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MDU - Q4 2019 MDU Resources Group, Inc. Earnings Call

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PRESENTATION

Operator

Hello. My name is Cheryl, and I will be your conference facilitator. At this time, I would like to welcome everyone to the MDU Resources Group 2019 Year-end Earnings Results and 2020 Guidance Conference Call. (Operator Instructions) This call will be available for replay beginning at 5 p.m. Eastern today through 11:59 p.m. Eastern on February 19, 2020. The conference ID number for the replay is 7173266. The number you dial for the replay is 1 (855) 859-2056 or (404) 537 3406.

I would now like to turn the conference over to Jason Vollmer, Vice President, Chief Financial Officer and Treasurer of MDU Resources Group. Thank you. Mr. Vollmer, you may begin your conference.

Jason L. Vollmer - MDU Resources Group, Inc. - VP, CFO & Treasurer

Thank you, Cheryl, and welcome to our conference call covering our 2019 earnings results and 2020 guidance. This conference call is being broadcast live to the public over the Internet, and slides will accompany our remarks. If you would like to view the slides, please go to our website at www.mdu.com and go to the Events and Presentations page under the Investors tab. Our earnings release is also available on our website.

During the presentation, we will make certain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934. Although the company believes that its expectations and beliefs are based on a reasonable assumption, actual results may differ materially. For a discussion of factors that may cause actual results to differ, please refer to Item 1A, Risk Factors, in our most recent Form 10-K. For our call today, I will discuss key financial highlights and then turn the presentation over to Dave Goodin, President and CEO of MDU Resources Group, for his formal remarks. After Dave's remarks, we will open the line for questions.

In addition to Dave and myself, members of our management team who will be available to answer questions today are: Dave Barney, President and CEO of Knife River Corporation; Jeff Thiede, President and CEO of MDU Construction Services Group; Nicole Kivisto, President and CEO of Cascade Natural Gas, Great Plains Natural Gas, Intermountain Gas and Montana-Dakota Utilities; Trevor Hastings, President and CEO of WBI Energy; and Stephanie Barth, Vice President, Chief Accounting Officer and Controller of MDU Resources.

Yesterday, we announced 2019 earnings of \$335.5 million or \$1.69 per share compared to 2018 earnings of \$272.3 million or \$1.39 per share. This is an increase of 23% year-over-year. In the fourth quarter, earnings were \$95.1 million or \$0.47 per share compared to \$78.8 million or \$0.40 per share in 2018. For 2019, our combined utility business reported earnings of \$94.3 million compared to \$84.7 million in 2018.

Our electric utility segment earned \$54.8 million in 2019 compared to prior year earnings of \$47 million. This increase in earnings was a result of higher electric gross margins, which increased due to higher average per unit rates that included rate recovery in the State of Montana. This business also reported higher revenues from the Big Stone-South-to-Elendale transmission line and higher investment returns during the year. Partially



offsetting these increases were higher depreciation, depletion and amortization expense from increased asset additions and higher operation and maintenance expense, primarily payroll-related costs.

The natural gas utility segment had earnings of \$39.5 million in 2019 compared to prior year earnings of \$37.7 million. The increase in earnings was largely due to higher retail sales margins as a result of a 9.9% increase in retail sales volumes, partially offset by weather normalization and conservation adjustments. Approved rate recovery and higher investment returns also had a positive impact on earnings. These increases were partially offset by higher operation and maintenance expense and higher depreciation, depletion and amortization expense.

At the pipeline and midstream business, earnings in 2019 were \$29.6 million compared to prior year earnings of \$28.5 million. Earnings in 2018 included a \$4.2 million tax benefit from the result of a reversal of a regulatory liability. The increase in earnings was largely the result of higher transportation revenues from record transportation volumes, largely related to organic growth projects and higher customer rates due to our FERC rate case settlement, which was effective May 1, 2019. Increased investment returns also had a positive impact on the year. Partially offsetting these increases was higher depreciation, depletion and amortization expense from increased asset additions as well as higher depreciation rates from the previously mentioned FERC rate case.

Our construction services business reported record revenues of \$1.85 billion, up from \$1.37 billion in the prior year and record earnings of \$93 million in 2019, up 45% from 2018 earnings of \$64.3 million. This business' earnings increased due to higher inside specialty contracting margins, a direct result of increased workloads in the hospitality and high-tech industries as well as the absence of changes in estimates on certain construction projects that we made in 2018. Outside contracting margins also increased for the year. This was driven by higher workloads from strong utility customer demand. Partially offsetting the increase was higher selling, general and administrative expense, primarily payroll-related costs due to record staffing levels.

Construction services backlog at the end of the year was \$1.14 billion, up 22% from 2018's record. The construction materials business also reported record revenues of \$2.19 billion and earnings of \$120.4 million compared to 2018 revenues of \$1.93 billion and earnings of \$92.6 million.

Higher contracting and materials revenues from strong economies across the company's footprint and higher materials volumes related to businesses acquired since the third quarter of 2018 drove the increase in earnings. This business had asset sale gains that were approximately \$5.6 million higher after-tax than the prior year, which further increased earnings. Partially offsetting these increases were higher selling, general and administrative expense and higher interest expense. The construction materials backlog at the end of the year was \$693 million, down just slightly from last year's record backlog of \$706 million.

Now I'd like to turn the call over to Dave for his formal remarks. Dave?

David L. Goodin - MDU Resources Group, Inc. - President, CEO & Director

Thank you, Jason, and good afternoon, everyone, and thank you for joining us this afternoon. I'm happy to report that our performance in 2019 was again at record levels in a number of areas. As we look to 2020, I am pleased with the opportunities in front of us to continue to execute on our growth strategy with a focus on growing both organically and through strategic acquisitions.

Before I dive into the details of 2019, I do want to extend a heartfelt thank you to the employees of our MDU Resources companies for another great year. Their commitment to our customers, communities and shareholders, all while operating safely and with integrity, is allowing us to provide exceptional operating results as we continue building a strong America.

Together, we reported 2019 earnings of \$1.69 per share compared to 2018 where we reported earnings of \$1.39 per share. We are very proud of our record of consistently rewarding our shareholders with a growing dividend while investing in our businesses to fund growth opportunities across all business lines.

At our utility companies, we reported record earnings for 2019 driven by a nearly 10% increase in natural gas sales volumes and implemented rate relief. Throughout the year, the utility completed several organic growth projects. Natural gas service was brought to Gwinner, North Dakota, and



the Big Stone-South-to-Blendale transmission line was brought into service. Rate cases were filed in several states, and utility was able to finalize and implement new rates in 2 of them.

Looking at 2020, the company currently has 2 pending rate cases and anticipates filing additional rate request throughout the year. On Monday of this week, a natural gas case in the State of Washington was approved with a 2.8% increase in Cascade's annual revenues, with new rates to be effective on March 1 of this year. This business continues to work on the regulatory filings and planning required to construct, own and operate an 88-megawatt simple cycle natural gas combustion turbine near Mandan, North Dakota. This facility is expected to cost approximately \$73 million and plans to be in service in 2023. These types of growth projects, paired with customer focus from our employees, allow us to provide some of the best customer service in the nation.

Recently, J.D. Power released their 2019 Gas Utility Residential Customer Satisfaction Study, which ranked Cascade Natural Gas, the highest mid-sized natural gas utility in the west region. Intermountain Gas ranked second, and Montana-Dakota ranked third. This is the second straight year that our utility companies have ranked 1, 2 and 3 and the fourth year that Cascade and Intermountain have filled the top 2 spots. Our utility companies take immense pride in serving our more than 1.1 million customers across our 8-state footprint.

And looking forward, we continue to see solid customer growth and expect to grow our customer base between 1% and 2% annually. We also expect rate base to grow approximately 5% compounded annually over the next 5 years, driven by investments in system infrastructure upgrades and replacements to safely meet customer demand.

At our pipeline business, we had a very full 2019 and for the third consecutive year, moved record volumes of natural gas through its pipeline system. Just yesterday, the company brought into service its Demicks Lake expansion project here in North Dakota, which has a capacity of 175 million cubic feet per day. With the additions of this expansion, coupled with Demicks Lake and Line Section 22 projects brought online in late 2019, the company now has capacity to transport more than 2.2 billion cubic feet of natural gas through its system per day. In the coming weeks, the pipeline business will be filing with FERC an application for a permission to proceed with construction on the North Bakken expansion project slated for 2021. This project would add approximately 350 million cubic feet of capacity per day. As you may recall, the North Bakken expansion project was originally introduced in early 2019 as a 200 million cubic foot per day project and has expanded twice to accommodate strong customer demand for this project and expected demand with continued record levels of natural gas production in the Bakken.

Now I'd like to turn to our construction businesses. The Construction Services Group ended another year with record revenues, record earnings and record backlog. The company continues to see strong demand for both inside and outside specialty contracting work. The inside contracting business segment is busy in the southwest and northwest markets where strong demand in the hospitality and high-tech industries are driving increased workloads. Outside contracting continues to see high volumes of electrical transmission, distribution, along with substation work for utility customers across our market areas. In 2019, this business acquired the assets of Pride Electric, an electric construction company based in Washington state. This business' strong performance throughout the remainder of the year added to the bottom-line growth we saw at this business.

More recently, on Monday of this week, we welcomed PerLectric to MDU Construction Services Group. PerLectric is a leading electrical construction company based in Fairfax, Virginia, with over 350 employees that specialize in new construction, tenant improvement and service work in the government, commercial, health care and high-tech markets. We are very excited to welcome the employees of PerLectric, along with their expertise to the MDU family.

At our construction materials business, we also had record revenues in 2019. This business continues to benefit from strong economic conditions in several states across its footprint. And as a result, material sales and contracting workloads increased in 2019, driving the 30% increase in earnings on a year-over-year basis. This business continues to successfully acquire businesses to expand aggregate reserves and market coverage across the western half of our nation.

For 2020, we will continue to evaluate additional acquisition opportunities at both businesses, and we look forward to successfully executing on projects in our record combined construction backlog, which now stands at \$1.84 billion, all while we focus on cost and efficiencies and most importantly, safety.



We expect full year construction services revenues to be in the range of \$1.85 billion to \$2.05 billion and construction material revenues to be in the range from \$2.2 billion to \$2.4 billion, with margins, importantly, comparable or slightly higher than our 2019 levels at both businesses.

That completes our individual business unit discussion. Now looking ahead as an overall corporation, and as noted in our release, we are initiating our 2020 earnings guidance to be in the range of \$1.65 to \$1.85 per share. This range reflects normal operating, economic and weather conditions, including precipitation and temperatures across all service areas and the investment of \$650 million for capital projects. And earnings from additional acquisitions made throughout the year would be incremental to this range and are not included in this capital forecast. Here at MDU Resources, we performed at record levels in 2019, and I'm optimistic that we're well positioned to produce significant long-term value as we execute on our business plans and explore potential acquisitions along with organic growth opportunities.

We continue to maintain a strong balance sheet, solid credit ratings and good liquidity positions. And for 82 consecutive years, we have continued to provide a competitive dividend to our shareholders while increasing it for the past 29 years. As always, MDU Resources is committed to operating with integrity and a focus on safety while creating superior shareholder value as we continue building a strong America. I certainly appreciate everyone's interest in and commitment to MDU Resources and ask now that we open the lines to questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from Chris Ellinghaus of Sebert Williams.

Christopher Ellinghaus - Sebert Williams Shank & Co., LLC., Research Division - Principal & Senior Equity Utility Analyst

I'm doing great, especially when you come out with earnings like this.

David L. Goodin - MDU Resources Group, Inc. - President, CEO & Director

Yes. Thank you, Chris.

Christopher Ellinghaus - Sebert Williams Shank & Co., LLC., Research Division - Principal & Senior Equity Utility Analyst

The PerLectric acquisition, that's kind of unusual being it -- on the East Coast. Does that tell us anything about your plans? Or was that just a one-off kind of get lucky?

David L. Goodin - MDU Resources Group, Inc. - President, CEO & Director

Yes, Chris. I'll start but then I'm going to hand over to Jeff, who really led that acquisition. Keep in mind, we already operate our construction services in some 43-or-so different states already, so we have nearly a nationwide footprint. But certainly, the Mid-Atlantic, where PerLectric is located is a nice addition, if you will, from a geography. I'll have Jeff, just maybe touch on the acquisition a little bit because we find it to be significant.

Jeffrey S. Thiede - President & CEO of MDU Construction Services Group, Inc

Thank you, Dave. Yes, PerLectric's office is less than 600 miles from another one of our CSG offices, ES in Ohio. We think they're a great fit. And we're involved in national contractor associations. And we look to find companies that have high integrity, a really good sound management team and excellent field people. And we found that with PerLectric, and it's not a one-off, and we'll continue to look for companies that are a fit for CSG in the Continental United States.



Christopher Elinghaus - Seibert Williams Shank & Co., LLC, Research Division - Principal & Senior Equity Utility Analyst

While I have you, Jeff, have you -- do you know in your backlog sort of what proportion is Vegas right now?

Jeffrey S. Thiede - President & CEO of MDU Construction Services Group, Inc

If you take a look at our Vegas backlog, without getting into specifics, if you take a look at Vegas our Southwest, our west and our Midwest, our backlog is broken up in thirds, so that's a good demonstration of our diversification and balance within our operations across the country.

Christopher Elinghaus - Seibert Williams Shank & Co., LLC, Research Division - Principal & Senior Equity Utility Analyst

And it also seems like maybe the Drew is gaining some traction lately, and you've expressed some reservations about having capacity to maybe work on the Drew. What do you know about the timetable there? And does it fit for you guys at all at this point?

Jason L. Vollmer - MDU Resources Group, Inc. - VP, CFO & Treasurer

Yes. Some of our backlog burns off, and that project has been pushed out. We think that we have a -- we'll have a part in that project, but it's confidential. And we are involved as one of the partners in that project.

Christopher Elinghaus - Seibert Williams Shank & Co., LLC, Research Division - Principal & Senior Equity Utility Analyst

Okay. Great. Also, Trevor, can you give us an update on other than what Dave had said about you'll be filing your permits soon? Can you just give us a little bit of update on the North Bakken expansion and what you're seeing there?

Trevor J. Hastings - President & CEO of WBI Holdings, Inc.

Sure, Chris. The -- as Dave mentioned in his opening remarks, we've increased the overall design on that project now to 350,000 Mcf a day. We have been working through the NEPA prefiling process where it works -- we work with all stakeholders. We're in the final stages of finishing up our draft application, which we expect to file with FERC in a couple of weeks.

Operator

Your next question comes from Andrew Levi of ExodusPoint.

Andrew Levi - ExodusPoint Capital Management, LP - Portfolio Manager

Just a very quick question. On the upper end of the range for '20, just describe to us kind of (inaudible) get you there, ex any (inaudible)

David L. Goodin - MDU Resources Group, Inc. - President, CEO & Director

Yes. I mean, we provided the range, Andy, between \$1.65 and \$1.85. And in that range guidance, I know we noted some factors there: normal weather, normal precipitation, normal ability to get out in the springtime with our construction activities, what we normally might expect from a fall, when the snow hits our northern tier areas. And so weather would have an impact on that. Certainly, favorable weather, we get out early.



We're sitting on a \$1.8 billion in backlog currently in construction. So clearly, there's quite a bit of work, kind of ready to go for this year. So important for us will be how early we can get out. I would say those would be some key factors. Again, we don't -- haven't baked in any acquisition activity as part of that range as well. And so acquisition activity could be incremental to that. But again, we'll update the earnings guidance as we go throughout the year as we've done in prior years as well. But -- so those would be some of the factors I would look at.

Andrew Levi - ExodusPoint Capital Management, LP - Portfolio Manager

January weather (inaudible) comments you (inaudible) I mean (inaudible)

David L. Goodin - MDU Resources Group, Inc. - President, CEO & Director

Yes. I mean, it's a tale of two cities. I mean, we're -- our utility business, obviously, does with natural gas sales, almost 1 million customers, relies on January weather there. We're normalized in or have more fixed bill rates in 6 of our 8 states, and so there's some normalization effect there.

And with our Northern tier exposure on the construction side, most of our ready-mix trucks are all parked from Minnesota through the Dakotas and to Montana, Wyoming and into Idaho. So I think it's early to tell so far as it's an early start to the year. We're just 1 month into it. I wouldn't opine on the weather so far. It's pretty early.

Operator

This marks the last call for questions. (Operator Instructions) This call will be available for replay beginning at 5 p.m. Eastern today through 11:59 p.m. Eastern on February 19, 2020. The conference ID number for the replay is 7173266.

At this time, there are no further questions, I would like to turn the conference back over to management for closing remarks.

David L. Goodin - MDU Resources Group, Inc. - President, CEO & Director

Thank you, Cheryl. 2019 was a very strong year for our businesses, which we all executed well on including our strategies. We are committed to building a strong America, along with being optimistic about our opportunities for 2020 and beyond. We appreciate everybody's participation on the call today.

And again, thank you for your continued interest in MDU Resources. With that, I'll turn this back to the operator. Cheryl?

Operator

This concludes today's MDU Resources Group Conference Call. Thank you for your participation. You may now disconnect.



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