



MDU Resources (MDU)

Updated December 2nd, 2020 by Josh Arnold

Key Metrics

Current Price:	\$25	5 Year CAGR Estimate:	8.3%	Market Cap:	\$5.1 B
Fair Value Price:	\$30	5 Year Growth Estimate:	2.0%	Ex-Dividend Date:	12/09/20
% Fair Value:	84%	5 Year Valuation Multiple Estimate:	3.4%	Dividend Payment Date:	01/01/21
Dividend Yield:	3.4%	5 Year Price Target	\$33	Years Of Dividend Growth:	30
Dividend Risk Score:	A	Retirement Suitability Score:	A	Last Dividend Increase:	2.4%

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 \$5.1 billion. It has paid an impressive 80 consecutive years of dividends and operates electric and gas utilities, pipelines, and construction businesses. It should generate \$5.4 billion in sales this year, and about 75% of that will come from the company's construction businesses; utility businesses make up the remaining ~25%.

MDU reported third quarter earnings on November 4th, 2020 and while revenue came in slightly below expectations, earnings were a bit better. Earnings-per-share came to 76 cents, or \$153 million, an 11% increase over the same period last year. For the first nine months of the year, MDU's earnings are up from \$1.21 per share to \$1.39 per share.

Revenue was up 1.5% year-over-year to \$1,587 million, as the company's regulated utility business was essentially flat, with the construction and unregulated energy delivery segment producing the entirety of the top line gain.

Operating expenses rose less quickly than revenue, leading to outsized profit gains. Indeed, operating income rose 7.5% year-over-year due to stronger margins. MDU also boosted its guidance for earnings-per-share from \$1.65 to \$1.85, to a new range of \$1.80 to \$1.90. We've boosted our estimate of earnings-per-share for this year to \$1.85 as a result.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$1.29	\$1.19	\$1.15	\$1.53	\$1.40	\$0.90	\$1.15	\$1.46	\$1.39	\$1.69	\$1.85	\$2.04
DPS	\$0.64	\$0.66	\$0.68	\$0.52	\$0.72	\$0.74	\$0.76	\$0.77	\$0.80	\$0.82	\$0.85	\$0.96
Shares¹	189	189	189	189	194	195	196	196	196	199	201	210

Earnings-per-share have 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. Management has stated it expects to grow earnings-per-share at an average rate of 5% to 8% annually for the long-term. However, we've reduced our earnings growth forecast to 2% because the construction business may suffer during a prolonged downturn.

The company can 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 2019, and we have little reason to believe that won't reoccur in 2020. The construction business has a backlog in excess of \$1.7 billion, which is down from the prior record on COVID-related delays from municipalities. 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, but keep in mind the risk of its cyclicity, particularly in the construction business.

We see the dividend continuing its very modest rate of growth, moving up to 96 cents from the current 85 cents over the next five years.

¹ Share count in millions

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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	15.8	18.0	19.0	17.4	22.1	22.0	19.6	18.4	19.5	15.8	13.5	16.0
Avg. Yld.	3.1%	3.1%	3.1%	2.0%	2.3%	3.7%	3.3%	2.9%	2.9%	3.1%	3.4%	2.9%

MDU's price-to-earnings multiple has moved around a lot, which is something you would expect for a cyclical company. The multiple is well off the highs of 2014/2015 and is now trading below our lowered fair value estimate of 16 times earnings; MDU remains comparatively cheap.

The yield could decline as low dividend growth rates could be more than offset by a rising share price. 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	49%	55%	74%	34%	52%	82%	65%	53%	58%	49%	46%	47%

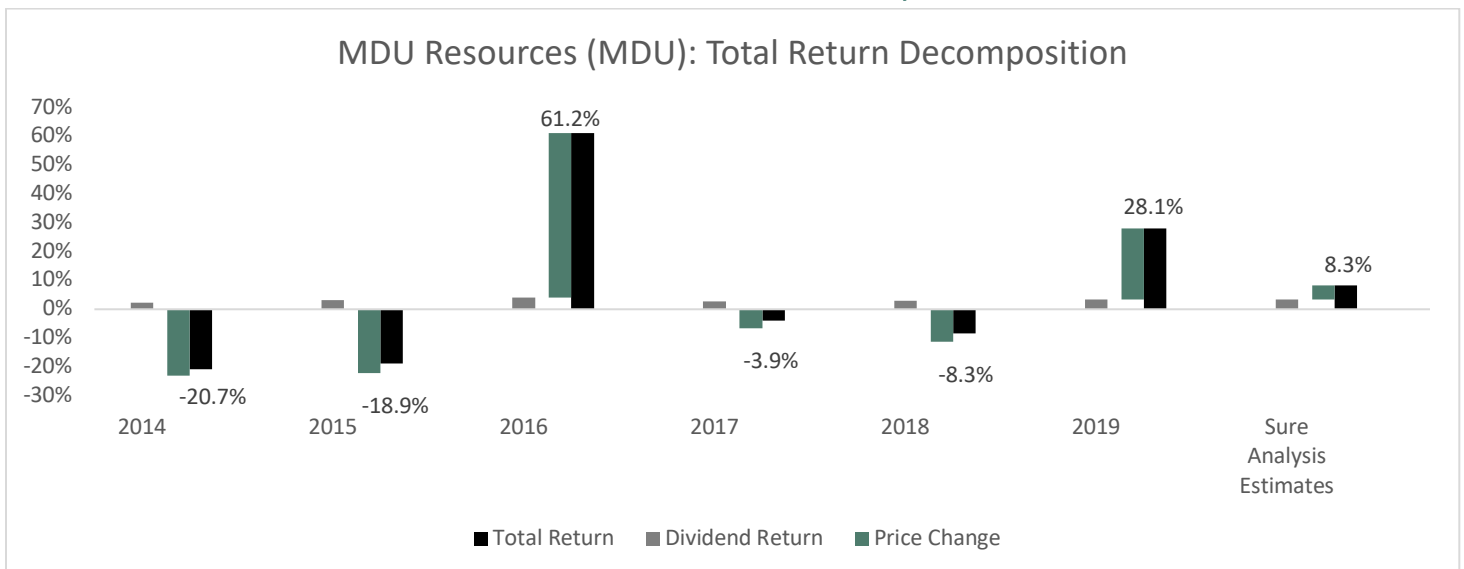
MDU's payout ratio is about half of earnings, so it is considered safe. The dividend has not necessarily been a priority in terms of capital allocation for management in recent years, as they have chosen to focus on growth instead. We do not believe that strategy will change in the near future.

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. This gives MDU a major leg up on other utilities in the good times 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 still trading below our fair value estimate, and it offers a nice yield with modest growth prospects. We see 8.3% annual total returns going forward consisting of the 3.4% current yield, a sizable tailwind from the valuation, and 2% earnings-per-share growth. We have moved our rating from buy to hold on slightly lower prospective total returns.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	3910	4050	4075	3920	4115	4014	4129	4443	4532	5337
Gross Profit	903	923	946	662	675	672	777	798	791	933
Gross Margin	23.1%	22.8%	23.2%	16.9%	16.4%	16.8%	18.8%	18.0%	17.4%	17.5%
Operating Profit	411	406	411	321	327	320	409	424	402	481
Operating Margin	10.5%	10.0%	10.1%	8.2%	8.0%	8.0%	9.9%	9.5%	8.9%	9.0%
Net Profit	241	213	-1	279	298	-622	64	281	272	336
Net Margin	6.2%	5.3%	0.0%	7.1%	7.2%	-15.5%	1.6%	6.3%	6.0%	6.3%
Free Cash Flow	102	130	-288	223	158	125	74	107	-68	542
Income Tax	123	110	-31	74	64	71	93	65	47	63

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	6304	6556	6682	7061	7832	6565	6284	6335	6988	7683
Cash & Equivalents	222	163	49	45	82	84	46	35	54	66
Inventories	253	274	317	282	289	241	238	227	287	278
Goodwill & Int. Ass.	660	656	653	649	645	643	638	636	676	697
Total Liabilities	3611	3781	4034	4205	4583	4045	3968	3906	4421	4836
Accounts Payable	301	337	388	405	279	286	280	312	359	403
Long-Term Debt	1527	1425	1773	1866	2094	1796	1790	1715	2109	2243
Shareholder's Equity	2678	2761	2633	2808	3119	2382	2301	2429	2567	2847
D/E Ratio	0.57	0.51	0.67	0.66	0.67	0.75	0.77	0.71	0.82	0.79

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	3.9%	3.3%	0.0%	4.1%	4.0%	-8.6%	1.0%	4.5%	4.1%	4.6%
Return on Equity	9.2%	7.8%	0.0%	10.3%	10.1%	-22.6%	2.8%	11.9%	10.9%	12.4%
ROIC	5.8%	5.1%	0.0%	6.1%	5.9%	-12.9%	1.5%	6.8%	6.2%	8.9%
Shares Out.	189	189	189	189	194	195	196	196	196	199
Revenue/Share	20.77	21.44	21.58	20.67	21.37	20.59	21.11	22.71	23.10	26.87
FCF/Share	0.54	0.69	-1.53	1.18	0.82	0.64	0.38	0.54	-0.35	2.73

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

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