

THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

MDU - Q1 2019 MDU Resources Group, Inc. Earnings Call

EVENT DATE/TIME: MAY 01, 2019 / 6:00PM GMT



CORPORATE PARTICIPANTS

David C. Barney President & CEO of Knife River Corporation

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

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

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

Stephanie A. Barth MDU Resources Group, Inc. - VP, CAO & Controller

CONFERENCE CALL PARTICIPANTS

Christopher Ellinghaus The Williams Capital Group, L.P., Research Division - Senior Equity Research Analyst of Power and Natural Gas

Sarah Akers Wells Fargo Securities, LLC, Research Division - Senior Equity Analyst

PRESENTATION

Operator

Hello. My name is Regina, and I will be your conference facilitator. At this time, I would like to welcome everyone to the MDU Resources Group 2019 First Quarter Conference Call. (Operator Instructions)

This call will be available for replay beginning at 5:00 p.m. Eastern Time today through 11:59 p.m. Eastern Time on May 15. The conference ID number for the replay is 5568769. The number to 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, and welcome to our first quarter 2019 earnings conference call. 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, you can find them on the Events and Presentations page under the Investors tab of our website at www.mdu.com. Our earnings release is also available on our website. During the course of this 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 its expectations and beliefs are based on reasonable assumptions, 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 some key financial highlights from the quarter and then turn the presentation over to Dave Goodin, President and CEO of MDU Resources, 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 are 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, Intermountain Gas and Montana-Dakota Utilities; Trevor Hastings, President and CEO of WBI Energy; and Stephanie Barth, Vice President, Chief Accounting Officer and Controller for MDU Resources.

Yesterday after market close, we announced our first quarter earnings of \$40.9 million or \$0.21 per share compared to first quarter 2018 earnings of \$42.4 million or \$0.22 per share. For the first quarter, our combined utility business reported earnings of \$52 million, up from \$45.7 million in the first quarter of 2018. The electric utility segment reported earnings of \$15.5 million for the quarter compared to \$13.1 million in 2018. Driving this increase in earnings were higher electric revenues associated with regulatory recovery in certain jurisdictions on the Thunder Spirit Wind farm expansion, which was purchased in the fourth quarter of last year. Higher returns on investments also had a positive impact on the quarter. Partially offsetting the increase in earnings were higher depreciation, depletion and amortization expense from increased property, plant and equipment balances.



Our natural gas utility segment reported earnings of \$36.5 million for the quarter compared to \$32.6 million in the prior year. This increase in earnings was a result of a 12% increase in natural gas sales volumes from colder-than-normal weather and higher returns on investments. Partially offsetting the increase was weather normalization in some jurisdictions and higher depreciation, depletion and amortization expense, again from increased property, plant and equipment balances. The pipeline and midstream business had earnings of \$6.8 million in the first quarter compared to \$5.3 million in 2018. The increase in earnings reflects higher transportation revenues primarily related to the organic growth projects that were placed in service in the second half of 2018. Partially offsetting the increase were higher interest expense and higher depreciation, depletion and amortization expense from higher property, plant and equipment balances as well as lower storage revenues. Our construction services business reported a record first quarter earnings of \$20 million compared to \$15.1 million in 2018 and record first quarter revenues of \$420.9 million, up 26% from the first quarter 2018 revenues of \$334.1 million. This business saw an increase in earnings from higher workloads at both its inside and outside specialty contracting lines. Inside specialty contracting companies saw higher workloads from increased customer demand for projects in the hospitality and high-tech industries. Outside specialty contracting workloads increased due to high continued demand for utility projects and demand for sales and rentals of the equipment that this business manufactures. Partially offsetting the increase in earnings was higher selling, general and administrative expense, primarily related to payroll costs due to the increased workloads. Our construction materials business reported a seasonal loss of \$34.4 million in the first quarter compared to a loss of \$23.5 million for the same period in 2018. Also, reported revenues of \$227.2 million up from first quarter 2018 revenues of \$213.4 million. The increased loss was driven by seasonal losses associated with the companies that this business has acquired since the first quarter of last year, along with lower materials margins due to less favorable weather conditions in certain regions. Partially offsetting the loss were higher construction margins from an increase in workloads.

That summarizes the financial highlights from the first quarter and now, I'll turn the call over to Dave Goodin for his formal remarks. Dave?

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

Well, thank you, Jason, and good afternoon, everyone. Thank you for your interest in MDU Resources and for taking time to join us today to discuss our first quarter results. We released our first quarter earnings after the market closed yesterday. Our business has performed well in the first quarter of 2019 and reported earnings of \$40.9 million or \$0.21 per share. Our combined utility companies reported record first quarter earnings, largely driven by a 12% increase in natural gas sales volumes, along with a 0.6% increase in electric retail sales volumes. These increased volumes were driven by colder-than-normal weather, which was partially offset by weather normalization or decoupling in certain jurisdictions. The company also benefited from the Thunder Spirit Wind farm expansion project acquired late last year, along with the Big Stone-South-to-Ellendale line that was put into service earlier here in 2019. The utility recently reached a tentative electric rate case settlement in the state of Montana. While subject to final regulatory approval, the settlement would increase annual revenues by a total of \$9.3 million, with \$9 million effective beginning this year and \$300,000 deferred for one year. We also filed in the state of Washington, a general rate case request for 5.5% increase in rates or \$12.7 million annually.

Earlier this year, we announced the planned retirement of our wholly-owned coal-fired electric generation units. The utility continues to work through that process while ensuring that we're providing safe and affordable electricity to our customers. The targeted dates for retirement are at the end of 2020 for the Lewis & Clark station, and the end of 2021 for the Heskett station. Looking forward, our utility business plans on investing \$308 million of capital expenditures this year and approximately \$1.5 billion over the next five years, with a projected rate base growth of 5% compounded annually.

At our pipeline business, we had an excellent first quarter and increased earnings nearly 30% on a year-over-year basis. For the ninth consecutive quarter, the pipeline business recorded record transportation volumes attributable to the success of their organic growth projects over the last two years. The company began construction in April on the Demicks Lake Project in McKenzie County, North Dakota and expects to start construction this month on the Line Section 22 project located near Billings, Montana. Both projects are expected to be in service later this year and are expected to add approximately 200 million cubic feet per day of capacity. Combined, these projects are designed to bring daily system capacity to now 2.0 billion cubic feet per day. Our North Bakken expansion project, which we announced earlier this year, is still in the planning phase, with construction expected to begin in 2021. As a reminder, we currently estimate this project to be approximately \$220 million of investment. As designed, the project would provide 200 million cubic feet per day of natural gas transportation capacity and could be expanded to provide up to 375 million cubic feet per day. The company plans to submit a FERC pre-filing request for the project in the second quarter of this year. The final scope and size of the project is still being determined based on customer demand.

In our first quarter earnings release shared with you yesterday, we announced that the company is in the preconstruction stage for another growth project in McKenzie County, North Dakota. We're calling this our Demicks Lake Expansion Project. This project is designed to provide an additional 175 million cubic feet of capacity per day as an expansion to the Demicks Lake Project currently under construction. The Demicks Lake Expansion Project construction is expected to begin later this year, with a targeted in-service date in early 2020.

Now I'd like to turn to our construction businesses. The Construction Services Group continues to deliver exceptional revenue and earnings growth. The company experienced increased customer demand for work at both the inside and outside specialty contracting lines, specifically for projects in the hospitality, high tech and utility industries. This business also announced over \$1 billion worth of backlog at the end of the first quarter. This record number is an increase of 51% year-over-year. Our construction materials business had an increased seasonal loss for the first quarter of this year. Our strong acquisition activity over the last year has increased our footprint in the Northwest and Upper Midwest markets, which in turn increased our exposure to winter weather, contributing to the larger loss this quarter. Knife River announced two additional acquisitions in the first quarter with the purchases of Viesko Redi-Mix in Salem, Oregon and Honey Creek deposits in Marble Falls, Texas. Both acquisitions are well positioned in our existing markets where we continue to see great opportunity for growth. We continue to evaluate additional acquisition opportunities for both of our construction companies.

Backlog at Knife River is strong at \$943 million worth of work at the end of the first quarter, up 36% from \$692 million in 2018. What gets us most excited is that combined, at the end of the first quarter, our construction companies had nearly \$2 billion in backlog, and we are optimistic about the opportunities these businesses have for strong performance throughout the rest of the year. Due to the strong performance of the Construction Services Group, we are increasing our 2019 revenue guidance for this segment to be in the range of \$1.4 billion to \$1.55 billion. This is an increase of \$50 million from our original estimate, with margins expected to be comparable to 2018.

At Construction Materials, we're holding our original guidance to be in the range of \$2.0 billion to \$2.15 billion with again, margins comparable or slightly higher than 2018. Heading into peak construction season, our combined construction companies are ready -- are already running at near record employment levels, with over 10,000 employees, up over 1,500 employees from a year ago. Overall, we are pleased with our first quarter solid results and as such, we are raising the lower end of our EPS guidance by \$0.05, which increased it to \$1.40 to \$1.55 per share. Our focus at MDU Resources has been to produce significant long-term value as we execute our business plans, organic growth projects and targeted acquisitions, and we are doing just that.

We continue to maintain a strong balance sheet, solid credit ratings, along with a good liquidity position. And for 81 consecutive years, we have continued to provide a competitive dividend to our shareholders while increasing it for the last 28 years.

Before I turn the line over to questions, I'm excited to announce that prompted by the strong performance of our construction services businesses, we made a decision to host our 2019 analyst tour to Las Vegas, Nevada. We are looking forward to the opportunity to showcase first hand just how strong the Las Vegas market is with tours of several operations and projects in the area. I'm now going to hand the call over to Jeff Thiede, our President and CEO of Construction Services, to give you an overview of our activities in the Las Vegas area. Jeff?

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

Thank you, Dave, and good afternoon, everyone. The CSG team and I are excited for the opportunity to showcase our diverse operations in the Las Vegas market. Las Vegas has been a core contributor to our success for many years, and a lot has changed since we last invited our analysts to the city. We look forward to showing everyone the expertise and leadership of our teams and what they're bringing to the strong growth in Las Vegas. Dave?

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

Well, thank you, Jeff. As always, MDU Resources is committed to operating with integrity and a focus on safety while creating superior shareholder value as we continue to act on our tagline of Building a Strong America. I appreciate your interest in and commitment to MDU Resources and ask that we now open the line to questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question will come from the line of Chris Ellinghaus with Williams Capital.

Christopher Ellinghaus - The Williams Capital Group, L.P., Research Division - Senior Equity Research Analyst of Power and Natural Gas

Jason, you have a little sort of footnote in the press release about some tax adjustments in the other segment for the quarter. Can you elaborate on that?

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

Yes. Certainly, Chris. I'll actually have Stephanie Barth, our Controller, talk about that particular adjustment.

Stephanie A. Barth - MDU Resources Group, Inc. - VP, CAO & Controller

Chris, GAAP requires us to record our interim income tax at our annual effective tax rate, and we really needed to make an adjustment to get that tax rate up to where we think it's going to be for the year. It will work its way out through our segments as the quarter continues. But with our mix of businesses and the different tax rates that each of them record at, we needed to push this adjustment through from a GAAP perspective.

Christopher Ellinghaus - The Williams Capital Group, L.P., Research Division - Senior Equity Research Analyst of Power and Natural Gas

Can you run it or what's the impact in the quarter?

Stephanie A. Barth - MDU Resources Group, Inc. - VP, CAO & Controller

It was just over \$3 million.

Christopher Ellinghaus - The Williams Capital Group, L.P., Research Division - Senior Equity Research Analyst of Power and Natural Gas

Okay, great. Dave, in terms of the backlog being strong, pretty flat from year-end, which is a pretty good thing, does that give you any better insight into your margins for the year?

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

Yes. Chris, you were asking Dave Barney in materials, particularly with that question?

Christopher Ellinghaus - The Williams Capital Group, L.P., Research Division - Senior Equity Research Analyst of Power and Natural Gas

Yes, exactly.

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

Yes, okay. Perfect. Dave?

David C. Barney - President & CEO of Knife River Corporation

Okay. Thanks, Chris. Yes, we're excited about that backlog, the record backlog. We expect to add to that over the next couple of months also. But if you're asking about the margins of the backlog, they're about flat from year-over-year. Is that what you're asking?

Christopher Ellinghaus - The Williams Capital Group, L.P., Research Division - Senior Equity Research Analyst of Power and Natural Gas

Yes. I wondered if you've gained any insights since you've gone through some of the backlog and added some to get to a little bit higher than year-end, whether that had given you any greater insights into this year's margins.

David C. Barney - President & CEO of Knife River Corporation

Well, we're expecting as our backlog fills up, our margins will continue to go up as some of the guys are -- some of the regions are more picky about what they're going to bid and how they're going to bid it, so I would expect our margins to continue to go up this year.

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

Chris, this is Jason. I'd just add to that. I mean, we've given guidance on the margins for Dave's business to be really comparable to the prior year or slightly increasing. That hasn't changed from what we talked about with our year-end release earlier. So we're still seeing that consistent with what we talked about previously.

Christopher Ellinghaus - The Williams Capital Group, L.P., Research Division - Senior Equity Research Analyst of Power and Natural Gas

Okay. Jeff, in terms of your backlog, what types of things, projects have you added in that big increase in the backlogs? What industries are they coming from?

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

Well, we've got a real diversified business and they're coming from multiple markets. All of our markets are strong, some stronger than others. We've most recently secured the electrical work at the Kansas City International Airport, that is in our backlog. But we're still looking to build capacity and we're adding projects like the Portland International Airport, which is not in our backlog. So we continue to look for opportunities. We're a little more selective because we have the opportunity to do so. We are experiencing some strong demand for our services in the mission-critical opportunities or data center in multiple geographic areas throughout the country. Hospitality in Las Vegas and gaming is very strong. We have our mechanical and our electrical company building a very large gaming and hospitality project on Las Vegas Boulevard. In addition, our fire protection company is working on a stadium in Las Vegas. So it's all of the above for us where we're located, and we're very excited about the backlog that will be mostly burned off in 2019, but most of our projects are multiyear.

Christopher Ellinghaus - The Williams Capital Group, L.P., Research Division - Senior Equity Research Analyst of Power and Natural Gas

Okay. One last thing, Dave or Jason. Can you just remind me how -- what did the weather look like in the third and fourth quarters last year?

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

Yes, I think from a weather perspective, this is Jason, we can talk to each one of the construction companies here, but we certainly saw a colder winter, I think. As you can see at least in the first quarter here, last -- third and fourth quarter last year, I mean, I would say probably relatively normal. We did have some rain that impacted some operations on the construction side but maybe Dave Barney can talk a little bit about what he saw for specific impacts.

David C. Barney - President & CEO of Knife River Corporation

Chris, in Texas last year for I think it was September, October, I don't think we did much construction work at all. Heavy rains, we got the same thing in Iowa and South Dakota, so it's basically those three markets that we had the weather impact from.

Operator

(Operator Instructions) This call will be available for replay beginning at 5:00 p.m. Eastern Time today through 11:59 p.m. Eastern Time on May 15. The conference ID number for the replay is 5568769. Our next question comes from the line of Sarah Akers with Wells Fargo.

Sarah Akers - Wells Fargo Securities, LLC, Research Division - Senior Equity Analyst

Can you walk through what drove the revisions to '19 operating cash flow guidance? Looks like it's down about \$75 million.

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

Sarah, this is Jason. I can certainly walk through that. The largest driver that we saw really relates to one of our utility companies, that would be actually Cascade. We had a pipeline instance with one of our suppliers in the Pacific Northwest, and we experienced a pretty significant increase in gas costs for that particular entity, especially for some of our Washington service territory. So we ended up accumulating a large purchased gas cost adjustment balance which as you know, is a pass-through to our customers, so we are able to recoup that. But given the magnitude of this particular adjustment, we've actually been working with the Washington Commission on a portion of at least through January -- from kind of November through January here to come up with a longer-term recovery of that. So we will recoup that so it's a temporary item in nature, but it is going to impact operating cash flows through this year. We did work with the Washington Commission on that and settled on a three-year amortization period for that piece of it and again, that's just through January. We had some additional items from February, March as well, that we have not come to an agreement with the State on that yet or the Commission, but we will be filing for that. So of that change, the vast majority of that is related to that PGA. We do expect to recoup and we have at this point in time, financed that with some short-term debt as we wait for a recoup of that.

Sarah Akers - Wells Fargo Securities, LLC, Research Division - Senior Equity Analyst

Perfect. And then on the material segment, looks like CapEx went up some from the year end release. Is that due to acquisitions? Or have you layered in additional organic investment at materials?

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

Sarah, this is Dave. You hit it spot on. That that's really primarily due to the two announced acquisitions that we had indicated earlier this year.

Operator

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

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

As noted earlier, we have a strong start to 2019 and have a number of growth projects underway. We are committed at MDU Resources to Building a Strong America as well as ensuring the safety of our more than 12,000 employees who are executing on many projects and opportunities ahead of us this year and beyond. We again appreciate your participation on the call here today, and thank you for your continued interest in MDU Resources. Operator?

Operator

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

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2019, Thomson Reuters. All Rights Reserved.