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MDU - Q1 2018 MDU Resources Group, Inc. Earnings

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

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

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

PRESENTATION

Operator

Hello. My name is Shelby, and I'll be your conference facilitator. At this time, I would like to welcome everyone to the MDU Resources Group 2018 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 17. The conference ID number for the replay is 5478625. The number to dial for the replay is 1 (855) 859-2056 or (404) 537-3406.

I would now like to turn the call 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, Shelby, and good afternoon, everyone. Welcome to our first 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 would 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 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, 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 for MDU Resources.

Yesterday, we announced first quarter earnings from continuing operations of \$41.9 million or \$0.22 per share compared to \$35.5 million or \$0.18 per share in 2017. On a consolidated basis, earnings were \$42.4 million or \$0.22 per share compared to \$37.2 million or \$0.19 per share in 2017.

For the first quarter, our combined utility business reported earnings of \$45.7 million, up from \$42.2 million in the first quarter of last year. The electric utility segment earned \$13.1 million for the quarter compared to \$14.3 million in 2017. This decrease was driven by higher operating costs



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and depreciation, depletion and amortization expense, partially offset by increased regulatory recovery. This business also experienced higher retail sales volumes of 3%, driven by all customer classes.

The enactment of the Tax Cuts and Jobs Act reduced operating revenues and income taxes but had a minimal impact on overall earnings since the company assumes the majority of the tax benefits will be refunded to our customers.

At our natural gas utility segment, we had earnings of \$32.6 million for the quarter compared to \$27.9 million in 2017. This earnings increase reflects higher adjusted gross margins resulting from approved rate recovery. This increase in earnings was partially offset by higher operating costs, higher depreciation depletion and amortization expense as a result of increased planned asset balances.

The enactment of the Tax Cuts and Jobs Act resulted in lower income taxes, which were partially offset by revenue amounts reserved pending the outcome of the company's regulatory filings.

At our pipeline and midstream business, earnings were \$5.3 million in the first quarter compared to \$3.9 million in 2017. This increase in earnings reflects higher transportation revenues primarily related to organic growth projects that were completed in the second quarter of last year as well as lower income taxes due to the enactment of the Tax Cuts and Jobs Act. Partially offsetting the increase were higher operation and maintenance expense and higher depreciation, depletion and amortization expense resulting from the organic growth projects.

Our construction services business reported earnings of \$15.1 million compared to \$7.4 million in 2017 and record first quarter revenues of \$334.1 million, up from first quarter 2017 revenues of \$299.6 million. This business's earnings increased due to higher outside and inside specialty contracting workloads and higher outside construction margins. The increase in margins is a result of higher customer demand driven by the additional number and size of construction projects as well as decreased labor costs, which were attributable to successful job performance. Higher workloads in areas impacted by storm activity and higher outside equipment sales and rentals also contributed to the increase in margins for the quarter. Partially offsetting these increases were higher selling, general and administrative expense.

Construction services backlog at the end of the quarter was \$675 million, up 28% from the first quarter of 2017.

Our construction materials business reported a normal seasonal loss of \$23.5 million in the first quarter compared to a loss of \$19.9 million for the same period in 2017 and revenues of \$213.4 million, up from first quarter 2017 revenues of \$200.9 million. The decrease in earnings was largely related to a \$3.9 million lower income tax benefit in the first quarter due to the enactment of the Tax Cuts and Jobs Act. While the bottom line loss was larger, this business reported a decreased pretax operating loss in 2018 from higher construction margins, which were positively impacted by increased workloads in states that experienced favorable weather as well as strong demand in some of our regions.

Construction materials backlog for the end of the first quarter was \$692 million, up from \$486 million at the end of 2017.

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. Thank you for your interest in MDU Resources and for taking the time to join us today to discuss our first quarter results.

We released our first quarter earnings after the stock market closed yesterday. We're off to a strong start to 2018 and reported a \$0.04 increase in earnings per share from our continuing operations compared to 2017. All of our businesses performed well throughout the quarter, and we are very pleased with the results.

Our combined utility companies reported record first quarter earnings, largely driven by an increase in natural gas distribution sales, adjusted gross margins. Approved rate relief and weather normalization helped to offset the warmer winter conditions that we saw in some of our areas. The



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outlook for our utility business includes plans for investing \$425 million this year and approximately \$1.5 billion over the next 5 years with a projected rate base growth of 6% compounded annually.

I'd like to provide a quick update on a couple of our larger projects at the utility group. The Thunder Spirit Wind expansion project is on track to be completed in the Fall of this year. All major project materials, including wind turbine components, have been received and are awaiting final delivery to the site.

In addition, construction on the Big Stone South to Ellendale 345 kV line has resumed for the season. This project is on schedule and under budget, with MDU's updated investment projected now at \$130 million to \$150 million.

At the pipeline business, we had an excellent first quarter an increased earnings year-over-year by 36%. The two expansion projects that were completed in the second quarter of 2017 helped the company move record first quarter volumes of natural gas through the system, with transport volumes up some 17% higher year-over-year. This business is a full year ahead, with construction expected to begin this month on the 38-mile Valley Expansion Project in Eastern North Dakota and Western Minnesota, along with the 13-mile Line Section 27 project in Northwestern North Dakota in the heart of the Bakken.

We're also pleased to announce in our earnings news release yesterday two new organic growth projects at our pipeline business. The Demicks Lake project is a 14-mile, \$30 million natural gas pipeline project in McKenzie County. Construction here is expected to begin in 2019 with an in-service date in the Fall of 2019.

And earlier this year, at our analyst seminar, we talked about the Billings expansion project, and this project is now being called Line Section 22 Expansion. Construction is scheduled to begin in 2019 with an in-service date in later 2019. This project is really driven by increased demand in the Billings, Montana area and will increase the system capacity by 22.5 million cubic feet per day and is estimated to cost between \$12 million and \$15 million.

Both of these projects have secured sufficient customer commitments to proceed. Expansion projects like these will allow the pipeline group to continue increasing transport volumes that will lead to longer-term earnings growth.

Now I'd like to turn to our two construction businesses. At construction service, this group continues to deliver exceptional revenue and earnings growth. This business more than doubled its first quarter earnings compared to last year and reported record revenues of \$334.1 million. Throughout the first quarter, construction services sent teams to perform power line repair work following severe -- several severe storms, particularly in the Northeast and saw an increase in demand for the sales and rental of electrical tools and utility construction equipment that it manufactures.

At our construction materials group, we've also started the year strong. And while they reported normal seasonal loss, mild weather in the Pacific Northwest helped the group report a \$12.5 million increase in revenues year-over-year, and we're optimistic about the earnings prospect from this business unit going forward.

We recently announced an acquisition at Knife River, which will enhance and expand our construction material services along the Oregon coast. Teevin & Fischer Quarry, which is headquartered in Seaside, Oregon, is a leading aggregate provider in the area with 6 million tons of aggregate reserves split between its Seaside quarry and its Oak Ranch quarry. This operation also includes rock crushing equipment and a trucking fleet.

One of the advantages Knife River brings to the operation, in addition to our back-office synergies, is the ability to use these aggregates in self-performed construction projects in Seaside and the surrounding areas.

Our diversification with respect to geographic location spreads our exposure to multiple climates, along with local economies. As Knife River continues to evaluate additional acquisition opportunities, it is this diversification that will be key to our success as we go forward.

Combined, our construction companies ended the quarter with nearly \$1.4 billion in backlog, and we're excited about the opportunities for these businesses as we think about 2018 and beyond.



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This completes our individual business unit discussion. And as we look to the overall corporation, I would like to reiterate that we are on track with our current year expectations. After looking at the first quarter results, we are reaffirming our current earnings per share range of \$1.25 to \$1.45. Furthermore, the company anticipates a 5% to 8% long-term compounded annual growth rate.

Our focus here at MDU Resources has been to produce significant long-term value as we execute our business plans, including organic growth projects and targeted acquisitions, and we're doing just that. We continue to maintain a strong balance sheet, solid credit ratings and good liquidity. And for 80 consecutive years, we have continued to provide a competitive dividend for our shareholders.

As always, MDU Resources is committed to operating with high integrity and a focus on safety while creating superior shareholder value as we continue to act on our tagline, that is, Building a Strong America.

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) Your first question comes from Paul Ridzon of KeyBanc.

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

I had a question on -- in your discussion around construction services, you cite lower labor costs attributable to successful job performance. Is that -- how does that work, sorry?

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

Could you repeat the first part of that question, Paul? You just broke up just a little bit.

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

I'm just trying to interpret some of your discussion around construction services where you cite decreased labor costs attributable to successful job performance. Is that some kind of performance award? Or how does that dynamic work?

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

I'll turn it over to Jeff Thiede, Paul. Thanks for the question.

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

Yes, it's attributed to our teams being able to beat the labor units that we had in our estimate. And that is due to planning, it's due to offsite prefabrication, it's due to modular construction. So we've hit some really good milestones with our company, and we'll continue to improve.



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

I know you talked about some of the modular construction at the Analyst Day. Can you help -- what kind of traction do you have there? What's the upside?

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

You said with regard to modular construction, Paul?

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

Yes, yes.

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

Yes. So we've been involved with a confidential client on a building that includes electrical and mechanical infrastructure. And we've shipped those buildings and dropped them in place. And this has helped us get the work done offsite in a confined -- in an area that we can control safety and productivity better and also have the work hours moved in an earlier part of the project instead of doing the work out in the field when there's more congestion and more constraints on schedule.

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

And at the competitive businesses, have you seen customers try to reach through and get a taste of your -- the margin that you're experiencing from lower taxes?

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

Yes, Paul, that's a great question. I'm going to actually ask Dave Barney to touch on his business, and then we'll switch gears and have Jeff touch on his.

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

We have not seen any impact from the tax reform. Our margins have actually increased on our construction backlog, and so we really haven't seen an impact at all from that.

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

Paul, this is Jeff. The answer is about the same. We're seeing with the tax reform, excitement and investment and growth in our economy, which is going to have an impact on our industry. If you looked at the ADP jobs report yesterday, the economy grew by over 200,000 jobs for the sixth straight month according to the ADP report, and we're looking forward to the Friday jobs report tomorrow from the U.S. Bureau of Labor and Statistics where they're estimating non-farms increase of 195,000 for April, that's another increase. So good signs for us. We'll have some constraints on labor availability, but those are good challenges to have. We're working on solutions for mitigating the labor risks for ourselves and for our customers.



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

So you kind of indicated margins, looking up, I mean, should we -- I think your last guidance was comparable to '17. Should we -- could we look for those to tick up a little bit?

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

Yes. Paul, as we noted in this release, we said for both construction businesses, materials and services, we expect margins comparable to slightly increasing. And I think you heard that comment from -- Dave Barney noted that as well about not seeing -- you termed it reach through from the owners so far as Tax Cuts and Jobs Act. But we're seeing some of that actually in both of our construction businesses as to comparable to actually slightly increasing when -- again when we talked early in the year, it was yet to be seen how the Tax Cuts and Jobs Act would affect competitive bidding environments. We're really blessed by having two very active businesses in the construction space that have a strong backlog and really strong demand for their services.

Operator

Your next question comes from the line of Chris Ellinghaus of Williams Capital.

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

Jason, the Oregon acquisition, was that a typical stock-type transaction?

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

Again, we maybe have a tough -- did you say was it a typical stock-type transaction, Chris?

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

Your typical construction materials have been a stock transaction. Is that what the Oregon financing looked like?

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

So Chris, this is Jason. I think as we look -- this is a great acquisition for us that kind of expands some of that. I'll let Dave maybe talk a little bit more about the acquisition itself. But this is a smaller bolt-on acquisition that we have financed, really to acquire the quarry in that area or a couple of some asset reserves in those areas and not a stock transaction in this case, no.

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

No, that would be in cash. Yes.

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

Okay. Can you give us any color in terms of the benefit in the first quarter from the storm restoration work? Was that a significant proportion of the improvement in construction services in the quarter?



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

Chris, this is Jeff. It made a strong contribution, and our outside companies had a very good quarter, strong quarter. I mean, they weren't the only ones in our company who had a strong quarter. We had a good contribution from our inside businesses as well, our health care, data center, mission-critical work, our higher education and our industrial work. So that just points out that we've got a very good, diversified company and exceptional people.

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

Okay. Jeff, you were talking about how the modular construction has helped you with your labor costs. Is that something that is generally being done throughout the industry, therefore, when you're rebidding, you might have a competitive advantage? Or is that something that's pretty common at this point?

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

It's not brand-new in our industry, and some of our competitors have been involved in that longer than we have. But our initial start has been very positive, and we continue to see demand for this type of service that we can provide. And we've got the ability to do it and the connections with our customers that are going to allow us to grow in this area.

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

Okay. One last question. Vegas has got a lot of pretty significant projects in the convention center deal, the Echelon project. There's a project downtown. The Wynn has some projects. Can you just give us some sense of what you're seeing in Las Vegas?

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

We're seeing very positive signs of the strong market, and it's just starting. So we also have the stadium -- football stadium that's being built, it just broke ground. So you named some of the projects, there are several more. So we're mapping all those opportunities and talking to our customers and making sure that we're going to be able to provide the resources so we continue to operate at a high level. We can't do them all, but we certainly are involved in many of these that you just mentioned.

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

Have you seen -- as far as the Wynn project, are they advancing?

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

Yes.

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

Okay. And I can't remember what the name of it is, but the old Echelon site, I know they're under construction, but do you know what the scale of that is?



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

We haven't seen much activity on the Alon project, but we are seeing some activity on Resorts World, and we're hoping to be involved in that.

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 17. The conference ID number for the replay is 5478625. 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, Shelby. As we noted earlier, our first quarter results represent a good start to 2018. We're committed to building a strong America and along with being optimistic about our opportunities for the rest of the year and beyond.

We also appreciate your participation on the call today and do appreciate and thank you for your continued interest in MDU Resources.

I'll turn it now over back 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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