



MDU Resources (MDU)

Updated May 9th, 2019 by Josh Arnold

Key Metrics

Current Price:	\$26	5 Year CAGR Estimate:	8.0%	Volatility Percentile:	15.6%
Fair Value Price:	\$26	5 Year Growth Estimate:	5.0%	Momentum Percentile:	26.6%
% Fair Value:	100%	5 Year Valuation Multiple Estimate:	-0.1%	Growth Percentile:	35.7%
Dividend Yield:	3.1%	5 Year Price Target	\$32	Valuation Percentile:	55.8%
Dividend Risk Score:	B	Retirement Suitability Score:	B	Total Return Percentile:	46.1%

Overview & Current Events

MDU Resources is a regulated energy delivery, transportation, and construction materials and services business. The company was founded back in 1924 and since that time, it has grown from a small electric utility in North Dakota to a market capitalization of \$5 billion. It has paid a very impressive 80 consecutive years of dividends and operates electric and gas utilities, pipelines, and a sizable construction business. It should generate almost \$5 billion in sales this year.

MDU reported Q1 earnings on 4/30/19 and results were largely in line with expectations. Revenue in the utility segment rose 3.6% year-over-year while the top line soared more than 18% higher for the construction business. The latter set another revenue record in Q1 and its backlog is at \$2 billion. The record quarter for the construction business – as well as a very strong 2019 outlook for that segment – caused management to boost its guidance slightly for this year, adding \$50 million to its revenue forecast.

However, higher operating and maintenance costs caused MDU's operating margins to fall meaningfully in Q1. Operating income was 5.9% of revenue in Q1 against 7.1% in the year-ago period thanks to these higher operating expenses incurred during Q1.

This also caused earnings-per-share to decline a penny to \$0.21 in Q1, but MDU slightly boosted its guidance for earnings-per-share to \$1.40 to \$1.55 in 2019. We've boosted our estimate from \$1.45 to \$1.50 for this year as a result of the guidance boost from MDU, as well as the construction business that continues to perform spectacularly well.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	\$1.41	\$1.29	\$1.19	\$1.15	\$1.53	\$1.40	\$0.90	\$1.15	\$1.46	\$1.39	\$1.50	\$1.91
DPS	\$0.62	\$0.64	\$0.66	\$0.68	\$0.52	\$0.72	\$0.74	\$0.76	\$0.77	\$0.80	\$0.81	\$0.88
Shares	188	189	189	189	189	194	195	196	196	196	196	196

Earnings-per-share has bounced around in recent years, owed to the very cyclical nature of its construction business that is somewhat – but not fully – offset by the steady utilities and pipeline businesses. MDU offers a bit of an odd mix in this way but when performance is robust, growth can be strong.

We are forecasting MDU to produce 5% growth annually going forward. It will achieve this expansion via sales growth, both organically and through acquisitions. The utility business continues to see low single digit customer growth and double-digit growth in natural gas retail sales. The pipeline business saw record transportation volume again in 2018. The construction business now has a backlog of nearly \$2 billion which is yet another record. On top of MDU's growing, diverse streams of revenue, margins are moving higher in the construction business, providing another tailwind to earnings growth. Things are certainly looking up for MDU today but keep in mind the risk of its cyclicity, particularly in the construction business. In addition, another risk that has been introduced by the Q1 report is shrinking margins. While we don't have any evidence that MDU's margins will be impaired for the longer-term, it certainly cramped earnings growth in Q1 and could do so in the coming quarters.

We see the dividend continuing its very modest rate of growth, moving up to 88 cents from the current 81 cents over the next five years.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	13.7	15.8	18.0	19.0	17.4	22.1	22.0	19.6	18.4	19.5	17.1	17.0
Avg. Yld.	3.2%	3.1%	3.1%	3.1%	2.0%	2.3%	3.7%	3.3%	2.9%	2.9%	3.1%	2.7%

MDU's price-to-earnings multiple has moved around a lot, which is something you would expect for a cyclical company. The multiple is somewhat off the highs of 2014/2015, and is now trading just in line with fair value. That means the impact to total returns could be essentially flat as MDU has become cheaper since our last update.

The yield could stay about where it is today near 3% as earnings-per-share growth is somewhat offset by a declining valuation, coupled with very low levels of dividend growth. MDU's capital allocation strategy calls for plenty of acquisitions as well as paying the dividend. However, growth in the latter is certainly not a priority.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	44%	49%	55%	74%	34%	52%	82%	65%	53%	58%	54%	46%

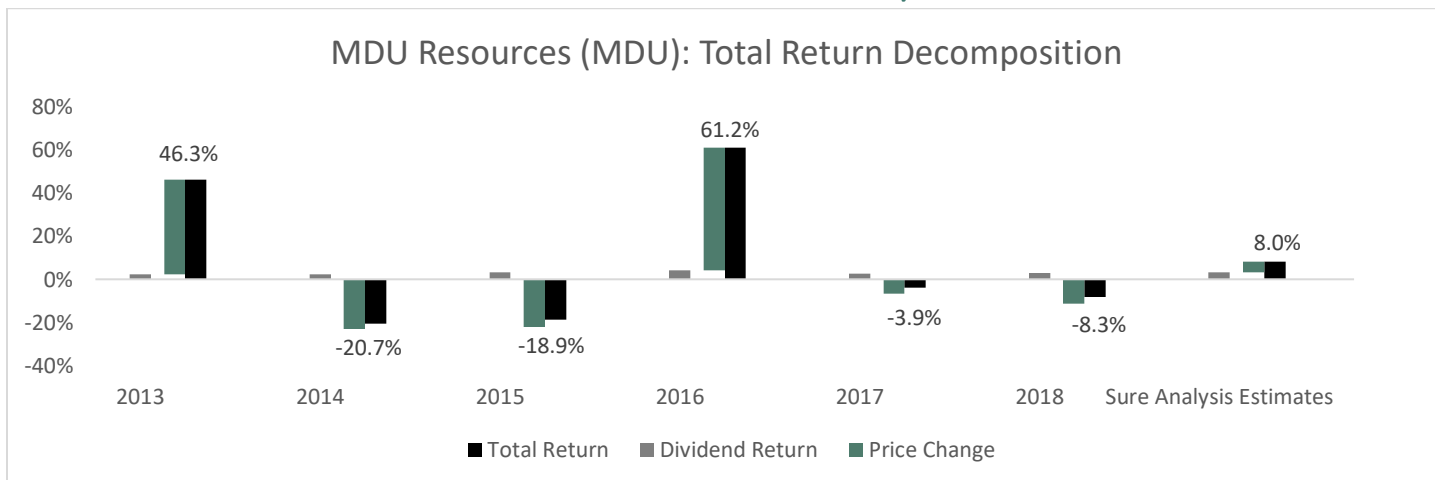
MDU's payout ratio is just over half of earnings, so it is certainly safe. The dividend has not necessarily been a priority in terms of capital allocation for management in recent years, as they have chosen to focus on growth instead. We do not believe that strategy will change in the near future.

MDU's competitive advantage can also be its downfall in that it operates a utility and pipeline business that are both stable, but it is also in construction, which is one of the most cyclical industries that exists today. This gives MDU a major leg up on other utilities in the good times – like we are seeing today – but can be its downfall in times of economic hardship. Indeed, its earnings fell very sharply from 2008 and still have not yet recovered.

Final Thoughts & Recommendation

MDU is now trading in line with fair value, and it offers a nice yield and solid growth prospects. We see 8.0% annual total returns going forward consisting of the 3.1% current yield, a 0.1% headwind from the valuation, and 5% earnings-per-share growth. Investors that want to own MDU now have the chance to do so at fair value, and the stock offers better total return prospects as a result. We continue to rate MDU a hold given the risk of an eventual slowdown in the construction business, and high single digit expected returns.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	4177	3910	4050	4075	3920	4115	4014	4129	4443	4532
Gross Profit	964	903	923	946	662	675	672	777	798	791
Gross Margin	23.1%	23.1%	22.8%	23.2%	16.9%	16.4%	16.8%	18.8%	18.0%	17.4%
Operating Profit	467	411	406	411	321	327	320	409	424	402
Operating Margin	11.2%	10.5%	10.0%	10.1%	8.2%	8.0%	8.0%	9.9%	9.5%	8.9%
Net Profit	-123	241	213	-1	279	298	-622	64	281	272
Net Margin	-3.0%	6.2%	5.3%	0.0%	7.1%	7.2%	-15.5%	1.6%	6.3%	6.0%
Free Cash Flow	398	102	130	-288	223	158	125	74	107	-68
Income Tax	-96	123	110	-31	74	64	71	93	65	47

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	5991	6304	6556	6682	7061	7832	6565	6284	6335	6988
Cash & Equivalents	175	222	163	49	45	82	84	46	35	54
Inventories	250	253	274	317	282	289	241	238	227	287
Goodwill & Int. Ass.	658	660	656	653	649	645	643	638	636	676
Total Liabilities	3419	3611	3781	4034	4205	4583	4045	3968	3906	4421
Accounts Payable	282	301	337	388	405	279	286	280	312	359
Long-Term Debt	1510	1527	1425	1773	1866	2094	1796	1790	1715	2109
Shareholder's Equity	2557	2678	2761	2633	2808	3119	2382	2301	2429	2567
D/E Ratio	0.59	0.57	0.51	0.67	0.66	0.67	0.75	0.77	0.71	0.82

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	-2.0%	3.9%	3.3%	0.0%	4.1%	4.0%	-8.6%	1.0%	4.5%	4.1%
Return on Equity	-4.6%	9.2%	7.8%	0.0%	10.3%	10.1%	-22.6%	2.8%	11.9%	10.9%
ROIC	-2.9%	5.8%	5.1%	0.0%	6.1%	5.9%	-12.9%	1.5%	6.8%	6.2%
Shares Out.	188	189	189	189	189	194	195	196	196	196
Revenue/Share	22.55	20.77	21.44	21.58	20.67	21.37	20.59	21.11	22.71	23.10
FCF/Share	2.15	0.54	0.69	-1.53	1.18	0.82	0.64	0.38	0.54	-0.35

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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