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Yield with a catch

James Robertson, Jr. writes:

In America, not-green coal has been on its way out for 19 years; its consumption peaked in 2005. Just before Thanksgiving, the Biden administration gave the industry a parting kick by barring new production in the nation's biggest and most productive coal deposit, the Powder River Basin, which lies beneath Montana and Wyoming. No surprise, then, that coal-mining shares are cheap. Cheaper, still, is the only publicly traded coal and soda-ash royalty company, Natural Resource Partners, L.P. (NRP on the Big Board). In preview, *Grant's* is bullish on it.

Natural Resources owns 13 million acres of mineral and other property interests across the United States. It trades at 8.5 times earnings and 5.4 times free cash flow versus 9.4 times and 6.3 times for miners represented in the Range Global Coal Index (thanks to paid-up subscriber Mitchell Schorr, who set this analysis in motion).

There are more than a few reasons why NRP trades at a discount to the miners that work its lands. For one, its founders set up the company as a master limited partnership, which complicates tax season with the dreaded K-1 form. For another, only about $3 million's worth of partnership units change hands on an average weekday. For a third, exactly not one analyst follows the company.

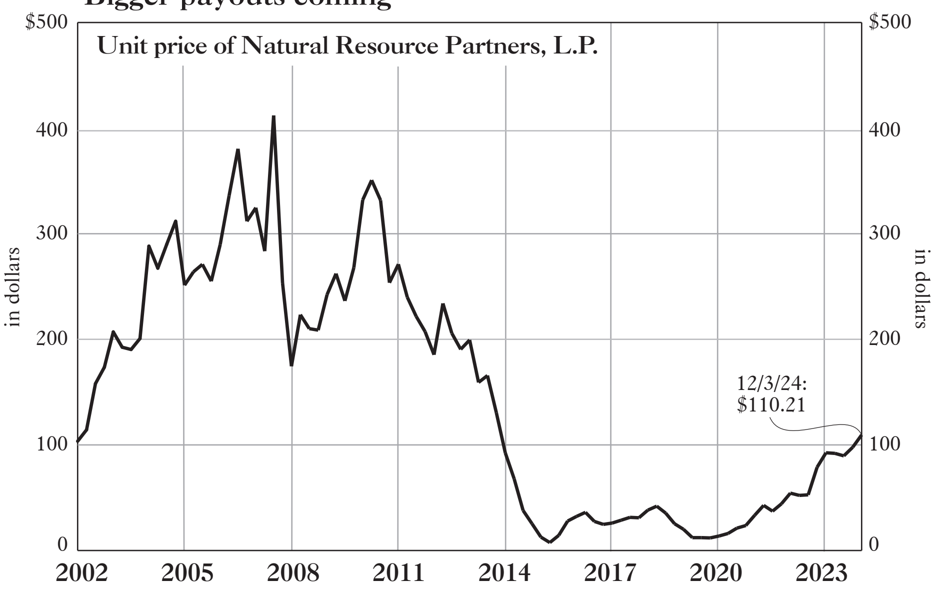
Besides, coal prices are weak, soda-ash prices are weaker and the company's export operations (most of its metallurgical coal finds markets abroad) could be at risk in a trade war.

Then there's the balance sheet. Following a near-death experience in the energy crash of 2015, management took the deleveraging pledge. It proceeded to pay off $1.3 billion in debt in the next 10 years, only slightly less than the current market cap. "We have learned firsthand," NRP's president and chief operating officer, Craig Nunez, declared on last year's second-quarter call, "that it would be imprudent for a company such as ours with our business profile to rely at all on sourcing capital from banks or capital markets to fund our business in the future"—not that many lenders would want anything to do with coal anyway. So no more slathering of financial leverage over commodity-price risk. All to the good, but there's a catch.

Over-encumbered, NRP had little room to chase potentially dilutive acquisitions. The partnership's chief executive, the Texas coal magnate Corbin Robertson, Jr. (no relation), also controls a wide-ranging energy empire and has offered NRP chances to participate in acquisitions scoped out by affiliated companies, most recently in 2020. NRP declined the opportunities. Now that the handcuffs of debt and associated covenants have been loosened, the temptation to build a little coal- and soda-ash-themed empire might one day prove irresistible.

What NRP does offer is a margin of safety in the volatile and unpredictable coal trade with the potential for a step-change in free cash flow and for the

Bigger payouts coming



source: The Bloomberg

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return of those funds to the owners. Besides the prospect of much higher dividends, units carry a call option on the carbon-capture industry among other uses for its aforementioned vast holdings of land and mineral rights.

Natural Resource Partners owns the subterranean rights to two types of coal, metallurgical and thermal. Met coal, most of which is fed to foreign steel-making blast furnaces, accounted for 54% of 2023 revenues. Thermal coal, which is burned to generate heat and electricity, contributed 16%.

NRP also owns a 49% stake in soda-ash producer Sisecam Wyoming. Soda ash is sold at home and abroad to chemical and industrial companies to make detergent, glass and lithium batteries, among other end uses; it chipped in 20% of last year's revenues. A hodgepodge of wheelage and transportation fees, oil and gas royalties and carbon-sequestration leases round out the revenue streams. Fifty-five employees work for the company, but none works full-time. They split their hours with, and receive their salaries from, other Robertson energy concerns.

Environmentalists revile the business. The Wall Street kind of disapproval takes the form of short sales, in this case of a mild 2% of the float. Then, again, those who know the business the best love it the best. Insiders own 28.9% of the outstanding units and have sold not a single unit in seven years.

Conference calls, as you can imagine, tend to be one-sided affairs with management fielding one or, more often, no questions at all after walking through their quarterly earnings. Not so on the latest call, however. Questions poured in after NRP announced the successful repurchase of the warrants and preferred equity shares that had previously honeycombed the capital structure. Nearly all the investors who queued up to speak wanted to know what NRP planned to do with the unencumbered free cash flow.

Nunez waved them away, insisting that the time to discuss distributions was when the residual $181 million in debt had been repaid. One investor asked whether management's goal was debt of exactly zero dollars and zero cents. No, Nunez responded, he might consider talking about the cash-distribution plan when debt registered nominally above zero.

In 2015, NRP cut its dividend by 87% as energy markets convulsed, and its portfolio of coal, oil and gas royalties, as well as its rock quarries, sand, gravel and asphalt plants, came under severe strain. At the time, debt stood at 5.7 times Ebitda and represented more than two-thirds of capital. Grasping for a lifeline in 2017, the company found Blackstone, Inc. and GoldenTree Asset Management, L.P., which charitably accepted preferred stock priced to yield 12%.

NRP units currently pay a dividend yield of 2.74% versus a free cash-flow yield of 18.4%. The Internal Revenue Service taxes MLPs not at the corporate but the individual level, so the FCF yield is a pretax figure. Nevertheless, the discrepancy between money coming into the partnership, on the one hand, and money going out to the unit holders, on the other, invites optimistic thoughts about future payouts. And with an asset-light royalty model, Natural Resource's FCF streams are better protected against adversity than those of the operating miners.

Some signs point to a firming of underlying commodity prices. While new thermal-coal-fired plants are unlikely, the changing of the guard at 1600 Pennsylvania Ave. may slow the closure of existing plants and reverse the bans on new coal mines. Utility companies Southern Co. and Duke Energy Corp. announced plans this month to revisit scheduled plant closures in the light of Trump Part II and AI data centers' voracious energy demand.

Data centers require steel—and a lot of it. Meta Platforms, Inc.'s new data center in Arizona, due in 2026, will need 12,000 tons, equivalent to 30 fully loaded Boeing 747s, as Horizon Kinetics's third-quarter commentary relates. Reestablishing made-in-America industry will also generate demand for met coal, especially for aeronautics and military applications, which require high-grade, virgin steel.

And while Chinese benchmark soda-ash prices have tumbled by 45% this year, NRP's interests in Wyoming operate some of the lowest-cost mining operations in the world. The key is that mined trona, which reduces to soda ash, is much cheaper than the synthetic kind produced by China, among other countries. Sisecam's advantageous position on the cost curve allows it to compete even when prices are depressed.

Growth could come from the cleaner side of NRP's operations, too, namely the unit for carbon capture and sequestration. Should the technology and market prove out—which nobody should expect to happen tomorrow—NRP holds 3.5 million acres of underground pore space, sponge-like pockets of sand and rock where carbon dioxide can be safely tucked away. So far, NRP has signed leases with ExxonMobil Corp. and Occidental Petroleum Corp. Of the tax credits contained in the Inflation Reduction Act, carbon capture is one of the likeliest to survive under Trump's new administration, Bloomberg reported two weeks ago.

So what might NRP pay out in dividends? Matthew Franz, principal at Eagle Point Capital, LLC and a holder of NRP shares, guesses a distribution yield on the order of 10%–15%. If the company paid out all its year-to-October free cash flow, units would yield 18.4% pretax. And while NRP does not quite have a listed peer, the oil and gas royalty company Black Stone Minerals, L.P. trades at 11.3 times forward earnings and pays a 9.7% dividend. With a yield in that neighborhood, NRP might just attract an analyst.

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