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MDU - Q3 2018 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

Andrew Levi ExodusPoint

Paul Thomas Ridzon KeyBanc Capital Markets Inc., Research Division - VP and Equity Research Analyst

Zane Adam Karimi D.A. Davidson & Co., Research Division - Research Associate

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 2018 Third 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 November 15. The conference ID number for the replay is 2136759. Again, the conference ID number for the replay is 2136759. 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, Regina, and welcome to our third quarter 2018 earnings release conference call. This conference call is being broadcast live to the public over the Internet, and slides will accompany our remarks. If you'd like to view the slides, please go to our website at www.mdu.com and follow the link to the conference call. Our earnings release is also available on our website.

During the course of this presentation, we'll make certain forward-looking statements within the meanings 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-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, for his formal remarks. After Dave's remarks, we'll 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 our third quarter earnings from continuing operations of \$107.4 million or \$0.55 per share compared to \$89.6 million or \$0.46 per share in 2017. On a consolidated basis, earnings were \$107.3 million or \$0.55 per share compared to \$87.4 million or \$0.45 per share in 2017. Our construction materials business reported record third quarter earnings of \$78.9 million compared to \$63.2 million for the same period



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in 2017 and revenues of \$743.9 million, up from \$686.1 million in 2017. The increase in earnings was mainly the result of lower income tax expense due to the Tax Cuts and Jobs Act.

The business had higher sales volumes in most product lines and reported higher asphalt product margins and volumes as well as higher construction revenues and margins. Partially offsetting the increase was higher selling, general and administrative expenses primarily related to payroll costs. Our construction services business reported third quarter earnings of \$9.3 million compared to \$13.1 million in 2017. Changes in estimates on certain construction projects resulted in a \$7.2 million negative impact to earnings, partially offsetting the decrease were lower income taxes, higher outside construction equipment sales and rentals and lower selling, general and administrative expenses primarily payroll-related.

At our pipeline and midstream business, earnings were \$11 million in the quarter compared to \$6 million for the third quarter of 2017. The increase in earnings was driven by a final accounting order recently issued by The Federal Energy Regulatory Commission, or FERC, that resulted in a \$4.2 million tax benefit in the quarter. Also contributing were higher revenues in transportation volumes from new projects. Higher earnings were partially offset by higher operation and maintenance expense.

For the quarter, our combined utility business reported earnings of \$3.4 million compared to \$4.8 million in the third quarter of 2017. The electric utility segment earned \$15.3 million for the quarter compared to \$15.7 million in the prior year. This increase was driven by lower electric margins primarily the result of a transmission rate adjustment due to lower estimated costs on our 345 kilovolt Big Stone South to Ellendale transmission project. Partially offsetting the decrease was lower operation and maintenance expense largely related to payroll costs.

Our natural gas utility segment reported seasonal loss of \$11.9 million for the quarter compared to a loss of \$10.9 million for the same period in 2017. This increase loss resulted from higher operation and maintenance expense and higher depreciation, depletion, amortization expense. Partially offsetting the decrease were higher natural gas retail margins from increased rate relief and conservation revenues.

I'll now 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. Thank you for your interest in MDU Resources and for taking the time to join us today to discuss our third quarter results. We released our third quarter earnings after the stock market closed yesterday. All of our businesses continued to build off the momentum we saw in the first half of the year. I am pleased with our solid execution during the third quarter and the progress we have made on our growth strategy, both organically and through strategic acquisitions.

Now I'd like to go through our two-platform business model, starting with the construction businesses. Our construction materials business had record third quarter earnings, seeing increased sales volumes on most of our product lines. Backlog numbers are strong as of the end the quarter at this business at \$590 million, up from \$520 million in 2017. In October, we announced our fourth construction materials acquisition of the year with the purchase of Sweetman Construction Company, a leading provider of aggregates, asphalt and ready-mix in the Sioux Falls market of South Dakota. We welcome the employees of Sweetman Construction to the MDU family and continue to evaluate additional acquisition opportunities at this business.

Construction services is having a strong year with year-to-date revenues as of September 30. Only 2% behind last year's record and record backlog at \$896 million at the end of the third quarter, which is up 33% over the third quarter of 2017. This business continues to perform high volumes of inside specialty contracting work specifically in the high tech and hospitality sectors as well as outside power, communications and gas specialty work. This business is engaged in power line repair work in areas recently impacted by hurricanes. This business is also exploring acquisition and organic growth opportunities. Combined, our construction companies ended the quarter with record revenues, earnings and backlog, and we're anticipating 2018 revenues between \$3.15 billion and \$3.4 billion. We are truly excited about the opportunities for these businesses going forward.

Now turning to our regulated energy platform. Here, our pipeline business continues to perform very well and is busy executing on several organic growth opportunities. For the fifth consecutive quarter, the company transported a record amount of natural gas through its system partially due



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to completing two expansion projects in 2017 and the 13-mile Line Section 27 expansion that we completed here just in mid-September. With natural gas production at record levels in the Bakken region, there's continued demand for additional transportation capacity.

We're also excited to announce today that the 38-mile Valley Expansion Project was actually put into commercial operation. This project will help bring much-needed gas capacity to Eastern North Dakota. Combined, Line Section 27 and Valley Expansion will bring our total capacity to over 1.8 Bcf per day. Yesterday, our pipeline business also filed a rate increase request with The FERC in accordance with our company's rate settlement agreement back from 2014 with FERC and our customers. Looking forward, our pipeline business is working on finalizing construction plans for two additional growth -- organic growth opportunities supported by long-term customer commitments. Demicks Lake, a 14-mile, 20-inch pipeline in McKenzie County North Dakota and Line Section 22 Expansion in the greater Billings, Montana area. We expect to start constructing both projects early next year with expected in-service dates late in 2019.

Our natural gas utility reported 1.5% higher natural gas sales volumes for the third quarter and continues to focus on pipeline projects that will enhance system reliability, safety, along with deliverability. And just yesterday, our electric utility announced that we have completed the purchase of the Thunder Spirit Wind farm expansion in southwest North Dakota. This expansion increases production capacity at the wind farm to approximately 155 megawatts.

Construction on the Big Stone South to Ellendale 345-kV transmission line is also progressing on schedule, with completion anticipated in the first quarter of 2019. Over the next five years, our utility expects it's 1.1 million customer base to grow between 1% and 2% annually.

This completes our individual business unit discussion. And as we look to the overall corporation, I would reiterate that we are on track with our current year expectations. After looking at the third quarter results, we're reaffirming our earnings guidance range of \$1.25 to \$1.45 for the year, with a long-term, compounded annual growth rate between 5% and 8%. 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're doing just that. We continue to maintain a strong balance sheet with solid credit ratings, along with a good liquidity position. And for 80 consecutive years, we provided a competitive dividend for our shareholders. As always, MDU Resources is committed to operating with both integrity and a focus on safety while creating superior shareholder value as we continue to -- as our tag line would say, 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) Your first question comes from the line of Paul Ridzon with KeyBanc.

Paul Thomas Ridzon - *KeyBanc Capital Markets Inc., Research Division - VP and Equity Research Analyst*

Anyway, you've been active in the M&A market. Do you think that, that market is pretty opportunity-rich for potential further deals?

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

Yes. Great question, Paul. I'm going to split that answer between both Dave Barney, and Jeff Thiede, which is really probably more we're targeting some of the M&A activity at and particularly with Dave, having closed four deals earlier this year. I'll start with Dave.



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

Paul, yes, the M&A market looks really strong. There's a lot of private companies out there. We have a long list of companies we're looking at. We have prioritized them. So we're very optimistic we'll be announcing some more deals in the near future, and I think it looks good for us going forward in the M&A market.

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

Paul, this is Jeff. And we're seeing a lot of opportunities for companies to be brought into the Construction Services Group. We've added Bill Connors to our efforts in M&A, and we believe that we'll be able to be announcing some additions to our team in the future. We'll keep you posted. We like the opportunities of these companies, and we're looking for fits geographically as well as adding to the services that we currently provide.

Paul Thomas Ridzon - *KeyBanc Capital Markets Inc., Research Division - VP and Equity Research Analyst*

And the estimate change for project cost at construction services, looks like it masks some strength in that segment. But what's driving that? Is that kind of the labor tightness we're hearing about?

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

Paul, that's one of the contributors. We have a collection of jobs, just several jobs that had impacts, obviously, significant due to results. We see this as an anomaly. And we rarely see this happen in the history of CSG, and we don't expect this going forward in the future.

Paul Thomas Ridzon - *KeyBanc Capital Markets Inc., Research Division - VP and Equity Research Analyst*

Okay. Can you give more flavor as to what that dollar amount is composed of?

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

Paul, you just broke up a little bit on that. If you could repeat the question.

Paul Thomas Ridzon - *KeyBanc Capital Markets Inc., Research Division - VP and Equity Research Analyst*

Sure. Could you just give a little more flavor as to what composes those dollars?

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

Paul, this is Jason. I'll try to give a little more clarity on that. So we have -- we've got various estimates that are involved as we go through many of these projects that we work on here and as we receive new information that helps us true-up some of the estimates, then we'll make changes on that. As Jeff mentioned, this was a little bit more significant this quarter as we adjusted a couple of contracts here. I would say this is a handful rather than the majority of contracts. But we certainly do see this on a regular basis as far as adjustments, it was just more significant in the quarter and wanted to highlight it. As far as what makes that up, it's kind of -- there's a lot of moving pieces there's, so really can't get into a lot of detail on that. But something that, as Jeff mentioned, seems like it's more of an anomaly for us this quarter than anything else. But you're spot on with your analysis of looking at the quarter absent that, I mean, the quarter that Jeff's business has had and the year-to-date performance for that business has just been exceptional.



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Operator

Your next question comes from the line of Zane Karimi with D.A. Davidson.

Zane Adam Karimi - D.A. Davidson & Co., Research Division - Research Associate

Thanks for the clarity so far guys. First question is kind of more for Knife River. Specifically, how much of the earnings growth and the recent backlog improvement basis were covered with the energy for the markets kind of versus and compared to the growth in your -- other market?

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

So your question, Zane, was what's the contribution relative to more the energy-producing states and how's the recovery there relative to our other markets that we're in?

Zane Adam Karimi - D.A. Davidson & Co., Research Division - Research Associate

Well, yes.

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

Yes, okay. Dave Barney?

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

Zane, I can tell you, most of our backlog recovery is not coming from the energy-producing states, except for Texas, but we are seeing that uptick in the Alaska, the North Dakota, northern Minnesota, Wyoming markets, so we're seeing some positive signs of more work coming out. So -- but right now, the majority of the uptick is coming from the non-energy states besides Texas.

Zane Adam Karimi - D.A. Davidson & Co., Research Division - Research Associate

Got you, thank you for that. And then also, do you see yourselves in the industry increasing your prices sufficiently to offset some of these cost headwinds that you're experiencing?

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

Again, Zane, just -- we must have a little light connection. Could you repeat your question? I think it was related to margins relative to Knife River? Or just your cost increases?

Zane Adam Karimi - D.A. Davidson & Co., Research Division - Research Associate

Yes, apologies. Is this a better volume?

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

Yes. It's a little bit better, yes.



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

So if you're looking at -- do you think our margins are going to continue to hold or improve? Is that what you're looking at, Zane?

Zane Adam Karimi - *D.A. Davidson & Co., Research Division - Research Associate*

Yes. I'll repeat the question real quick. But do you see yourselves in the industry increasing prices sufficiently to offset cost headwinds related to Knife River?

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

I think we'll continue to see what we've seen in the last three or four years, pricing continue to go up, margins continue to go up. I don't see anything that's going to be stopping that in the near future.

Zane Adam Karimi - *D.A. Davidson & Co., Research Division - Research Associate*

Great, thank you very much. I'll jump back in queue.

Operator

(Operator Instructions) Your next question will come from the line of Andrew Levi with ExodusPoint.

Andrew Levi - *ExodusPoint*

The stock's doing well today, finally. There's a lot of fear out there as far as construction. I just have two questions. First one just relating to kind of the hurricane that we saw down south and whether your line business will benefit from that.

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

Yes. Andrew, the short answer is, we did some response to those incidents. I'll turn it over to Jeff Thiede to give you a little more details though.

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

Thanks for the question, Andrew. Our industry responded and our company responded to safely restore power to those impacted by the hurricanes. We're grateful for all the first responders including our line industry. We've sent crews to the northeast, to the Carolinas and most recently to Georgia for this year, so we benefited from the opportunity to serve. Our company is not reliant solely on the work of storm and storm work for the success of our business. We also have an equipment company that participated in supporting line companies in storm work. Our equipment company also is able to offer tools in addition to the wire stringing equipment, which we think is the best in the industry.

Andrew Levi - *ExodusPoint*

Okay. And there's no way to kind of quantify, I guess, in the fourth quarter what the benefit of that may be?

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

It made a contribution, a strong contribution, and it was a small part of our success but it wasn't an overwhelming part of our success.

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Andrew Levi - ExodusPoint

Okay. And then just on the aggregate business, as you guys kind of watch the last months, whether it's your stock action or whether some it -- or some others -- stocks got badly hit and then there was a lot of fear about margins and pricing and things like that and adjusted somewhat. But as you kind of look into '19 and obviously, you haven't given guidance to '19, but can you kind of just address that and whether the fear were kind of overblown. I mean some of their issues also related around hurricane where their aggregates were. But if you can kind of address that because it's nice to see the stock recovering, but stock went from trading at a premium -- again, I focus more on the utility group where you're one of the cheapest stocks in the sector, obviously still is -- call it part of the business on the other company plus the aggregates and...

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

Yes, yes. Andrew, this is Dave. I'll weigh in on that. We also watch with some of the other peer companies that released into the market here. I can best comment about our company in that we had a record third quarter at our materials group. I mean, a very strong quarter. In addition, I talked earlier in my comments about moving our backlog up from \$520 million to now \$590 million. You heard Dave Barney, just a few moments ago to an earlier question, talk about margins and where we're expecting those. And in our guidance, we talked about comparable to actually slightly increasing margins in our materials business as well. So those are all factors that we like. Again, commenting about our business, we understand what some of the others in the industry have put out there. We think our position, I can comment the most about, and I feel very good about where we're at. In particular, we talked two years ago about getting into the M&A activity and resuming that. Really, we did actually two years ago, November of '16. Well, this year, we're hitting our stride, if you will. The material sector with four acquisitions, we've been here very recently. So we feel good where we're at and like how '19 is starting to shape up.

Andrew Levi - ExodusPoint

Great thank you very much your stock is super cheap.

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

Okay... thank you Andrew.

Operator

Your next question comes from the line of Zane Karimi with D.A. Davidson.

Zane Adam Karimi - D.A. Davidson & Co., Research Division - Research Associate

Actually, you guys, just answered it so thank you very much and I look forward to hearing from you guys again.

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 November 15. The conference ID number for the replay is 2136759.

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

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

Thank you very much. As I noted earlier, we had another strong quarter, and we expect a strong execution throughout the remainder of 2018. At MDU Resources, we're committed to Building a Strong America, along with being optimistic about our long-term opportunities. We also appreciate

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your participation on our call today. And again, thank you for your continued interest in MDU Resources. And with that, I'll turn it back over to the operator.

Operator

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

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