

ANNUAL REPORT

STATE OF NORTH DAKOTA

GAS OPERATIONS

FOR THE YEAR ENDED DECEMBER 31, 2016



MONTANA-DAKOTA
UTILITIES CO.

A Division of MDU Resources Group, Inc.

In the Community to Serve®

INDEX

- I. Intrastate Return on Equity
- II. Capital Structure
- III. Affiliated Transactions
- IV. Miscellaneous Statistics

**MONTANA-DAKOTA UTILITIES CO.
ANNUAL REPORT
TO THE
NORTH DAKOTA PUBLIC SERVICE COMMISSION**

Line #	Description	(A)	(B)	(C)	(D)	(E)
		2016 Total Company	2016 North Dakota	ND % (B / A)	2015 North Dakota	Variance (B-D / D)
<u>Operating Revenues:</u>						
1	Residential	\$111,666,018	46,612,278	41.74%	\$58,665,366	-20.55%
2	Firm General	73,425,584	33,131,057	45.12%	45,104,955	-26.55%
3	Small Interruptible	5,219,828	3,703,732	70.96%	6,176,854	-40.04%
4	Large Interruptible	447,046	31,412	7.03%	248,067	-87.34%
5	Transportation	4,200,203	2,116,969	50.40%	2,096,638	0.97%
6	Other Operating Revenues	5,296,907	4,146,114	78.27%	3,975,504	4.29%
7	Unbilled Revenue	6,101,399	2,152,533	35.28%	(4,656,073)	-146.23%
8	Reserve for Refunds	(179,353)	(24,359)	13.58%	(947,218)	-97.43%
9	Total Operating Revenues	\$206,177,632	\$91,869,736	44.56%	\$110,664,093	-16.98%
<u>Operating Expenses:</u>						
10	Cost of Purchased Gas	\$117,374,561	\$51,338,373	43.74%	\$72,479,031	-29.17%
11	Other Gas Supply Expense	761,652	356,251	46.77%	290,570	22.60%
12	Distribution Expense	19,145,053	8,874,515	46.35%	8,941,446	-0.75%
13	Customer Accounts Expense	6,910,895	2,757,308	39.90%	2,494,409	10.54%
14	Customer Service & Info. Exp.	521,751	246,252	47.20%	255,989	-3.80%
15	Sales Expense	287,263	133,030	46.31%	224,247	-40.68%
16	Administration & General Exp.	17,615,456	7,880,939	44.74%	7,136,557	10.43%
17	Depreciation Expense	17,438,193	7,630,836	43.76%	6,928,475	10.14%
18	Taxes Other than Income	8,065,837	1,901,169	23.57%	1,814,044	4.80%
19	Total Operating Expenses	\$188,120,661	\$81,118,673	43.12%	\$100,564,768	-19.34%
20	Net Operating Income					
21	before Income Taxes	\$18,056,971	\$10,751,063	59.54%	\$10,099,325	6.45%
<u>Income Tax Expense:</u>						
22	Investment Tax Credits					
23	Deferred Income Taxes	(\$3,352,966)	(\$1,249,456)	37.26%	(\$2,553,934)	-51.08%
24	Income Taxes	7,726,835	3,979,441	51.50%	5,124,074	-22.34%
25	Total Income Tax Expense	\$4,373,869	\$2,729,985	62.42%	\$2,570,140	6.22%
26	Net Regulated Earnings	\$13,683,102	\$8,021,078	58.62%	\$7,529,185	6.53%

I. INTRASTATE RETURN ON EQUITY

MONTANA-DAKOTA UTILITIES CO.
ANNUAL REPORT
TO THE
NORTH DAKOTA PUBLIC SERVICE COMMISSION

Line #	Description	(A)	(B)	(C)	(D)	(E)
		Total Company	2016 North Dakota	ND % (B / A)	2015 North Dakota	Variance (B-D / D)
<u>Rate Base:</u>						
1	Plant in Service 1/	\$506,603,935	\$245,350,306	48.43%	\$227,993,084	7.61%
2	Less: Accumulated Depreciation 1/	222,611,178	88,119,207	39.58%	82,577,466	6.71%
3	Net Plant in Service	\$283,992,757	\$157,231,099	55.36%	\$145,415,618	8.13%
<u>Additions:</u>						
4	Materials and Supplies 2/	\$3,827,853	\$2,109,464	55.11%	\$2,363,307	-10.74%
5	Prepayments 2/	497,064	232,480	46.77%	221,558	4.93%
6	Prepaid Demand/Commodity 1/	1,142,119		0.00%		
7	Fuel Stocks 2/	101,812	101,812	100.00%	72,172	41.07%
8	Gas in Underground Storage 1/	4,103,611		0.00%		
9	Other 1/	171,705		0.00%		
10	Unamortized Loss on Debt 1/	1,183,148	638,319	53.95%	687,944	-7.21%
11	Gain and Loss on Property 1/	(316,643)	(316,643)	100.00%	(335,782)	-5.70%
12	Total Additions	\$10,710,669	\$2,765,432	25.82%	\$3,009,199	-8.10%
<u>Deductions:</u>						
13	Accum. Deferred Income Taxes 1/	\$47,419,538	\$20,608,456	43.46%	\$20,712,493	-0.50%
14	Cust. Advances for Construct. 2/	16,155,142	12,724,578	78.76%	12,451,719	2.19%
15	Total Deductions	\$63,574,680	\$33,333,034	52.43%	\$33,164,212	0.51%
16	Average Rate Base	<u>\$231,128,746</u>	<u>\$126,663,497</u>	54.80%	<u>\$115,260,605</u>	9.89%
17	Rate of Return on Avg. Rate Base	5.920%	6.333%		6.532%	
18	Less: Weighted Cost of Debt	2.396%	2.396%		2.494%	
19	Weighted Cost of Pref. Stock	0.052%	0.052%		0.058%	
20	Weighted Return on Equity	3.472%	3.885%		3.980%	
21	% of Equity to Capital Structure	50.195%	50.195%		49.171%	
22	Return on Equity	<u>6.917%</u>	<u>7.740%</u>		<u>8.094%</u>	

1/ Beginning and ending year average.

2/ Thirteen month average.

**MONTANA-DAKOTA UTILITIES CO.
ANNUAL REPORT
TO THE
NORTH DAKOTA PUBLIC SERVICE COMMISSION**

		(A)	(B)	(C)	(D)
Line #	Description	2016 Average (000's)	Ratio	Cost	Weighted Cost
1	Long-Term Debt 1/	\$575,451	42.587%	5.447%	2.320%
2	Short Term Debt 2/	82,230	6.085%	1.249%	0.076%
3	Preferred Equity	15,309	1.133%	4.581%	0.052%
4	Common Equity	<u>678,262</u>	<u>50.195%</u>	3/	<u>3/</u>
5	Total	<u>\$1,351,252</u>	<u>100.000%</u>		<u>3/</u>

1/ Includes additional other long term debt.

2/ Reflects monthly average short term debt.

3/ Return on equity is calculated in Section I, page 2 of 2.

II. CAPITAL STRUCTURE - TOTAL UTILITY

MONTANA-DAKOTA UTILITIES CO.
LONG-TERM DEBT CAPITAL
DECEMBER 31, 2016

Description	Date of Issuance	Date of Maturity	Interest Rate	Principal Amount of Issue	Gross Proceeds	Underwriters' Commission		Loss on Reacquirement Redemption and Issuance Expense	
						Amount	% Gross Proceeds	Amount	% Gross Proceeds
Unsecured Long Term Debt									
5.98% - Senior Note	12/15/2003	12/15/2033	5.980%	\$30,000,000	\$30,000,000	\$624,465	2.082%	0	0.000%
6.33% - Senior Note	8/24/2006	8/24/2026	6.330%	100,000,000	100,000,000	344,061	0.344%	10,532,009	10.532%
6.04% - Senior Note	9/16/2008	9/16/2018	6.040%	100,000,000	100,000,000	362,431	0.362%	0	0.000%
5.18% - Senior Note	4/15/2014	4/15/2044	5.180%	50,000,000	50,000,000	239,178	0.478%	0	0.000%
4.24% - Senior Note	7/15/2014	7/15/2024	4.240%	60,000,000	60,000,000	291,263	0.485%	0	0.000%
4.34% - Senior Note	7/15/2014	7/15/2026	4.340%	40,000,000	40,000,000	197,042	0.493%	0	0.000%
3.78% - Senior Note	10/29/2015	10/30/2025	3.780%	87,000,000	87,000,000	471,997	0.543%	0	0.000%
4.87% - Senior Note	10/29/2015	10/30/2045	4.870%	11,000,000	11,000,000	59,461	0.541%	0	0.000%
4.03% - Senior Note	12/10/2015	12/10/2030	4.030%	52,000,000	52,000,000	286,355	0.551%	0	0.000%
4.15% - Senior Note	11/21/2016	11/21/1946	4.150%	40,000,000	40,000,000	66,042	0.165%	0	0.000%
Total Long-Term Debt Capital				<u>\$570,000,000</u>	<u>\$570,000,000</u>	<u>\$2,942,295</u>		<u>\$10,532,009</u>	

Description	Net Proceeds		Cost of Money 1/	Principal Outstanding	Annual Cost	Embedded Cost
	Amount	Per Unit				
Unsecured Long Term Debt						
5.98% - Senior Note	\$29,375,535	97.918%	6.210%	\$30,000,000	\$1,863,000	
6.33% - Senior Note	89,123,930	89.124%	7.514%	100,000,000	7,514,000	
6.04% - Senior Note	99,637,569	99.638%	6.181%	100,000,000	6,181,000	
5.18% - Senior Note	49,760,822	99.522%	5.280%	50,000,000	2,640,000	
4.24% - Senior Note	59,708,737	99.515%	4.346%	60,000,000	2,607,600	
4.34% - Senior Note	39,802,958	99.507%	4.440%	40,000,000	1,776,800	
3.78% - Senior Note	86,528,003	99.457%	3.883%	87,000,000	3,378,210	
4.87% - Senior Note	10,940,539	99.459%	4.964%	11,000,000	546,040	
4.03% - Senior Note	51,713,645	99.449%	4.122%	52,000,000	2,143,440	
4.15% - Senior Note	39,933,958	99.835%	4.203%	40,000,000	1,681,200	
Total Long-Term Debt Capital	<u>\$556,525,696</u>			<u>\$570,000,000</u>	<u>\$30,331,290</u>	<u>5.321%</u>

1/ Yield to maturity based upon the life, net proceeds, semiannual compounding of stated interest rate.

III. AFFILIATED TRANSACTIONS

MONTANA-DAKOTA UTILITIES CO.
ANNUAL REPORT
TO THE
NORTH DAKOTA PUBLIC SERVICE COMMISSION
MAJOR TRANSACTIONS 2016

Line #	Affiliate's Name	General Description of Service Rendered and/or Supplied	Revenue or (Expense)	
			Total Company	Allocated to North Dakota
1	Knife River Corporation	Electric Sales	\$207,059	\$207,059
2		Natural Gas Sales	138,094	137,291
3	WBI Energy	Electric Sales	354,935	103,436
4		Natural Gas Pipeline Services	(49,436,254)	(21,408,743)
5		Natural Gas Sales	23,087	3,208
6	FutureSource	Electric Sales	173,418	173,418
7		Natural Gas Sales	10,808	10,808
8	JTL Group	Natural Gas Sales	20,438	0
9	Total Corrosion Solution	Electric Sales	639	639
10		Natural Gas Sales	2,166	503
11	Whiting Petroleum	Electric Sales	41,707	40,869
12		Natural Gas Sales	5,129	4,807
13	Rocky Mountain Contractor	Natural Gas Sales	3,144	0
	Total		<u>(\$48,455,630)</u>	<u>(\$20,726,705)</u>

IV. MISCELLANEOUS

MONTANA-DAKOTA UTILITIES CO.
ANNUAL REPORT TO THE
NORTH DAKOTA PUBLIC SERVICE COMMISSION

Line #	Description	2016	2015	2014	2013	2012
	<u>Customer Related</u>					
1	Year End Customers - Residential	93,722	93,295	91,288	88,372	85,638
2	- Firm General	14,854	14,487	14,031	13,522	13,031
3	- Small Interruptible	118	168	179	164	129
4	- Large Interruptible	1	1	1	1	1
5	- Other - Transportation 1/	88	78	80	79	79
6	- Total	108,783	108,029	105,579	102,138	98,878
7	Dk Sold - Residential	7,274,157	7,757,907	9,280,391	8,514,963	6,762,592
8	- Firm General	6,497,983	6,897,228	7,920,494	7,041,584	5,458,987
9	- Small Interruptible	1,048,439	1,243,285	1,608,358	1,418,415	1,216,105
10	- Large Interruptible	5,816	47,386	59,521	44,053	24,626
11	- Other - Transportation	5,251,263	5,482,942	6,380,462	6,228,357	6,084,714
12	- Total	20,077,658	21,428,748	25,249,226	23,247,372	19,547,024

1/ May include duplication of customers also receiving sales service.

NORTH DAKOTA COST OF SERVICE STUDY

GAS OPERATIONS

2016

MONTANA-DAKOTA UTILITIES CO.
INCOME STATEMENT
GAS UTILITY
TWELVE MONTHS ENDED DECEMBER 31, 2016

	Total Company	North Dakota	Others
<u>Operating Revenues</u>			
Sales Revenues			
Residential	\$111,666,018	\$46,612,278	\$65,053,740
Firm General	73,425,584	33,131,057	40,294,527
Small Interruptible	5,219,828	3,703,732	1,516,096
Large Interruptible	447,046	31,412	415,634
Unbilled Revenue	6,081,949	2,121,873	3,960,076
Reserve for Refunds	(179,353)	(24,359)	(154,994)
Total Sales Revenues	<u>196,661,072</u>	<u>85,575,993</u>	<u>111,085,079</u>
Transportation Revenues			
Small Interruptible	1,516,975	790,363	726,612
Large Interruptible	2,683,228	1,326,606	1,356,622
Unbilled Revenue	19,450	30,660	(11,210)
Total Transportation Revenues	<u>4,219,653</u>	<u>2,147,629</u>	<u>2,072,024</u>
Other Operating Revenues	5,296,907	4,146,114	1,150,793
Total Operating Revenues	<u>\$206,177,632</u>	<u>\$91,869,736</u>	<u>\$114,307,896</u>
<u>Operating Expenses</u>			
Operation and Maintenance			
Cost of Purchased Gas	\$117,374,561	\$51,338,373	\$66,036,188
Other Gas Supply	761,652	356,251	405,401
Distribution	19,145,053	8,874,515	10,270,538
Customer Accounts	6,910,895	2,757,308	4,153,587
Customer Service & Information	521,751	246,252	275,499
Sales	287,263	133,030	154,233
Administrative & General	17,615,456	7,880,939	9,734,517
Total O&M Expenses	<u>162,616,631</u>	<u>71,586,668</u>	<u>91,029,963</u>
Depreciation			
Distribution	13,576,421	5,898,369	7,678,052
General	673,036	193,869	479,167
Common	930,306	490,465	439,841
Amort. of Intangible Plant - General	415,559	271,460	144,099
Amort. of Intangible Plant - Common	1,842,871	776,673	1,066,198
Total Depreciation Expense	<u>17,438,193</u>	<u>7,630,836</u>	<u>9,807,357</u>

MONTANA-DAKOTA UTILITIES CO.
INCOME STATEMENT
GAS UTILITY
TWELVE MONTHS ENDED DECEMBER 31, 2016

	<u>Total Company</u>	<u>North Dakota</u>	<u>Others</u>
<u>Operating Expenses Con't.</u>			
Taxes Other Than Income Taxes			
Ad Valorem Taxes			
Distribution	\$5,080,695	\$917,762	\$4,162,933
General	237,706	50,415	187,291
Common	354,310	38,182	316,128
Intangible	113,019	67,678	45,341
Total Ad Valorem Taxes	<u>5,785,730</u>	<u>1,074,037</u>	<u>4,711,693</u>
Other Taxes	2,280,107	827,132	1,452,975
Total Taxes Other Than Income Taxes	<u>8,065,837</u>	<u>1,901,169</u>	<u>6,164,668</u>
Current Income Taxes	7,726,835	3,979,441	3,747,394
Deferred Income Taxes	<u>(3,352,966)</u>	<u>(1,249,456)</u>	<u>(2,103,510)</u>
Total Operating Expenses	<u>\$192,494,530</u>	<u>\$83,848,658</u>	<u>\$108,645,872</u>
Operating Income	<u>\$13,683,102</u>	<u>\$8,021,078</u>	<u>\$5,662,024</u>
Year End Rate Base	<u>\$233,949,529</u>	<u>\$128,046,293</u>	<u>\$105,903,236</u>
Rate of Return	<u>5.85%</u>	<u>6.26%</u>	<u>5.35%</u>

MONTANA-DAKOTA UTILITIES CO.
YEAR END RATE BASE
GAS UTILITY
TWELVE MONTHS ENDED DECEMBER 31, 2016

	Total Company	North Dakota	Others
<u>Plant in Service</u>			
Gas Plant in Service			
Distribution	\$412,485,551	\$205,905,424	\$206,580,127
General	41,681,194	12,453,137	29,228,057
Intangible Plant - General	6,339,710	5,195,880	1,143,830
Common	23,433,875	13,394,871	10,039,004
Intangible Plant - Common	30,472,126	13,048,910	17,423,216
Acquisition Adjustment	97,266	97,266	0
Total Gas Plant in Service	<u>514,509,722</u>	<u>250,095,488</u>	<u>264,414,234</u>
Accumulated Reserve for Depreciation			
Distribution	194,204,404	76,245,272	117,959,132
General	11,508,320	3,175,163	8,333,157
Intangible Plant - General	1,436,589	1,041,531	395,058
Common	8,973,746	4,597,411	4,376,335
Intangible Plant - Common	11,584,637	5,222,915	6,361,722
Acquisition Adjustment	66,489	66,489	0
Total Accum. Reserve for Depreciation	<u>227,774,185</u>	<u>90,348,781</u>	<u>137,425,404</u>
Net Gas Plant in Service	286,735,537	159,746,707	126,988,830
<u>Additions</u>			
Materials and Supplies	3,531,189	1,874,194	1,656,995
Fuel Stocks	113,968	113,968	0
Prepayments	125,716	57,756	67,960
Prepaid Demand/Commodity	1,171,602	0	1,171,602
Gas in Underground Storage	4,353,773	0	4,353,773
Other	235,027	0	235,027
Unamortized Loss on Debt	1,013,461	558,870	454,591
Gain or Loss on Property	(307,861)	(307,861)	0
Total Additions	<u>10,236,875</u>	<u>2,296,927</u>	<u>7,939,948</u>
Total Before Deductions	\$296,972,412	\$162,043,634	\$134,928,778
<u>Deductions</u>			
Accumulated Deferred Income Taxes	45,746,161	20,179,366	25,566,795
Customer Advances	17,276,722	13,817,975	3,458,747
Total Deductions	<u>63,022,883</u>	<u>33,997,341</u>	<u>29,025,542</u>
Year End Rate Base	<u><u>\$233,949,529</u></u>	<u><u>\$128,046,293</u></u>	<u><u>\$105,903,236</u></u>

**REPORT OF INDEPENDENT
PUBLIC ACCOUNTANTS
2016**



Deloitte & Touche LLP
50 South 6th Street
Suite 2800
Minneapolis, MN 55402-1538
USA

Tel: +1 612 397 4000
Fax: +1 612 397 4450
www.deloitte.com

INDEPENDENT ACCOUNTANTS' REPORT

To the Managing Committee of
Montana-Dakota Utilities Co.:

We have examined the accompanying schedules of the Cost of Gas Adjustment Factors and Fuel Cost Adjustment Factors (collectively, "the Schedules") of Montana-Dakota Utilities Co. (the "Company"), a wholly-owned subsidiary of MDU Resources Group Inc., for the period from January 1, 2016 through December 31, 2016. These Schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these Schedules based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence supporting the Schedules and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

In our opinion, such Schedules present, in all material respects, the cost of gas adjustment factors and fuel clause adjustment factors of the Company for the period from January 1, 2016 to December 31, 2016, as calculated in accordance with the criteria established by the North Dakota Public Service Commission (the "Commission") and based upon Chapters 69-09-01-30 and 69-09-02-39 of the North Dakota Administrative Code (the "Code") and Cost of Gas Rate 88 and Fuel Clause Rate 58 (the "Tariffs") filed by the Company with the Commission.

This report is intended solely for the information and use of the Managing Committee of the Company and the Commission and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche LLP

April 7, 2017

MONTANA-DAKOTA UTILITIES CO.

SCHEDULE OF 2016 COST OF GAS ADJUSTMENT FACTORS

Effective for the Month of	Adjustments per Dekatherm		
	Residential and General Service	Small and Large Interruptible	Air Force Interruptible
January	0.154	0.180	0.179
February	(0.223)	(0.220)	(0.219)
March ⁽¹⁾	N/A	N/A	N/A
April	(0.393)	(0.394)	(0.392)
May	(0.262)	(0.263)	(0.262)
June	0.120	0.117	0.117
July ⁽¹⁾	N/A	N/A	N/A
August	0.751	0.751	0.747
September	(0.170)	(0.172)	(0.170)
October	0.286	(0.033)	(0.046)
November ⁽¹⁾	N/A	N/A	N/A
December	0.167	0.183	0.182

⁽¹⁾ No Cost of Gas adjustment filing was required for the indicated month pursuant to Cost of Gas Adjustment Rate 88, since the adjustment was less than \$0.10 per dekatherm.

MONTANA-DAKOTA UTILITIES CO.

SCHEDULE OF 2016 FUEL COST ADJUSTMENT FACTORS

Effective for the Month of	Fuel Cost Adjustments per Kilowatt Hour	
	Primary (1)	Secondary (1)
January	0.00410	0.00485
February	0.00344	0.00411
March	0.00345	0.00403
April	0.00154	0.00174
May	(0.00169)	(0.00158)
June	(0.00319)	(0.00304)
July	(0.00380)	(0.00353)
August	(0.00310)	(0.00275)
September	0.00005	0.00054
October	0.00117	0.00163
November	0.00144	0.00192
December	0.00282	0.00337

⁽¹⁾ Excludes base cost of fuel of \$0.02024 for primary service customers and \$0.02087 for secondary service customers.