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MDU - Q3 2019 MDU Resources Group, Inc. Earnings Call

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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

CONFERENCE CALL PARTICIPANTS

Ryan Levine Citigroup Inc, Research Division - Equity Analyst

PRESENTATION

Operator

Hello. My name is Jessa, and I will be your conference facilitator. At this time, I would like to welcome everyone to the MDU Resources Group 2019 Third Quarter Conference Call. (Operator Instructions) This call will be available for replay beginning at 5 p.m. Eastern Time today through 11:59 p.m. Eastern Time on November 13. The conference ID number for the replay is 1536787. 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, Jessa. I'd like to welcome everyone to our third 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 & 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 the key financial highlights 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 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, 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 third quarter earnings of \$137.6 million or \$0.69 per share compared to third quarter 2018 earnings of \$107.3 million or \$0.55 per share. Our combined utility business reported earnings of \$700,000 for the third quarter, down from \$3.4 million in the third quarter of 2018.

The electric utility segment reported earnings of \$16.3 million for the quarter compared to \$15.3 million in 2018. This increase in earnings was largely a result of higher adjusted gross margin from the absence of an adjustment related to the Big Stone-South-to-Elendale project that was realized in the prior quarter in 2018.



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Rate recovery from interim and final rates implemented in the state of Montana also increased adjusted gross margin in the quarter. Partially offsetting the increase was a 6% decrease in electric sales volumes. This volume decrease was largely due to mild summer temperatures across our service territory. Higher depreciation, depletion and amortization expense and higher operation and maintenance expense also had a negative impact on results.

Our natural gas utility segment had a seasonal loss of \$15.6 million for the quarter compared to a loss of \$11.9 million in the prior year. The increased loss was a result of higher operation and maintenance expense, mainly payroll-related costs, as well as higher depreciation, depletion and amortization expense from increased property, plant and equipment balances and increased property taxes. Partially offsetting the higher cost was an increase in adjusted gross margin from approved rate recovery in certain jurisdictions. A 4% increase in retail sales volumes was offset by weather normalization and conservation adjustments in the quarter.

The pipeline and midstream business had earnings of \$7.7 million in the third quarter compared to \$11 million in 2018. The decrease in earnings is largely related to the absence of a \$4.2 million tax benefit that was recognized in the third quarter of 2018. This tax benefit is outlined in our third quarter 2018 release, was a result of a regulatory liability reversal.

Higher depreciation, depletion and amortization expense due to higher depreciation rates from a recent FERC rate case as well as increased property, plant and equipment from organic growth projects also contributed to the decrease in earnings. Record transportation volumes, primarily related to organic growth projects that were placed into service in the second half of 2018 and higher customer rates from the previously mentioned FERC rate case, had a positive impact on the quarter.

Our construction services business reported record third quarter earnings of \$21.1 million compared to \$9.3 million in 2018 and record third quarter revenues of \$479.6 million, up 45% from the third quarter 2018 revenues of \$330.4 million. These increases were driven by higher workloads at both the inside and outside specialty contracting lines. Inside specialty contracting company saw higher workloads from increased customer demand for projects in the hospitality and high-tech industries.

Outside specialty contracting workloads increased due to continued high demand for utility industry construction projects. Partially offsetting the increase in earnings was higher selling, general and administrative expense, primarily payroll-related costs due to the increased workloads that this business is experiencing. Results in 2018 included a \$7.2 million charge from changes in estimates on certain construction contracts.

Our construction materials business reported record earnings of \$102.6 million in the third quarter compared to \$78.9 million for the same period in 2018. This business also reported record third quarter revenues of \$869.5 million, up 17% from third quarter 2018 revenues of \$743.9 million. Higher revenues from contracting services and material sales, along with higher gross margins as a result of strong economic conditions seen across many of our states of operation, drove the increase in earnings.

Additional material sales volumes from acquisitions made over the last 12 months and asset sales gains that were approximately \$5 million higher than the prior year also had a positive impact on the quarter. Partially offsetting the increase in earnings were higher interest expense and higher selling, general and administrative expense largely related to companies that were acquired since the third quarter of 2018. We also experienced higher payroll-related costs.

That summarizes the financial highlights for the quarter. And 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

Well, thank you, Jason, and good afternoon, everyone. Yesterday, we reported third quarter earnings of \$0.69 per share compared to \$0.55 per share last year. Our year-to-date earnings are 24% higher than this time last year, and we are on track and well positioned to deliver earnings within our narrowed 2019 guidance of \$1.50 to \$1.60 earnings per share. This strong performance is a direct example of the value of our 2-platform business model.



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During the quarter, our more than 15,000 employees came together and helped us to execute on our operating plan and report strong operational and financial results. With these employees, our companies continue to complete infrastructure projects across various industries and geographic markets. Not only do our shareholders benefit as we continue Building a Strong America, but so does our nation because a strong infrastructure is the heart of our economy. We continue to focus on organic growth and infrastructure improvements at our regulated energy delivery companies.

Our utility had a full quarter, seeking and implementing regulatory recovery for costs associated with upgrading and expanding our facilities to safely serve our growing customer base.

In the third quarter, the electric utility implemented new rates in the state of Montana. This settlement, finalized earlier this year, will increase annual revenues by a total of \$9.3 million with \$9 million of which became effective in September of this year and the balance effective one year later. We also received approval from the state of North Dakota for an increase to our transmission cost adjustment rate.

Our electric utility completed its filing for an advance determination of prudence with the state of North Dakota to own and operate an 88-megawatt simple-cycle, natural gas-fired combustion turbine. This facility, if approved, will be in service by 2023 and is expected to cost approximately \$73 million to construct.

The natural gas utility filed for a rate increase with the state of Minnesota and filed a joint settlement agreement related to a previously filed case in the state of Washington.

At our pipeline business, we reported our 11th consecutive quarter of record transportation volumes. And with natural gas production remaining at record levels in the Bakken, we continue to grow organically to handle the increased production volumes.

During the quarter, the pipeline group placed into service the Demicks Lake project in Northwestern North Dakota and continued construction on line Section 22 project near Billings, Montana. Together, these two projects will add approximately 200 million cubic feet per day of natural gas transportation capacity.

Construction on the Demicks Lake Expansion project is expected to begin here in November. This project will add another 175 million cubic feet of capacity per day and is expected to be in service early in 2020. This business is also in the process of working with FERC on the National Environmental Policy Act prefiling review process for its North Bakken Expansion project.

We announced in our release yesterday that based on long-term customer commitments and the continued record levels of natural gas production in the Bakken, we are increasing the design capacity of this project for the second time. This project, which had an original design capacity of 200 million cubic feet per day of transportation capacity, has now been increased to 350 million cubic feet per day.

Now I'd like to turn to our construction platform. We are pleased with the continued momentum we are seeing in our construction businesses. Third quarter backlog is at record levels at both materials and services businesses with a combined backlog now standing at \$1.95 billion, some \$461 million higher than this time last year. The Construction Materials business reported record third quarter revenues, earnings and backlog. This strong performance led us to narrow the 2019 revenue guidance at that business to now a range of \$2.1 billion to \$2.2 billion.

Given the strong economic environments we are seeing across our footprint, at Knife River, we are optimistic about how they will finish out the remainder of 2019. At construction service, our Construction Service Group continues to operate at record levels. High demand for both inside and outside contracting service resulted in record third quarter revenues, earnings and backlog. And for the third consecutive quarter, we are increasing 2019 revenue guidance for this segment to now a range of \$1.75 billion to \$1.85 billion.

Construction services announced during the quarter, the acquisition of the assets of Pride Electric located and headquartered in Redmond, Washington. This business will operate as a division of OEG, Inc., a subsidiary of MDU Construction Services, which is currently one of the largest electrical contracting companies in the Pacific Northwest. We are very excited to add Pride Electric to our team and to strengthening the presence we have in the Seattle, Bellevue and the Redmond markets.



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So to conclude, I want to reiterate that we are certainly very pleased with our third quarter results. Our focus at MDU Resources has been to utilize our two-platform business model to produce significant, long-term value as we execute on our business plans, both organic growth projects and acquisitions, and that's just what we are doing. We are committed to operating with integrity and with a focus on safety while we continue to act on our tagline of Building a Strong America.

I certainly appreciate your interest in and commitment to MDU Resources and ask now that we open the line to questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Ryan Levine from Citi.

Ryan Levine - Citigroup Inc, Research Division - Equity Analyst

What percentage of construction material and service EBITDA year-over-year growth was driven by acquisition?

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

I appreciate that question, Ryan. We'll start off with Dave Barney on the materials segment. And then after that, we'll move over to Jeff and talk about services.

Dave, would you be able to respond to Ryan?

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

Yes, I can do that. Hi, Ryan, how are you doing? About 36% of the growth on EBITDA was from new acquisitions.

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

Jeff?

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

Yes. Thanks, Ryan. We closed the transaction for Pride on September 17, so we essentially had two weeks of their performance so not an impact for this quarter. We're excited about this acquisition. We think it's a great fit as a division of OEG, Inc., and we expect successful results from Pride Electric in the future.

Ryan Levine - Citigroup Inc, Research Division - Equity Analyst

Great. Are you able to quantify what the longer-term financial impact of the Pride Electric deal is? Or are you limited in your disclosure?



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

Yes, we're not going to disclose that at this time, and we think it's a great company. And the services that they complement us in the Pacific Northwest will be a contributor, that's for sure.

Ryan Levine - Citigroup Inc, Research Division - Equity Analyst

Okay. And then on that vein, in construction services, what are you -- what are the characteristics you're looking for in potential future acquisitions?

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

We have a strategy called Go & Grow. And we look to grow our companies organically. But as far as acquisitions, which is our second choice, we look for areas of the country that we are not currently located in with services that are same or similar to what we provide, such as mechanical, electrical equipment inside and outside. So we've got a lot of areas of the country that we cover, and we are strategically looking at other markets where we can find companies that fit our culture and performance.

Ryan Levine - Citigroup Inc, Research Division - Equity Analyst

Is there a certain characteristic, size or scope that would fit in the MDU umbrella?

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

We have a range of companies in the \$30 million to \$200 million range of revenue. And of course, it's going to be about performance, safety and their financial as well as the ability to fit in with our team.

Operator

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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

Thank you, Jessa.

Our focus here at MDU Resources has been to produce significant, long-term value as we execute on our business plans, organic growth projects along with acquisitions. And again, we're doing just that.

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

We are committed to Building a Strong America, as well as ensuring the safety of our more than 15,000 employees who are executing on many, many projects and opportunities ahead of us this year and beyond. We again appreciate your participation on the call today and thank you for your continued interest in MDU Resources.

Operator?



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Operator

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

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