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MDU - Q3 2020 MDU Resources Group, Inc. Earnings Call

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OVERVIEW:

Co. reported 3Q20 earnings of \$153.1m, or \$0.76 per share. Expects 2020 EPS to be \$180-190.

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

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

CONFERENCE CALL PARTICIPANTS

Ryan Michael Levine Citigroup Inc., Research Division - VP

PRESENTATION

Operator

Hello. My name is Maria, and I will be your conference facilitator. At this time, I would like to welcome everyone to the MDU Resources Group 2020 Third Quarter Conference Call. (Operator Instructions)

This call will be available for replay beginning at 5:00 p.m. Eastern today through 11:59 p.m. Eastern on November 19. The conference ID number for the replay is 1654638. 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, Maria. And welcome, everyone, to our third quarter 2020 earnings conference call. Our 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 news release detailing our third quarter results 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 that 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-Q and 10-K.

We'll also reference certain non-GAAP measures during the call, such as EBITDA in our construction operations and adjusted gross margin for our utility businesses. Definitions and reconciliations of non-GAAP measures to the nearest GAAP measure can be found in our earnings release issued last night.

Today, I will start by briefly covering this quarter's financial results, and then turn the presentation over to Dave Goodin, President and CEO of MDU Resources, for an update on our forecast for the remainder of 2020 and beyond. 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 include: 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 our Utility Group; Trevor Hastings, President and CEO of WBI Energy; and Stephanie Barth, Vice President, Chief Accounting Officer and Controller of MDU Resources.

Yesterday, we announced record third quarter earnings of \$153.1 million or \$0.76 per share compared to third quarter 2019 earnings of \$137.6 million or \$0.69 per share. This is an increase of 11% year-over-year, the majority of which was organic growth.

Based on our company's year-to-date performance and our strong outlook for the remainder of this year, we are again increasing our 2020 earnings per share guidance, now predicting it will be in the range of \$1.80 to \$1.90 per share. This is an increase from our previous range of \$1.65 to \$1.85 per share.

Now moving on to results achieved by each of our business segments. Our combined utility business reported a net loss of \$800,000 for the quarter, down from earnings of \$700,000 in the third quarter of 2019. We experienced a seasonal loss of \$17.6 million in our natural gas utility segment, which was \$2 million higher loss than the previous year. We expect the loss of this business segment in the third quarter each year due to seasonal impacts on customers' natural gas usage.

Our natural gas segment had higher operation and maintenance costs and higher depreciation and amortization expense in the quarter. Partially offsetting these decreases was higher adjusted gross margin from approved rate recovery in certain jurisdictions.

The electric utility segment reported a strong third quarter earnings of \$16.8 million compared to \$16.3 million for the same period in 2019. A 14% increase in residential sales volumes led to higher adjusted gross margin. This volume increase was partially offset by decreased industrial and commercial volumes attributable to the slowdowns from the COVID-19 pandemic.

The pipeline business had earnings of \$8 million in the third quarter compared to \$7.7 million in the third quarter of 2019. Higher transportation revenues from organic growth projects that were placed in service in 2019 and early 2020 as well as stronger demand for the company's storage services were the primary drivers behind the earnings increase. These increases were partially offset by lower nonregulated project revenues.

Turning to our construction businesses. Construction services reported record third quarter earnings of \$29.8 million compared to \$21.1 million in the third quarter of 2019. This is an increase of over 41%. Construction services also reported record third quarter revenues of \$551 million, up from third quarter 2019 revenues of \$479.6 million. EBITDA at this business also increased in the quarter to \$46.8 million, an increase of \$12.3 million as a result of increased workloads for inside and outside specialty contracting.

Inside specialty contracting workloads increased during the quarter with strong demand for hospitality and high-tech projects, while natural disaster recovery work drove an increase in the outside specialty contracting workloads. These increases were partially offset by higher selling, general and administrative costs, primarily an increased allowance for uncollectible accounts and higher payroll-related costs as this business continues to operate at record employment levels.

Our construction materials business also reported record results for the third quarter with \$107.3 million in earnings, up from the prior year's \$102.6 million. This increase is even more impressive when considering last year's results included gains on the sale of assets, which were approximately \$4.4 million higher after tax than the current year. Revenues at this business were \$822.5 million, down slightly compared to the \$869.5 million for the same period in 2019.

The EBITDA at this business increased \$8.5 million from the same period in 2019 to \$172.3 million for the quarter. The increased earnings and EBITDA were driven by higher margins on the majority of the company's product lines. Margins from asphalt and asphalt-related products were stronger during the quarter as a result of decreased energy-related costs as well as favorable weather where these operations are located. Ready-mixed concrete pricing also continues to be strong in most markets. These increases were partially offset by work slowdowns caused by tropical storms and wildfires in certain markets.

That summarizes the financial highlights for the quarter. And now I'll 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 thank you for listening, everyone, and spending this time with us today and for your continued interest in MDU Resources. We hope that you are both safe and healthy.

Our balanced mix of regulated energy delivery and construction materials and services businesses continue to allow us to post strong operating results, despite the challenges this pandemic has imposed on our nation. With the help of our more than 15,000 employees, we are able to continue providing essential services to customers across all our business lines during this challenging time.

As Jason said, with strong performance we saw in the third quarter, including record earnings at both construction companies and strong results from our regulated energy delivery companies, we are raising our earnings per share target for this year to a range of \$1.80 to \$1.90 per share. Looking at our forecasts for the remainder of 2020 and our performance in the third quarter, we are also narrowing revenue guidance for both construction services and construction materials. We have increased our expected revenues at construction services to now a range of \$2 billion to \$2.15 billion, with margins comparable to or slightly higher than 2019 levels; and adjusted construction material revenues to a range of \$2.15 to \$2.25 billion with margins higher than what we saw in 2019.

To summarize activity by business unit, I'll start off with the regulated energy delivery side of our business mix. Our utility operations had solid performance through the third quarter, with earnings at the electric segment muted by a seasonal loss on the natural gas side. During the quarter, our regulatory team was very active with filings at both utility segments, producing several positive outcomes.

On October 28, the North Dakota Public Service Commission approved a rate increase of \$6.3 million for electric transmission rates, which took effect on November 1. In Minnesota, the Public Utilities Commission approved a \$2.6 million natural gas rate increase with interim rates in effect since January 1 of this year. The effective date for this increase has not yet been determined.

In the western part of our service territory, the Washington Utilities and Transportation Commission approved a rate increase of \$1.1 million for pipeline replacement projects, also effective November 1. And there is currently a \$3.2 million natural gas rate increase request pending before the Oregon Public Utilities Commission.

There are several more natural gas rate increase pending cases before state utility commissions. You can read more about these in our 10-Q filed just this morning.

Our pipeline business also performed very well throughout the third quarter. This business continues to benefit from increased revenue as a result of organic growth projects being brought online. With these recent organic growth projects, WBI now is able to move approximately 2.2 billion cubic feet of natural gas through its system each and every day. The pipeline business also continues to benefit from increased storage balances as customers take advantage of seasonal commodity price differentials.

Preparatory work continues on the North Bakken Expansion Project. This project is scheduled for construction beginning in early 2021, pending regulatory and environmental permitting. The project is expected to be online in late 2021 and will add 250 million cubic feet per day of capacity to the existing transmission system.

As the pandemic continues to impact our nation, there have been demand decreases and pricing impacts that are delaying forecasted Bakken oil and associated natural gas production. While the long-term outlook for Bakken gas production is strong, the company has negotiated adjustments to certain customer contracts, and a portion of the first year committed volumes from these customers has been delayed 1 year. However, through a combination of rate, volume and/or term adjustments, the overall financial returns of this project really remain unchanged. Our customer contracts support the design capacity of 200 million cubic feet per day and the long-term viability of this project, which can be readily expanded in the future when forecasted production growth levels rebound.

Now I'd like to move on to our construction platform, starting with our construction services. At construction services continues its run of outstanding performance with record revenues, record earnings and record backlog for the quarter. Opportunities for both inside and outside specialty contracting remain high with strong demand for hospitality, high-tech and natural disaster recovery work. CSG ended the quarter with record

backlog of nearly \$1.3 billion, showing the strength of the bidding opportunities across this business' footprint. As a reminder, we are increasing revenue guidance in this business to a range of \$2 billion to \$2.15 billion, with margins comparable to or slightly higher than 2019 levels.

And finally, turning to our construction materials business. Our third quarter has historically been the strongest quarter for this business, and 2020 was no exception with record earnings of \$107.3 million this year. Construction materials backlog was \$571 million at the end of the quarter, down from the prior year's \$747 million.

As we discussed in our news release and on last quarter's call, we have seen a delay in some new projects being awarded, specifically in the public sector, which we believe can be attributed to the COVID-19 pandemic. Fortunately, we now have more clarification on the FAST Act, which has been extended for 1 year and includes an additional \$13.6 billion into the Highway Trust Fund and maintains funding levels of \$47.1 billion for highway programs, along with another \$12.3 billion for transit programs through 2021. We are optimistic that this extension will allow the states where we operate to evaluate their budgetary needs and dedicate dollars to much needed surface and transportation updates.

On an overall basis, MDU Resources and our companies had very strong results, reporting combined record third quarter earnings, all while operating under new protocols and safety measures related to the COVID-19 pandemic. We added to our workforce over the quarter and are now operating with record employment of more than 15,600 employees.

With the help of each of our employees and our balanced mix of business, regulated energy delivery and construction, we have been able to continue providing the infrastructure support that our nation needs. As always, MDU Resources is committed to operating with integrity and with a focus on safety while creating superior shareholder value as we continue providing the essential services to our customers.

I 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) Our first question is coming from the line of Ryan Levine of Citi.

Ryan Levine - Citigroup Inc., Research Division

First question on the pipeline segment, can you unpack exactly what were the dynamics and how the contracts have changed related to the 1-year delay for certain customers on the North Bakken Expansion?

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

Sure, Ryan. I'll ask Trevor Hastings to kind of outline what we're seeing today with North Bakken and just maybe a broad overview of the project. Because it's really a keynote project for WBI as we think about 2021 and beyond. Trevor?

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

Sure. Thanks, Dave. Thanks, Ryan.

We remain excited about the project. As Dave noted, we anticipate our FERC approval early in 2021, construction to follow that with an in-service date that's unchanged to November of 2021.

As we went through the kind of pandemic-related production declines in the Bakken from March through this summer, we had various conversations with our 6 customers and offered a first year delay in a portion of their volumes. And then as Dave noted in his opening remarks, basically we kept each of those customers' contracts on a net present value basis whole by then adjusting either some combination of rate volume or term. At the conclusion of those negotiations or conversations with customers, 3 customers elected to take a reduced volume, and then offset that impact in the first year with either an additional year in term or higher volume or rate increase.

And so over the look of the whole project from kind of a return hurdle standpoint, the project really remains whole, other than we'll have lower year 1 volumes. And then actually we will end up with slightly higher year 2 volumes. And a few contracts that will move, instead of through year 10, will move into year 11.

Ryan Levine - Citigroup Inc., Research Division

What percentage of the overall customer volume expectation was amended in this revision of the contract?

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

So our full year -- well, let's call it, second year full volumes will be 245,000 Mcf a day. The first year volumes will be 133,600 per day. And we'll still be positive from a net income and an EBITDA perspective in that first year.

And then Ryan, in the -- oh, go ahead.

Ryan Levine - Citigroup Inc., Research Division

Yes, I was going to ask if to the extent that DAPL is shut down, does that trigger any events in terms of customer demand for the system? Or have any impact on this project's commercial viability?

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

It shouldn't directly. It hasn't to this point. I wouldn't foresee that being an issue directly related to this project. It would have an impact overall to the Bakken potentially.

Ryan Levine - Citigroup Inc., Research Division

Okay. And then switching gears to construction materials, I noticed the backlog had fallen. Would you be able to elaborate as to the drivers of that, and what -- how the composition of the project backlog is today compared to maybe a year ago or prior quarters?

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

Ryan, thanks for the question. We had Dave Barney dialed in from another state. I want to make sure Dave is here to answer that.

Before he does that, I just want to maybe do a quick go back for you on your questions that related to North Bakken. You need to also understand that actually the gas volumes in the Bakken, while they did come off on the early days of the pandemic, are actually back to about 85% of the volume flow in which we saw pre-pandemic. And so there are certainly dynamics out there, and it's a demand and response, and drilling activity has tapered off some. But certainly, there's been -- it's largely returned to, again, nearly pre-pandemic levels on gas volumes.

So just -- I think that goes in the context of why we feel confident and excited about this 2021 project. And sorry for that go back, but I think that just helps maybe a little more the larger picture there.

And then I'll ask Dave Barney. Dave, hopefully you're still on the line. I know it was -- Ryan's question related to our backlog there, and how we're thinking about that. What's changed on a year-over-year basis?

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

Thanks, Dave. A big portion of our backlog being down this year, Ryan, we were able to get out earlier. Weather was favorable early in the year. A lot of our regions were out in February and March. In the year before, it was April and May.

Not that concerned about our backlog. It was a record backlog last year. But if you look at it, we're about where we were in 2018 and we had record earnings in 2020. Most of our work starts bidding in the first 5 to 6 months of this coming year, 2021. The bid schedule looks strong in most of our areas. So not really worried about picking up backlog. We'll get our share.

Ryan Levine - Citigroup Inc., Research Division

And have -- given the last few weeks, have you noticed any change in the margin profile for your business? Seems like there was strong margins in the third quarter. Curious if you're seeing that continue.

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

We really haven't seen any change in margins. Our margins are staying strong. We're holding our margins. So no change right now on our margins. They're still strong. It's still rising in most areas. In some areas, they've flattened. But in most markets, they continue to hold or increase.

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

Yes. Thanks for the question on that, Ryan. And as we noted in our earnings guidance for construction materials, that we do expect margins to be increasing in that segment. So thanks for the questions, Ryan.

Operator

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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

Well, thank you for taking the time to join us on our third quarter earnings call today. As a reminder, we were able to post record results at our businesses, while all working under modified conditions as it relates to the COVID-19 pandemic.

And given our strong results for the first 9 months of the year, we have increased our earnings per share guidance range to \$1.80 to \$1.90 per share for 2020. We have increased revenue guidance at our construction service business and expect margins to be higher at our construction materials business than prior year.

Again, thank you. Thank you, and we appreciate your continued interest in and support of MDU Resources. Operator?

Operator

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

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