affect its longer term goal.

While the current regulatory environment for development of new coal projects has improved, continued [ph] low (08:18) natural gas prices and growth in renewable energy sources such as solar and wind could unfavorably affect the amount of electricity generation attributable to coal fired power plants over the longer term. We will be reevaluating our outlook over the longer term for coal deliveries to our customers' coal fired power plants, and commensurate with this the long-term financial goal.

Finally, we expect cash flow before financing activities to be strong in 2017 at North American Coal, but decrease significantly in both the second half and for the full year compared with the same periods in 2016.

Moving on to Hamilton Beach, Hamilton Beach continues to have a solid year. Both operating profit and net income in this quarter increased over the prior year on comparable revenue. Lower costs and an increase in sales of higher-margin and higher-priced products lead to higher gross profit, which was only partially offset by an increase in employee-related costs.

Looking forward, we believe overall consumer confidence and changing consumer buying patterns continue to create uncertainty about the overall growth prospects for the U.S. retail market for small appliances.

In the second half of 2017, we expect U.S. and Canadian consumer retail markets for small kitchen appliances to be comparable to the second half of last year while international and commercial markets in which Hamilton

Beach participates are expected to continue to grow moderately. Sales are expected to continue to shift from in-store channels to Internet sales channels.

As a result of this market environment and with the number of new products in its product pipeline, we expect Hamilton Beach's sales volumes and revenues to increase in the remainder of this year compared with the second half of last year resulting in overall modest full-year increases provided consumer spending is at expected levels.

These increases are expected to be slightly more than the anticipated market growth due to enhanced distribution and increased higher margin product placements resulting from the execution of the company's strategic initiative, both domestically and internationally.

In addition, we expect Hamilton Beach's net income in the second half and for the full-year 2017 to increase modestly compared with the prior-year period as benefits of the increased revenues are expected to be partially offset by the cost to implement these initiatives as well as by increased distribution, advertising, and employee-related costs.

For both the second half 2017 and full-year 2017, we expect Hamilton Beach's cash flow before financing to be substantial, but lower than full-year 2016.

Finally, our Kitchen Collection business reported a net loss of $2 million both this quarter and a year ago on a revenue decrease attributable to closing underperforming stores over the past year.

A shift in consumer shopping patterns has led to declining consumer traffic to physical retail locations and reduced in-store transactions as consumers buy more over the Internet or utilize the Internet for comparison shopping. We expect these factors to increasingly minimize Kitchen Collection's target consumer spending on housewares and small appliances in more locations.

Given this market environment, Kitchen Collection closed 18 stores in the first half of 2017 and expects to continue to aggressively manage its store portfolio with a continued focus on a smaller core group of profitable Kitchen Collection outlet stores in more favorable mall locations.

As a result of these actions, we expect that revenues and results at Kitchen Collection will continue to decline in the second half to 2017 compared with the prior year. And we also expect full-year 2017 operating results to decrease compared with 2016.

Finally, we expected Kitchen Collection's 2017 cash flow before financing activities to be close to breakeven.

Before I open up the call to questions, we want to note that the company did not repurchase any shares under our stock repurchase program this quarter.

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And you have no questions coming into the queue at this time.

Christina Kmetko

Investor Relations Consultant, NACCO Industries, Inc.

Okay, any comments?

Alfred M. Rankin

Chairman, President & Chief Executive Officer, NACCO Industries, Inc.

I have no concluding comments. I think our earnings release sums up the situation.

Christina Kmetko

Investor Relations Consultant, NACCO Industries, Inc.

Okay. Thank you for joining us today. We appreciate your interest and if you have any additional questions, please feel free to give me a call at my number 440-229-5130. Have a great day.

Operator: And ladies and gentlemen, this concludes today's call. You may now disconnect.