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+++ presentation

Operator^ Good day, ladies and gentlemen, and welcome to the Black Hills Corporation Third Quarter 2022 Earnings Conference Call. My name is Liz, and I will be your coordinator for today. (Operator Instructions)

As a reminder, this conference is being recorded for replay purposes. I would now like to turn the presentation over to Mr. Jerome Nichols, Director of Investor Relations of Black Hills Corporation. Please proceed, sir.

Jerome E. Nichols^ Thank you, and good morning, everyone. Welcome to Black Hills Corporation's Third Quarter 2022 Earnings Conference Call. You can find our earnings release and materials for our call this morning at our website at www.blackhillscorp.com under the Investor Relations heading.

Before we begin today, we would like to note that Black Hills leadership will be attending the EEI Financial Conference starting November 13 in Hollywood, Florida. Materials for our investor meetings will be posted on our website prior to the start of the conference.

Leading our quarterly earnings discussion today are Linn Evans, President and Chief Executive Officer; and Rich Kinzley, Senior Vice President and Chief Financial Officer. Also in attendance this morning is Kimberly Nooney, Vice President, Corporate Controller and Treasurer.

During our earnings discussion today, some of the comments we make may contain forward-looking statements as defined by the Securities and Exchange Commission, and there are a number of uncertainties inherent in such comments. Although we believe that our expectations and beliefs are based on reasonable assumptions, actual results may differ materially. We direct you to our earnings release, Slide 2 of the investor presentation on our website and our most recent Form 10-K and Form 10-Q filed with the Securities and Exchange Commission for a list of some of the factors that could cause future results to differ materially from our expectations.

I will now turn the call over to Linn Evans.

Linden R. Evans^ Thank you, Jerome. Hello, everyone. Thank you for joining us this morning. As Jerome noted, I'm pleased to have Rich and Kimberly with me this morning. We issued a news release last week announcing that Rich has provided notice of his ~~attempt~~ intent to retire midyear 2023. We will enjoy celebrating his retirement at a future date, but I want to take this early opportunity to thank Rich for his exemplary contributions to our company, and of course, wish he and his family the very best in their next chapter. Rich has proven to be a great partner and friend, and he will be missed.

And now I have the pleasure to introduce Kimberly, our current Vice President, Corporate Controller and Treasurer, who many of you already know well. She will become our CFO on April 1 of next year and she will continue to work closely with Rich over the next several months to ensure a smooth transition. For those of you that already know Kimberly, she has been a passionate leader within Black Hills for the past 26 years, and she brings deep experience and terrific leadership skills to the CFO role. I look forward to working with Kimberly to continue executing our strategy and delivering shareholder value.

Moving to the investor presentation. I'll start my comments on Slide 4. I'm very pleased with our team's strong execution of our strategy and solid financial performance for the year. Through September, earnings per share were up 9% compared to the same period last year, driven by solid operations performance, great regulatory execution and continued customer growth. Yesterday, we affirmed our 2022 earnings guidance, and we initiated 2023 earnings guidance in the range of $4 to $4.20 per share. We increased our capital forecast by $250 million to a total of $3.5 billion for 2022 to 2026, and we increased our dividend by 5%, which completes 52 consecutive years of annual increases.

On the operations side, I'm once again extremely pleased with what our team has accomplished throughout this year. I note the performance of our generation team and the outstanding availability of our generation fleet during the quarter, we successfully served 3 new all-time peak electric loads in the third quarter. That's 4 for the year during very hot summer temperatures without a major outage. As I noted last quarter, this was our ninth consecutive summer that our South Dakota and Wyoming Electric Systems reliably serve new all-time customer demand peak loads. This excellent performance by our generation fleet also enabled strong off-system sales of excess energy throughout the quarter and the year, benefiting both our customers and shareholders through sharing arrangements that reduce customers' bills and enhance our profitability.

We continue to make excellent progress on our regulatory strategies, and we're excited about the approval of our 260-mile Ready Wyoming transmission expansion project in Southeastern Wyoming. We continue to experience population migration into our service territories and expect this trend to continue. As an example, a recent study for Rapid City projected 19% population growth within the next 7 years, representing a continued acceleration of population growth above the 15% we experienced between 2010 and 2020.

On Slide 5, we outlined our progress with our regulatory rate review plans. In Arkansas, after reaching a partial settlement, we received final approval for $8.8 million of new annual revenue with new rates effective since October 21st. We also received approval for our new and comprehensive safety and integrity rider that consolidated and replaced 3 former riders. We also advanced our Wyoming electric rate review. We're requesting new rates in first quarter of 2023 to recover the $250 million of investments we made in the Cheyenne region since our last rate review 8 years ago.

In October, we filed a new rate review for Rocky Mountain Natural Gas, our 600-mile intrastate pipeline in Colorado. We're seeking recovery for over $120 million of investments we made since our last rate review 5 years ago. Taking a step back, I note our team has successfully managed multiple rate reviews and other regulatory requests simultaneously. This is normal course of business for us as we operate utilities in 8 states, and we see this as a core strength. Once again, our team demonstrated our ability to achieve constructive regulatory results in multiple dockets and states as outlined on Slide 6. That slide sets forth how we recently finalized all of our Winter Storm Uri cost recovery plans in all of our states.

I also note, we have recovered more than 1/4 of the incremental costs we incurred for customers, and have completed recovery for our South Dakota and Wyoming electric utilities. On this slide we provided you, by jurisdiction, that detail how we are recovering the $546 million of incremental costs we incurred for customers during Winter Storm Uri. At the bottom of this slide, you'll note our expected recovery by year, excluding carrying costs.

Turning to Slide 7. We're very pleased that we received a bench approval from the Wyoming Public Service Commission for a CPCN to construct Ready Wyoming, our 260-mile electric transmission expansion project. We expect to start construction later next year, and we expect to have the transmission line in service for customers in~~at~~ 2025. This strategic project will provide a cost-effective, resilient and cleaner energy future for our customers. It will also enable customer growth, expand access to renewable resources and facilitate renewable generation development across the wind and solar rich state of Wyoming.

Slide 8 lays out our emissions reduction goals. In August, we published our comprehensive and expanded 2021 sustainability report, which highlights our ESG achievements and strategies to further reduce emissions on our electric and natural gas utility systems. We also provided key updates for our other ESG disclosures, including SASB, the AGA, EEI templates and the natural gas sustainability initiative.

For the first time, we also published TCFD disclosures. We've made tangible progress on our targets through 2021, reducing our greenhouse gas emissions intensity by 1/3 of a 2005 baseline for our electric utilities and natural gas mains and service lines. We also announced our new net 0 by 2035 target for our total natural gas distribution system, which doubled the previous target of a 50% reduction by 2035. Overall, our emissions targets are aggressive, but achievable based on current technologies and do not require advancements in technology to be realized. We see this as a responsible approach to serving our stakeholders with integrity and transparency. Should technologies advance, we could see upside to our current emissions targets over the long term. Meanwhile, we are producing real results while delivering a cost-effective, safe and resilient energy our customers depend upon.

Moving to Slide 9. In Colorado, we continue to work through the procedural schedule for approval of our clean energy plan, which sets out our path to a potential 90% reduction in greenhouse gas emissions intensity in Colorado by 2030, again, off a 2005 baseline. Our plan opts into the state's clean energy legislation and would exceed Colorado's stated goal of 80% by 2030. Our plan proposes to add 400 megawatts of wind and solar resources and 50 megawatts of battery storage between 2025 and 2030. We expect to initiate the competitive bidding process by 2023 for these new resources and Colorado legislation provides up to 50% company ownership of these additions.

These new clean energy additions would result in almost 80% of our Colorado customers' electricity coming from renewable resources. Importantly, our ability to add intermittent renewable resources to our Colorado territory could only happen because of our dispatchable natural gas-fired generation assets located at our Pueblo generating station.

In South Dakota, we're evaluating next steps to add 100 megawatts of renewable resources and 10 megawatts of battery storage, which will likely include a competitive bidding process. Our plan proposes converting our 90-megawatt ~~Niel~~Neil Simpson II coal-fired power plant to natural gas in 2025 at the end of its engineered life, and we're also evaluating additional transmission opportunities.

And last, but certainly not least, we have a legacy of supporting new technology and research at our generation facilities to reduce emissions and make our generation fleet more efficient. We have an ongoing study for hydrogen blending with our natural gas-fired generation and a coal-to-hydrogen fuel experiment in cooperation with the Wyoming Energy Authority and the University of Ohio.

In total, by 2030, we plan to add 570 megawatts of new clean energy resources. We also expect to operate an expanded enhanced transmission system with the addition of Ready Wyoming and other potential transmission projects. And we could see upside to our emissions targets and resource optionality should advancements in clean energy technology be achieved.

Slide 10 summarizes our disciplined and customer-focused growth plan. For our base capital investment plan, we increased our total 5-year capital forecast by $250 million for a total of $3.5 billion with the largest increase in capital investment occurring in 2024. Other growth opportunities include investments to support and attract new customers, including our recently announced new large blockchain customer, which remains on track to be in service by year-end. We also remain excited about continued hyperscale data center growth in Cheyenne.

We're also improving our effectiveness and efficiency as a team through our Energy Forward initiative. We're cultivating a mindset to identify and think more holistically about how we can better serve our customers every day.

Moving to Slide 11. Before I turn the call over to Rich for his financial update, I'm going to brag one more time on our team for excellent operational performance this year. Slide 11 mentions just a few of our recent accomplishments. First, our focus on safety is embedded in our culture on a daily basis. Our headquarters in South Dakota was recently recognized with the Governor's Meritorious Award. On the right side of the slide, you'll note that 2021 EEI system reliability results. Once again, all 3 of our electric utilities were in the top quartile.

To my talented coworkers listening in today, thank you for your focus on excellence in all we do. You're at the tip of the spear, delivering our reliable and safe service, providing our customers with a positive experience and advancing our engaged culture and great workplace. Thank you for what you do to make us the energy partner of choice for all of our stakeholders.

That completes my comments, and I'll turn it over to Rich for our financial update.

Richard W. Kinzley^ Very good. Thanks, Linn, and good morning, everyone. And a thank you to Lynn for your kind words about my retirement, and I'm excited for Kimberly and her appointment as the next CFO. I look forward to assisting Kimberly with the transition and the great thing she and the company will accomplish.

As Lynn noted, we've had strong performance through the first 3 quarters of the year. As a reminder, our team is focused on long-term benefits for customers and sustaining long-term value for shareholders. With that said, you will see more emphasis in our future earnings reports on year-to-date results versus quarterly. Since we operate both electric and gas utilities, we have seasonal variations in earnings driven by weather, which have been dramatic in recent years. Rather than trying to explain these variances every quarter, we'll focus more on year-to-date results which will help investors better understand our operations.

I'll start on Slide 13, which shows our EPS and segment operating income. EPS was $0.54 compared to an exceptional $0.70 since last year in Q3 2021. Year-to-date, we've delivered EPS of $2.86 compared to $2.63 in the same period during 2021, an increase of 9%. Our solid execution on our strategy more than offset the impacts of interest rates and inflation year-to-date. During the third quarter, we experienced our peak cooling season for our electric utilities and peak irrigation demand for our gas utilities. While hot and dry weather was a tailwind for the quarter and the year, the dominant earnings drivers were new rates and rider recovery.

Slides 14 and 15 illustrate the detailed drivers of change in net income year-over-year for the third quarter and year-to-date. All amounts are after tax with more detail available in our earnings release distributed yesterday and in our 10-Q to be filed later today.

For the third quarter, on Slide 14, both electric and gas margins were higher due to new rates and rider recovery and benefits from hot and dry summer weather. Cooling degree days for the electric utilities were up 36% and irrigation loads at our gas utilities provided a solid bump in gross margin. Gross margin benefits were tempered by a mark-to-market gain in the prior year of $0.08 of EPS compared to $0.02 of EPS benefit this year. Compared to normal, weather provided $0.07 of EPS benefit for the quarter compared to last year's third quarter weather provided $0.06 of EPS favorability. As a reminder, electric margins were negatively impacted by the lower repricing of the Wygen I contract that commenced January 1 this year. O&M was higher primarily due to higher outside services, higher bad debt allowances due to increased revenues and higher vehicle fuel expenses.

Depreciation increased as a result of new capital investment and interest expense was driven by higher short-term balances and higher interest rates on short-term debt.

Moving to year-to-date drivers on Slide 15. Through September, year-to-date net income increased 12% year-over-year to $186 million. Earnings benefited from regulatory recovery, customer growth and favorable weather, which more than offset higher operating expenses, lower Wygen I contract pricing and higher interest rates. Gross margins benefited from new rates at our gas utilities in Colorado, Kansas and Iowa, and rider recovery across our electric and gas utilities. In addition, last quarter, we experienced a onetime true-up related to Winter Storm Uri recovery. Through September compared to normal, weather benefited EPS by $0.13 this year and $0.05 compared to last year. Mark-to-market adjustments year-to-date were a positive $0.04 of EPS. Slide 35 in the appendix provides detail of the quarterly impacts of weather, mark-to-market adjustments and Winter Storm Uri.

Year-to-date O&M was higher, driven primarily by higher outside services, cloud computing costs and vehicle fuel costs. DD&A increased due to our capital investment program and interest expense increased due to higher debt balances and higher interest rates. Our financial outlook is listed on Slide 16. We reaffirmed 2022 EPS in the range of $3.95 to $4.15 based on solid year-to-date results. We've been able to largely mitigate the impact of rising interest rates, inflation and supply chain constraints on our financial results. We remain confident in our long-term EPS growth target of 5% to 7%, while recognizing that macroeconomic factors pose a challenge for the fourth quarter this year and full year 2023. I want to emphasize, we manage our business with a long-term discipline and focus. We remain optimistic about our future, while recognizing these broader market impacts represent a near-term challenge for us and our customers.

We initiated 2023 earnings guidance in the range of $4 to $4.20 per share which reflects earnings growth over 2022. More details about our earnings guidance assumptions can be found in the appendix. We have a strong runway of growth drivers and developing opportunities in our 5-year plan and beyond. In the near term, we are limiting capital investment in 2022 and 2023 to deliver on our commitment to solid investment-grade credit ratings and to be sensitive to customer bill pressures. As Lynn noted, we increased our capital plan by $250 million or 8% to $3.5 billion for 2022 through 2026. This increase was largely in 2024 through 2026 and reflects our continued refinement of our long-term capital investment plan.

Slide 17 shows our financial position through the lens of capital structure, credit ratings and financial flexibility. We have a manageable debt maturity profile, and we're committed to maintaining our solid investment-grade credit ratings.

Our debt to total capitalization ratio was 61.5% at quarter end compared to 62% at year-end 2021. Cash flows from operations, recovery of Winter Storm Uri costs and recovery of recently incurred high natural gas costs will help drive the debt ratio lower through the end of 2023 as we use those cash flows to repay short-term debt. Also, we've issued $20 million of equity year-to-date through our ATM program, and our guidance for 2022 and 2023 assumes a total of $210 million to $250 million of additional equity issuance by year-end 2023. With these actions, we expect to achieve our targeted capital structure of mid-50s by late 2023 or early 2024. This was reflected in Fitch's recent affirmation of the BBB+ credit rating, recognizing the temporary nature of both storm Uri impact and our progress on cost recovery to restore our balance sheet strength.

Given current market conditions and volatility, we are being very thoughtful about our equity needs. Slide 18 lays out alternatives we're exploring to strengthen our balance sheet and fund our growing business.

As an example, we are evaluating a minority interest investment in our gas utilities, which could potentially fund our planned equity needs through our current 5-year plan. We also have our ATM in place, which has proven to be an effective tool in recent years and is the current basis for our earnings guidance assumptions. We will provide an update should we have something to publicly announce.

Our dividend is displayed on Slide 19. The Board recently approved a 5% increase in our quarterly dividend rate. And over the last 5 years, we've increased our dividend by 6% annually on average. Our 2022 dividend represents 52 consecutive years of dividend increases, the second longest track record in our industry and a record we're quite proud of, illustrating our long-term focus on sustainable growth.

Looking forward, we anticipate increasing our dividend by more than 5% annually through 2026 as we maintain our 50% to 60% payout target. And with that, we'll be happy to take your questions.

+++ q-and-a

Operator^ (Operator Instructions) Your first question comes from Paul Zimbardo with Bank of America.

Paul Andrew Zimbardo^ Following up where you left off on the equity side, just given the equity you've issued to date in 2022 and the guidance -- full year 2022, it kind of implies more of a block type transaction. Just wanted to see if that's kind of a message you're sending? Or do you have some flexibility to defer that into next year?

Richard W. Kinzley^ Well, Paul, I'd say it's a combination of all that. Certainly, there's enough trading days that we think we can, through the ATM, dribble that kind of level if we need to. And if a block is attractive, we could do that within the ATM and certainly, if a little of it bleeds into next year, it's not the end of the world, but we're going to work to get that done this year.

Paul Andrew Zimbardo^ Okay. Understood. And then going to the multiyear CAGR that you reaffirmed, it implies that if you use '23 as a base, it's more meaningful growth and probably above the high end to get you back towards that trajectory. Should we think about in '24 as having that meaningful improvement? Or is it more back-end weighted to like the '25, '26?

Linden R. Evans^ Paul, that's very insightful and thank you for the question. Yes, if you look at our growth off of 2023, we agree we'd be toward the high end of that 5% to 7% CAGR growth. And we've got opportunity in 2022 through 2023, and that's why we gave you some of the data we did in our assumptions around our earnings guidance for next year, how we [could be] impacted by inflation, how we could be impacted by interest rates, et cetera. In fact, you can kind of see that for the large part, O&M was kind of flat year-over-year. And of course, we're focused on a lot of our growth initiatives, our base plan off of 2022 gets us into the range, perhaps to the lower end of the range. But as we look at our growth initiatives, our hyperscale data centers as examples, the in-migration of customer growth, our efforts around cost control, our focus on regulatory relationships, et cetera. I think you're spot on by indicating that we'll be toward that higher end of that growth rate in those outer years.

Paul Andrew Zimbardo^ Okay. Excellent. And then just quick -- to clarify. I think I heard you say that the kind of a strategic financing transaction that is not contemplated in the guidance, that'd be upside in theory.

Linden R. Evans^ You are correct, Paul. That is not contemplated in our guidance.

Operator^ Your next question comes from Brandon Lee with Mizuho.

Brandon Wayne Lee^ Just a quick question on the investment by the partner. What would the potential regulatory approval process look like for that? Would you need approval from all the commissions in all the gas states?

Linden R. Evans^ Brandon, thank you for that question. Good question. The short answer is no. We would be looking at a potential investor that would not require any regulatory approvals.

Operator^ (Operator Instructions) Your next question comes from Brian Russo with Sidoti.

Brian J. Russo^ Just a follow-up on, I guess, the -- just a follow-up on the EPS CAGR up to 2023. Is the bias towards the high end also driven by the incremental $250 million CapEx, most of it in 2024. And what is that CapEx for? And is most of that recovered through rider mechanisms? Or is that something you need to file rate cases for?

Richard W. Kinzley^ This is Rich, Brian. It's kind of a combination of all that. Certainly, the bulky CapEx in 2024 is going to be helpful to 2025 and 2026 earnings, right? So -- and it's a combination of rider, it's growth. Some of it will require some rate review activity. And you can see that in our disclosures in terms of how we've showed you the breakouts of the different CapEx totals. So hopefully, that answers your question.

Linden R. Evans^ And Brian, this is Lynn. Rich did a nice job answering. I think it just shows once again as we fill out our opportunities with respect to clarity and gain good insight into what our capital opportunities are, it's a function of that and that ongoing exercise within our organization.

Operator^ With no further questions, I will return the call back to Linn Evans for closing remarks.

Linden R. Evans^ Well, thank you, everyone. We appreciate your time, your questions and certainly your interest in Black Hills. We'll look forward to seeing many of you, I think, in about 9 or 10 days at the EEI Financial Conference. We'll look forward to seeing each other in person and visiting further. But please enjoy a safe and productive day. And again, thanks for your interest in us. Take care.

Operator^ Thank you for your participation in today's conference. This concludes the presentation. You may now disconnect. Have a good day.