NACCO Industries (NC)

Updated August 15th, 2018 by Nate Parsh

Key Metrics

Current Price:	$36	**5 Year CAGR Estimate:**	8.4%	**Volatility Percentile:**	99.7%
Fair Value Price:	$50	**5 Year Growth Estimate:**	0.0%	**Momentum Percentile:**	99.4%
Fair Value:	72%	**5 Year Valuation Multiple Estimate:**	6.6%	**Valuation Percentile:**	94.9%
Dividend Yield:	1.8%	**5 Year Price Target**	$50	**Total Return Percentile:**	54.0%

Overview & Current Events

NACCO Industries is a holding company for The North American Coal Corporation. The company incorporated in 1913. The company supplies coal from surface mines to power generation companies. NACCO has been very active in purchasing and spinning off a wide variety of businesses in recent years. In 1988 and 1990, NACCO made several purchases that expanded the business to include housewares. In 2012, NACCO spun off its Materials Handling Group (a combination of Yale Materials Handling Corporation and the Hyster Company). The company completed its spinoff of its housewares-related business on 9/29/2017. NACCO operates in the states of North Dakota, Texas, Mississippi, Louisiana and on the Navajo Nation in New Mexico. NACCO has a current market cap of almost $252 million.

NACCO reported 2nd quarter earnings on August 1st. The company earned $0.92 per share, a decline of 7.1% year over year. Revenue grew 10.2% to $31.2 million.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$0.74	$1.03	$9.53	$14.86	$5.02	$5.79	$3.98	$3.13	$4.32	$4.14	***$4.14***	***$4.14***
DPS	$2.05	$2.07	$2.09	$2.12	$1.88	$1.00	$1.02	$1.05	$1.07	$0.98	***$0.66***	***$1.04***

Because NACCO spun off its Materials Handling Group in 2012, it is not appropriate to compare today's company to the pre-spinoff equivalent. Over the past 5 years, NACCO has seen its earnings per share decline 6.5% per year through 2017. Management has not offered guidance for 2018, but the company did perform better in its final quarter of 2016 versus 2017. Because NACCO has show negative growth since 2012, and volatile earnings-per-share since then, we are projecting flat earnings-per-share growth out over the next 5 years.

NACCO saw its unconsolidated coal deliveries increase 6.7% in the 2nd quarter while consolidated coal deliveries improved 14.3%. Unconsolidated coal is easier to acquire because it is found among loose materials where consolidated coal is found among solid rock. Limestone deliveries were up 6.3%. Revenues were up for both products in large part to an increase in the number of tons sold at the company' Mississippi Lignite Mining Company. Earnings-per-share totals were down on a comparable basis because of asset sales during the 2nd quarter of 2017. NACCO ended the quarter with $80 million in cash and debt of $28 million, for a net cash position of $52 million. The company announced in February that it would repurchase up to $25 million of its own stock, which would equate to 10% of its current market cap.

Adjusting for the spin-off of its housewares business, NACCO increased its dividend 92% for last December's payment. While NACCO has increased its dividend by 11.6% per year over the past 5-years, the company will likely be unable to match this growth rate if earnings do not reverse their decline. Using the average payout ratio over the past 5 years (25%), shareholders are likely looking at $0.69 in dividends per share by 2023.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	105.4	41.6	8.9	6.2	18.4	10.0	13.8	16.8	14.5	18.2	***8.7***	***12.0***
Avg. Yld.	2.6%	4.8%	2.5%	2.3%	2.0%	1.7%	1.9%	2.0%	1.7%	1.3%	***1.8%***	***2.1%***

Shares of NACCO have increased $1, or 2.9%, since our April 27th update. Focusing on just the past 5 years, NACCO shares have traded with an average price to earnings multiple of 14.7. This is significantly higher than the stock's current multiple of 8.7. Investors are just not willing to pay for a company that has declining earnings while the rest of the investment world enjoys an extended bull market. We do expect some reversion to the mean here, but NACCO needs to prove it can reliably grow earnings-per-share before it reaches its 5-year historical averages. We are targeting a price to earnings ratio of 12.0 for the stock.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	29.1%	27.4%	14.9%	11.6%	29.1%	27.3%	24%	-1.7%	1.8%	4.3%	***3.7%***	***1.5%***
Debt/A	78.9%	73.3%	73%	68.1%	63.8%	63.2%	72.6%	69.3%	67%	43.7%	***47.6%***	***63.2%***
Int. Cov.	-11.5	2.1	6.8	13.8	10.5	12.7	-9.1	-0.46	-.55	9.5	***8.2***	***3.4***
Payout	277%	201%	21.9%	14.3%	37.5%	17.3%	25.6%	33.5%	24.8%	23.7%	***15.9%***	***25%***
Std. Dev.	79.5%	99.6%	70.7%	55.7%	43.9%	33.2%	31.5%	34.3%	31.6%	77.7%	***70.5%***	***41.7%***

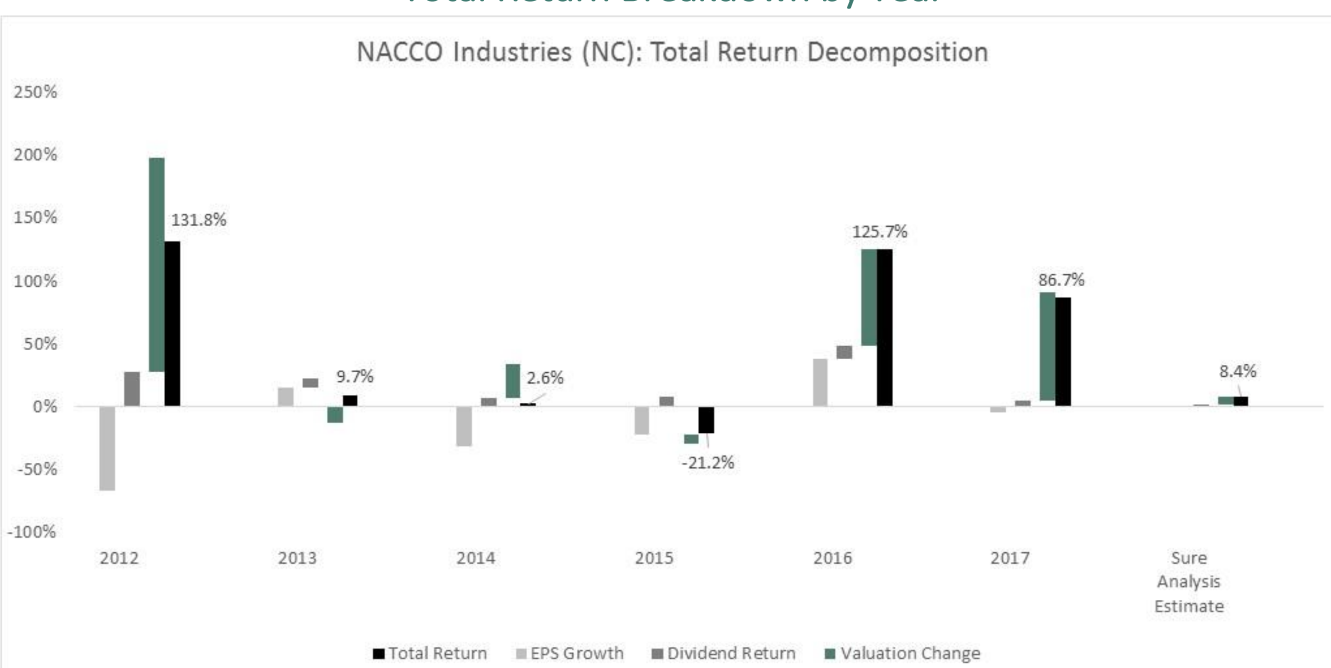
The previous version of NACCO actually saw earnings improve during the last recession, but this is not the same company. NACCO now sees a substantial portion of revenues from coal. As demand for coal fluctuates, so will NACCO's ability produce revenue. Gross profit has also severely declined over the past three years and so far, the company has not given investors reason to think that trend will reverse in the near future.

On the plus side, NACCO has managed to maintain or lower its debt to asset ratio in recent years. The company has also kept its payout ratio low in recent years, which is a prudent decision by management as earnings-per-share continues to drop. NACCO is not at risk for a dividend cut, though if earnings continue to drop then a cut could eventually occur.

Final Thoughts & Recommendation

We now expect total annual returns of 8.4% through 2023 for shares of NACCO, up from our earlier estimate of 7.6%. The majority of this expected return should come from valuation expansion. Earnings-per-share for 2018 is an unknown quantity because NACCO has not offered any guidance in this area. If the company sees its earnings-per-share continue to decline, stock performance will likely be significantly worse. While there is upside potential for multiple expansion, we maintain our sell rating on NACCO as the stock possesses significant risk and uncertainty. Unless earnings-per-share growth returns, investors are encouraged to seek alternative investments. We maintain our 2023 price target of $50.

Total Return Breakdown by Year



Disclosure: This analyst has no position in the security discussed in this report and no plans to initiate one in the next 72 hours.