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NC - Q3 2015 NACCO Industries Earnings Conference Call

EVENT DATE/TIME: NOVEMBER 04, 2015 / 3:00PM GMT

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CONFERENCE CALL PARTICIPANTS

Vishu Dev *Resurgence Investment - Analyst*

PRESENTATION

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 Incorporated 2015 third-quarter earnings conference call. All lines are in a listen-only mode. After the presentation, there will be a question-and-answer session. (Operator Instructions). Thank you.

I will now turn the call over to Christina Kmetko with Investor Relations. You may begin your conference.

Christina Kmetko - *Evergreen Consulting & Associates - IR*

Thank you. Good morning everyone and welcome to our 2015 third-quarter earnings call. I am Christine Kmetko and I am responsible for Investor Relations at NACCO. 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 evening we published our third-quarter 2015 results and filed our 10-Q for the three and nine months ended September 30, 2015. 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 For anyone who is not able to listen to today's entire call, an archived version of this webcast will be on our website later this afternoon and available for approximately 12 months.

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 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 third-quarter earnings release available on our website.

Now let's discuss our results for the quarter.

Our consolidated revenues increased to $239.1 million in the third quarter of 2015 from $221.7 million last year. However, our net income decreased to $3.1 million or $0.45 per share from $7.7 million or $1.02 per share. While our Hamilton Beach and Kitchen Collection businesses both had improved results this quarter compared with last quarter, the decline in our consolidated net income was driven by our North American cooperation and more specifically its Centennial operations.

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We told you last quarter that we would cease mining operations at Centennial by the end of 2015 and would incur additional charges related to reclamation and severance as a result of this decision. The charges were not as large as we had anticipated but we did record pretax charges totaling $8 million during the third quarter which included $500,000 for severance and $7.5 million to increase Centennial's mine reclamation obligation.

Including these charges and all normal mine operating costs, Centennial realized an operating loss of $15.3 million in the third quarter of 2015 compared with a loss of $3.1 million last year. This substantial loss was partially offset by improvements at Mississippi Lignite Mining Company and an increase in royalty and other income. But North American Coal still reported an overall net loss of $5.3 million compared with net income of $3.2 million last year.

Looking forward to the fourth quarter of 2015, we expect improved operating performance in North American Coal's coal mining operations compared with the 2014 fourth quarter. Excluding the asset impairment charge of $66.4 million after-tax and the gains on the sale of assets recorded in the fourth quarter of last year, we expect income before income taxes in the fourth quarter of 2015 to increase substantially over last year's fourth quarter.

The bulk of this improvement is expected to come from a lower operating loss at Centennial than in the prior year.

To put some parameters around this, we anticipate Centennial's fourth quarter loss to be moderately improved from the loss recognized in the third quarter of 2015 excluding the mine reclamation and severance charges. Cash expenditures related to mine reclamation at Centennial will continue until reclamation is complete. We will continue to evaluate strategies to maximize cash flow at Centennial including the sale of mineral reserves, equipment and parts inventory.

Some equipment and parts inventory will be deployed to other North American Coal mine locations to minimize future capital expenditures. In addition to the reduced loss at Centennial, we expect fourth-quarter results from operations to be higher at the Mississippi Lignite Mining Company from an increase in tons sold. Substantially fewer tons were sold in the 2014 fourth quarter as a result of significant planned outages at the customers' power plant.

Cash flow before financing activities for the fourth quarter is expected to be modestly positive as compared with negative cash flow before financing activities last year.

In this quarter's release we have also provided some insight into our expectations for 2016. We expect 2016 income before taxes and North American Coal to increase compared with 2015. Results in 2016 are expected to benefit significantly from the elimination of North American Coal's only direct exposure to coal market price volatility with the cessation of mining operations at Centennial as well as higher income from the unconsolidated mining operation as production levels at Caddo Creek and Camino Real increase and Coyote Creek commences deliveries in 2016.

We still expect Centennial to incur a moderate loss in 2016 as it manages mine reclamation obligations and disposes of certain assets. The 2016 expected operating loss does not anticipate any potential gains on the sale of assets which could offset the anticipated loss.

Results at Mississippi Lignite Mining Company are expected to decline in 2016 compared with 2015. Mississippi Lignite Mining Company sells lignite at contractually agreed-upon coal prices. However, these prices are subject to changes in the level of established indices over time and the price of diesel fuel is heavily weighted among these indices. As a result, we expect the recent substantial decline in diesel prices to reduce earnings because the decline in revenue will only be partially offset by the effect of the lower diesel prices on production costs.

Finally, we expect cash flow before financing activities to decrease substantially in 2016 compared with 2015 primarily as a result of the receipt of cash from the repayment of the receivable related to Coyote Creek in 2015 and higher capital expenditures. Capital expenditures are expected to be approximately $25 million in 2016 compared with $7.6 million in 2015.

Now let me turn to Hamilton Beach. Again this quarter Hamilton Beach reported very solid and improved results over 2014. Excluding the impact of the Weston Brands acquisition which occurred in December 2014, revenues increased approximately 14% or $18.6 million this quarter compared with last year predominantly driven by higher sales volumes in the US consumer market. Unfortunately only a small portion of this substantial increase flowed through to net income which increased to $6.4 million in the third quarter from $6 million last year.

The benefits of increased volume as well as incremental operating profit from Weston were substantially offset by unfavorable foreign currency movements which negatively affected both revenues and net income, a shift in mix to lower margin products, higher product costs and an increase in operating expenses.

Current market conditions are uncertain and vary between markets. However in spite of these market conditions, we expect Hamilton Beach's consolidated sales volumes in the fourth quarter of 2015 to increase compared with last year. This anticipated increase in sales volumes coupled with new products and the execution of the Company's strategic initiative are expected to lead to an increase in revenues in the fourth quarter compared with last year provided consumer spending is at anticipated fourth-quarter levels.

We expect Hamilton Beach's fourth-quarter 2015 operating profit to be comparable to the fourth quarter of 2014. The benefits from the anticipated increase in sales volumes in revenues along with recognition of a full quarter of Weston's operating profit and related synergies from the acquisition are expected to be fully offset by unfavorable foreign currency movements, increased advertising costs and higher transportation and warehousing costs from the increased sales volumes. Nonetheless, we expect fourth-quarter 2015 net income to be lower than in the fourth quarter of 2014 because of the absence of $1.6 million of discrete tax benefits realized last year.

Excluding the cash paid for Weston last year, we expect Hamilton Beach's cash flow before financing activity to be higher in 2015 than it was a year ago.

Looking at 2016, the consumer retail market for small kitchen appliances is expected to be comparable to down slightly from this year. However, the hunting, gardening and food enthusiast markets that Weston Brands participates in as well as Hamilton Beach's international markets are expected to grow moderately.

As a result, we expect Hamilton Beach's sales volumes, revenues and net income to increase in 2016 compared with 2015 due to enhanced distribution and increased higher-margin product placements resulting from the execution of Hamilton Beach's strategic initiative partially offset by the cost to implement these initiatives, increased advertising costs, modest increases in distribution costs and unfavorable foreign currency movements.

We also expect cash flow before financing activities in 2016 to be slightly higher than this year.

Finally, our Kitchen Collection business also improved in the third quarter. While revenues continued to decline mainly as a result of a strategic decision to close a significant number of stores since the third quarter of 2014, results continued to improve.

Kitchen Collection reported a lower net loss of $600,000 in the third quarter, an improvement from a net loss of $1 million last year mainly because of the closure of unprofitable stores combined with improved results at the Kitchen Collection comparable stores.

Kitchen Collection expects continued market softness in the fourth quarter of this year and in 2016. Given this market environment, Kitchen Collection has realigned its business by closing underperforming stores leaving a smaller number of core Kitchen Collection outlet stores which are expected to perform with acceptable profitability. Kitchen Collection still expects to open an additional seven outlet stores during the fourth quarter of 2015.

In total, fewer stores will be opening during the fourth quarter than a year ago which is expected to result in lower fourth-quarter revenues compared with last year's fourth quarter.

Despite substantially lower sales volumes, we expect a significant improvement in Kitchen Collections operating profit in the fourth quarter 2015 compared with last year largely because of the absence of charges totaling $2.8 million pretax recorded in the fourth quarter of last year related to realigning the business.

The improvement in profitability per store is primarily the result of closing underperforming and loss generating stores early in 2015 and reducing the Company's expense structure. The anticipated improved fourth-quarter results are also expected to contribute to roughly breakeven operating profit for full-year 2015.

Cash flow before financing activities for the full-year is expected to be positive again but down from the level generated in 2014. Despite continued market weakness, we anticipate Kitchen Collections 2016 revenue to increase marginally compared with 2015. As a result of the anticipated increase in revenues and the comprehensive realignment actions taken during 2014 and 2015, we anticipate Kitchen Collection may return to profitability in 2016 and be prepared to take advantage of any future market rebound.

Finally, we expect cash flow before financing activities to be positive next year but substantially lower than this year.

Before I open up the call for questions, I want to note that on October 6 we completed our $60 million stock repurchase program. Under the program which began in November 2013, we repurchased 1 total of approximately 1,122,900 shares.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions).

Christina Kmetko - *Evergreen Consulting & Associates - IR*

While we are waiting, let me provide you with some contact information for any additional questions at the conclusion of today's call. My number is 440-229-5130. Are there any questions?

Operator

There are no questions at this time.

Christina Kmetko - *Evergreen Consulting & Associates - IR*

Okay.

Operator

[Vishu Dev], [Resurgence Investment].

Vishu Dev - *Resurgence Investment - Analyst*

Good morning. Congratulations on a good quarter. Just a couple of big picture questions if you will. Resurgence was a shareholder since the spin-off approximately three years ago and we are value investors and NACCO continues to be very substantially undervalued possibly because of the unusual mix of assets and the perceived exposure to what maybe the most hated asset class today which is coal.

And I was wondering if the Board and the management has given any thought to spinning off or separating Hamilton Beach in some fashion so that it receives a valuation befitting its high return capital growth and the fact it is a branded consumer appliances company? That is my first question.

Unidentified Company Representative

The tradition and history for our Company is that our Board considers all kinds of strategic options periodically. Obviously the Board under the right circumstances is prepared to consider a spin-off. So we did it with Hyster Yale and we have discussions on these matters periodically with the Board. But at this time there is no plan in motion to do that.

Vishu Dev - *Resurgence Investment - Analyst*

Understood. My second question pertains to free cash flow. Now with Centennial gone thankfully free cash flow ought to improve very considerably going forward. And I was wondering to what use you expect to put that free cash flow? The two buybacks of course were terrific, you bought back a substantial amount of undervalued stock and I was wondering how you might use free cash flow going forward?

Unidentified Company Representative

I think you are correct in terms of your premise that each of our three businesses we expect to be free cash flow generators prospectively and we will look at a whole variety of options. As you know, we have had a share repurchase program. That is certainly one possibility that the Board could consider looking at.

Secondly, we do have debt on our coal company balance sheet in particular and so there is a debt reduction opportunity if we choose to do that. And we of course continue to pay dividends and we will look at our dividends. We will look at a whole variety of things but I think the core point that you make at the moment is that as we see it right now, don't see opportunities to invest in the core businesses that we have. We are of course willing to look at certain kinds of acquisitions. We looked at the Weston acquisition for Hamilton Beach. We keep our eyes open for that sort of incremental niche sound fit within existing business but at this point I would leave it at that.

Vishu Dev - *Resurgence Investment - Analyst*

Understood. My final question pertains to the line in the press release about targeting 2017 unconsolidated mine profits of about 50% higher than 2012. I think that brought me to a number of about [$68,000] to $1 million versus trailing earnings for that unconsolidated business of about $49 million. I was just wondering how we would bridge that gap between now and 2017 given the Liberty mine doesn't really come on really posting for some time.

Unidentified Company Representative

Of course the Liberty Mine plan at the moment we would hope is a conservative plan. We don't know. We have other mines that are coming on stream. We have opportunities to increase and we have other things that we hope will fall into this general area. So that continues to be our objective. We will evaluate that on a continuing basis as we look forward especially as we complete our long-range financial forecasting and our strategic planning activities which historically come together at the end of this year. But generally, it is coming from new mining operations that are coming up to speed that contribute to those numbers. At this point I think I would leave it at that.

Vishu Dev - *Resurgence Investment - Analyst*

I have no further questions. Thank you for your time.

Operator

There are no further questions at this time.

Christina Kmetko - *Evergreen Consulting & Associates - IR*

Okay. Thank you so much for joining us and again if you do have any additional questions, please feel free to give me a call.

Operator

Thank you for participating in today's NACCO Industries Incorporated 2015 third-quarter earnings conference call. This call will be available for replay beginning at 1 PM Eastern time today through 11:59 PM Eastern time on November 11, 2015. The conference ID number for the replay is 58805733. Again, the conference ID number for the replay is 58805733. The number to dial for the replay is 1-800-585-8367.

Thank you for joining today's call. You may now disconnect.