Black Hills Corporation

SHELBY TUCKER: Good morning. This is Shelby Tucker. Actually, good afternoon, this is Shelby Tucker, power and utility analyst at RBC. Again, welcome to the second day of the RBC Energy and Power Conference.

For this fireside chat session, we have Black Hills joining us. Linn Evans is going to be leading the charge, president and CEO of the company. Rich Kinzley is also on senior VP and chief financial officer and Jerome Nichols, who runs the IR department will be joining us too. As many of you know, this is a Q&A session, no formal presentations. To the extent you have any questions that you want to submit, feel free to do so through the Vericast system, and as I receive them, I will read them to the management team.

Let me start off, Linn, talking about some of the recent developments, particularly as raised to Wygen. If you could maybe get the audience up to speed on some of the recent regulatory developments.

LINN EVANS: Sure, thank you, and good afternoon, good morning to those of us still on the-- out here on the west side of the country, but thank you for joining us today. We hope you are all healthy and well, and thank you for the question of Shelby.

As you might know, we filed-- we issued a news release on Monday evening indicating that we had reached a settlement on Wygen I PPA. That's a PPA between our independent power production company and Cheyenne Light, Fuel, and Power, our utility subsidiary. They have had an agreement in place between those two entities for quite some time, since 2003.

And so, very recently, we were able to renegotiate and extend that PPA. We had used on a transaction, a comparable transaction, that we had negotiated with the city of Gillette for 5 megawatts of Wygen I. So we filed that PPA to be approved reflecting the same agreement we had with Gillette.

We had some interveners. We had two industrial interveners from Cheyenne. We had the office of consumer advocate supply comments. They were not an intervener in the FERC filing. And, of course, we had FERC staff engaged.

FERC several months ago recommended that we work for a settlement because there was a question raised by the interveners whether or not the Gillette agreement was indeed a market transaction. So we entered into negotiations with a FERC settlement judge for several months, and then recently, the last couple of weeks, we were able to reach a settlement that the interveners agreed with and have signed off on. And FERC staff agreed, in my mind, at least, at least remain neutral and certainly not going to oppose the settlement.

And then the FERC judge indicated that the settlement had reached and let the court know. We filed that settlement agreement on Monday. So in order to settle the issue and remove that from our risk side of the column, we have agreed to about a 10% reduction in the capacity charge.

We've also agreed to put the contract in place one year earlier, so ~~usually~~ 2022, as opposed to 2023 when the other contract expires. The purpose for that, of course, is our customers will receive a rate reduction when the 60 megawatts becomes available to our customers in terms of the new price.

So it helps us get the capacity that we now need for Cheyenne Light through the year 2032 with that 60 megawatts. So we are pleased to have that behind us and have that settled. We look forward to the possibility of FERC approving that agreement. Our best guess based upon FERC counsel indicates we may have that settlement agreement approved late this quarter, Q2, or perhaps an early Q3, but we don't know for sure when that might happen.

We do anticipate a slight more hit to our earnings than what we had indicated in prior calls. We were indicating high single digits. This will have another $0.03 to maybe $0.04 negative hit compared to the current PPA, again, which will expire now the end of next year.

So we're very focused now now that we have this challenge ahead of us a year earlier, focused on how we continue to grow the organization, become more efficient with O&M as we focus on how we begin to make up that difference as we go forward. Also, in our news release on Monday, we indicated, or let you know, that we have filed for a rate review in Nebraska Gas.

It has been more than a decade since the legacy Black Hills Energy has filed a rate review in Nebraska. They've had some good investments there over the last decade. And so we have been spending time with the commission staff, the Nebraska Office of Consumer Advocate and, to some degree, the commissioners discussing this filing. They've known it's coming for at least about a year when we start talking to about this filing.

With the advent of COVID-19 within the last three months, we have been cognizant of the fact that certainly customers are impacted by that. And so we've been talking very closely with staff, closely with the Office of Consumer Advocate, and we have agreed to go ahead and file that case. They were fine with that.

What we have done, there is a recognition of COVID-19. The rules allow us to implement interim rates in Nebraska. I believe it's either 60 or 90 days after we filed that application. We have agreed not to seek interim rates. Rather let the rate review process go through and then hopefully have the rate review done maybe by early Q1. And we can implement new rates then.

So that's a quick update of what we told you about on Monday, Shelby. Maybe there's some questions. I'm sure there's some questions inside that that we can respond to.

SHELBY TUCKER: Yeah, I guess one of the questions I have is regarding the lower rate capacity payment and trying to get a better sense of what can you do to offset that capacity reduction, that payment reduction?

LINN EVANS: Well what we'll focus on is, of course, the remainder of the organization and all the other levers that we have to pull across all of our business with respect to replacing that particular earnings, that contract. That will now hopefully be in place soon, and we'll take that hit, but there are some offsetting things, as you may know, that we've included in the numbers that I just discussed.

The mine will do slightly better because we will move to a different contract price for the coal, things of that nature. So I'm not sure I answered your question, and Rich and others speak up if you want to.

RICH KINZLEY: Yeah, I might add a bit to that. We've obviously been planning for this for some time now, Shelby. We knew that that drop off was coming from that contract. Of course, we thought it was 2023. So it's moved up a year on us. So it just makes us light that fire a little harder.

But in addition to O&M and, you know, as Linn mentioned other levers, we've been pretty focused on some good growth opportunities that we think are going to help fill that shortfall too, data center growth and just other general growth in our territories, and then we believe we'll have some decent capex upsides to what we've disclosed over the coming couple of years.

SHELBY TUCKER: Got it. OK, and maybe just expanding a little bit on the regulatory slash-- at least the more recent announcements. Some of you may-- some of the people out there may not have-- received an update on Pueblo, the vote that went in their favor.

LINN EVANS: Sure.

SHELBY TUCKER: Can you maybe just give us an update there too?

LINN EVANS: Yeah, I sure will. The sun's rising on Colorado from our perspective, and things are looking better for us there. Two primary things are going on first. As Shelby just indicated on May 5th, there was a ballot initiative in the community of Pueblo that had been announced earlier in the year, I think in January, for the citizenry or the population to vote on whether or not the community should continue to pursue the possibility of municipalization.

The mayor promoted municipalization. A former Colorado public utility commissioner was supporting municipalization. She was from Pueblo. She was a plaintiff's attorney that had been practicing in Pueblo most of her career, who recently left the commission. She's no longer on the commission. So that's the other one of the two things I want to talk about.

First is the election went very positive in our direction despite the fact that the sitting commissioner at the time was very aggressive in favor of __municipalization. So on May 5, a subject to record turnout for voting. 78%, nearly 78%, of the voting population suggests or elected to continue with Black Hills Energy as the [INAUDIBLE] as a supplier to Southern Colorado.

So we're very thrilled about that and happy about that. It gives us a second chance to consider make our first impression, if you will. And that's gone well, and then, as I indicated, a relatively antagonistic commissioner toward us is no longer on the commission. So we have that fresh opportunity going forward with respect to her.

SHELBY TUCKER: Got it. One of the other, of course, developments has been COVID-19 affecting all of us, and, of course, in your case, it did have an impact on your 2020 guidance. But looking past that, any updates since your first quarter call as it relates to demand expectations? And more importantly, if you could just maybe remind us within your service territories, where are we in phasing the economy back to life?

LINN EVANS: Sure. I'll start maybe with the last and working my way forward. All of our states were officially reopened several weeks ago, probably three weeks ago now. A couple of our states argue we were never even really closed. Some communities were taking precautions and suggesting restaurants and bars, you know, things of that nature, need to be more cautious and encouraging-- here in Rapid City, for example, there was an ordinance asking restaurants and bars to close.

In terms of what anything that's changed since our first quarter earnings call, I would suggest that the guidance or the assumptions that we made to put our guidance in place are basically where we are. We had forecasted a 5% to 10% reduction in C&I loads and had forecasted, and we're seeing an increase in the residential load that would help offset some of that.

Interestingly on our electric side, we have 100% AMI. So we are getting real-time data. Of course, it has to be analyzed and weather normalized, things of that nature. We've also taken the initiative over the last three months~~.~~, ~~O~~on a weekly basis, we speak to our top nearly 250 customers, 240 some-odd customers that we call each week, discuss with them what they're seeing, what their loads are. So we get that kind of real-time perspective from them as well.

We serve primarily an agrarian agricultural load and a mining load and then the data center load and other things too such as cement plants. So sometimes people get confused about our territory and think we may be serving the oil and gas industry. We do not.

However, on our gas side of the business, we serve some ethanol plants, and those are transportation customers on the gas side of our business. So now that we're through the heating season and, frankly, COVID bit just as we were ending the heating season, we haven't seen a real strong impact on our gas side of the business except for those transportation customers, which are relatively low-margin customers who are watching those pretty closely.

Commodity prices from the mining side, we serve a number of gold mining operations. Those are going very strong. The data center loads, given many of us working from home using Zoom, using more-- more electronic kind of things, Netflix, whatever, the data center loads continue to expand, and, frankly, we're having biweekly calls with some of those customers as they figure out how they want to continue to grow. So we're pretty excited about that.

So in terms of our guidance, we indicated that we would see a 5% to 10%-- we were forecasting a 5% to 10% reduction in the C&I load in Q2 into Q3, and then, in late Q4, we might begin to see a rebound. Those are the assumptions that we made for purposes of our guidance. And to date, that's what we have seen. And now that all of our states have re-opened in the past three weeks, we're hopeful that perhaps we've been somewhat conservative, but it's too early for us to tell that right now.

SHELBY TUCKER: Got it. OK. Going back to the capacity payment reduction and the timing in particular, what is your-- I'm trying to remember, because I don't have in front of me, but I can't remember if you actually had provided a guidance range for the growth point of view, but how should we think about if you have, how should we think about that relative to some of these offsets, the COVID-19 for 2020, Wygen I for 2021?

What would you recommend? I mean, how do you think about that relative to your growth goals?

LINN EVANS: Well, we're still very focused on the long-term nature of the business. We've got a very good, as I think you know, very good capital investment program that's going quite strong through COVID. So I think the question really is we see this hit, if you will, that's going to occur in 2022, and, you know, how do we think we can overcome that?

That's where we're very focused on, Rich indicated before, we thought a-- we thought we had a couple of years to grow into that, if you will. Now it's coming a year earlier. That just means the management team's all that much more focused on how we work to make up as much of that difference as we possibly can through our growth initiatives, and we have a number of those that we are working on.

My response to one of your prior questions, data centers, we're seeing strong interest and good phone calls and having good conversations with existing customers and with potentially new customers. So we believe that can impact 2022 earnings as we go forward, although we don't have any numbers that we are prepared or talked about yet with respect to that.

We continue to evaluate things like the pipelines connecting our systems that we've acquired over the years, primarily the old Aquila ~~[INAUDIBLE]~~ system that we've had for a number of years and then more recently SourceGas. How do we continue to efficiently connect those systems, improve reliability for our customers, provide different resources in terms of the field from which the gas is coming, you know, those kinds of things.

And we also have an opportunity to continue to put loops around communities where we're improving reliability for communities that continue to rely upon gas. We're watching the PHMSA (Pipeline and Hazardous Materials Safety Association) ~~FIMSA~~ rules very closely that re-authorization has not occurred, still watching for that, but if the last set of rules were to be approved, that will drive some more investment for us with respect to pipeline replacement programs.

And on the storage side of our business, we have a number of small storage facilities. We'll have some opportunity to drive capital investment there. And then on the generation side, we've got a number of things happening as part of our settlement, if you will, in the Wygen I cases that we will file, IRPs every three years now in Wyoming going forward.

And we see opportunity there as we continue to see this load growth that I've talked about, especially with data centers and things of that nature, and it's also an area of the business where we frankly closed more and shuttered more megawatts than we've had the opportunity to rebuild. So we're watching that closely.

We have a 50-megawatt lease at the Colstrip facility that's expiring, I believe, at the end of 2023, if I'm not mistaken. So the IRP will certainly incorporate that. We've got a couple of very nice, we think, transmission project opportunities where, interestingly, we can eliminate third-party costs and, therefore, the customer could might actually certainly be neutral to seeing a decline in cost that we pass on to the customer while still having the opportunity to improve reliability.

Something else that's important to us we're working on now is kind of-- you've heard a lot of discussion about improving the smart grid. The enclave, or the onslaught, I should say, sorry, of electric vehicles, while we don't anticipate a huge load from electric vehicles, although it's a growing load, Southern Colorado, I think, will be an area that might grow the most with respect to electric vehicles.

It's given us a great opportunity for insights into that interconnection with a grid and our customers and investment opportunities that we believe we need to make there to continue to improve reliability and the customer experience. So we've got buckets of things that we're very focused on, Shelby, and we're not to the point yet where we can say how much of that difference we're going to make up, but that's what we're focused on as a management team.

SHELBY TUCKER: Got it. Yeah, and I meant 2022 for Wygen I, not 2021. One of the developments we're seeing in some states, it's not really in yours so far, has been focused on renewable natural gas. Would you mind sharing with us any discussions that may be happening? What would be the potential there if it were to develop over time and if there's even a possibility of that happening?

LINN EVANS: It is a possibility of it happening. It has happened, and we are doing those kinds of projects in our territories. We've got at least a half a dozen projects right now that are up and running from everything from landfill gas to biogas. You know, we serve a lot of ranching and farming communities, lots of cattle, if you will, are raised in our service territories, especially in Kansas and Nebraska.

And so we have those ongoing now. So it is a focus of ours. We're still evaluating how much of a growth opportunity it will be versus maybe a defensive opportunity, in other words, being able to talk from an ESG perspective about renewable natural gas. We have a team that's focused strictly on renewable natural gas, and, you know, how we incorporate that into our system and, importantly, looking at it what kind of growth opportunities can come from it.

SHELBY TUCKER: Speaking of ESG, clearly you're in a very unusual position. You continue to operate coal plants, but on the flipside, your coal assets produce among the lowest cost power in ~~Europe,~~ for sure the lowest cost power in your jurisdiction. How do you reconcile that, and what do you do to address some of the criticisms that the ESG investors may have about your stock?

LINN EVANS: Yeah, first of all, we're working there right now, and I hope relatively soon, certainly, I really hope by the end of the year, we'll be much more transparent and much more vocal, certainly, about ESG and how we see the future with respect to our coal facilities. Another reason we're working on the IRPs, we're doing IRPs now in Wyoming and South Dakota that aren't due for a while, but the point is, we're working through those literally now.

Interestingly, if you look at our territory closely on the electric side, Colorado, we have no more coal. That's probably and arguably the cleanest utility in the country with all renewables ~~in~~ and natural gas. And right now, we're seeking it to see if we can add yet another 200 megawatts of renewables for Southern Colorado. And by the way, we'll have that-- report will be submitted this month, I think by the end of this month, to the commission. We can talk more about that when that report is out.

But I will say what we learned from that report, we did go out for RFPs bids for 200 megawatts, a pretty decent-sized project, and it's interesting to note that our coal assets were still far cheaper than any renewable project that we saw, and, of course, the coal being-- that can be counted as 100%, or very close to 100%, capacity.

So that was an interesting something to learn that our coal assets continue to be, I'd say by far, our cheapest assets in terms of serving our customers. And then so our coal assets are all located only in Wyoming. We closed all of our coal assets in South Dakota and Colorado, as I mentioned previously.

So everything is now in Wyoming, which is a very-- obviously, if you aren't aware of, are a very strong, supportive state with respect to coal, and, in fact, anytime a company announces they're closing a coal facility, it's obvious that the legislature works overtime to kind of penalize that company. You see that in Rocky Mountain Power as an example right now.

And then if you look at the data for Wyoming, 3 out of every 10 families in Wyoming are directly or indirectly related to the coal economy in Wyoming. So it's very important to our customers that we serve in terms of them and their livelihood and frankly paying bills.

So we'll be much more transparent about this relatively soon, we believe, but something that we are doing as an organization, our approach has been to look not just at CO2 emissions, but to be focused on greenhouse gas emissions and all the work, the very positive work, we're doing on the natural gas side of business with pipeline replacement.

We're eliminating a lot of greenhouse gas emissions and looking at the organization as a whole and talking about it from the perspective of greenhouse gas, not just CO2. And then the question for us right now, a serious question that we're wrestling with through these IRPs is is it prudent for us to invest in a life extension capital into our coal assets? And so just a question mark there to be honest about it.

And so to the extent that we do not invest in life extension capital into those assets, of course, then they would be retired earlier and kind of all, frankly, be retired kind of the time same timeline that you hear many companies talking about, you know, being essentially coal-free, if you will, by 2030, 2040, 2050. Ours will probably be in that 2040 to 2050 timeline, but those are the things we are wrestling with now, Shelby, and how we talk about that, while serving a state that is very pro coal.

And I would say that that state isn't sticking their head in the sand and just saying-- ignoring what's going on. If you visit with the Wyoming governor, he's very clear, I understand, where this is headed, where the trend is headed. He's just looking for a glide path, if you will. He doesn't need every plant to close all at once.

And so they are involved in research on CO_2 sequestration capture, sequestration. Also, a lot of research just based on how do you use carbon in other ways so a lot of research being done ~~to~~ at the University of Wyoming and other entities in Wyoming in the legislature is very supportive of that. So it went on for a bit there, but, hopefully, it gives you an idea of the things that we're wrestling with and thinking about.

SHELBY TUCKER: And very helpful. It is a challenge for many to obviously, focus on the E in the ESG, but socially, providing low rates is an important consideration also.

LINN EVANS: So true. Thank you.

SHELBY TUCKER: Shifting to-- and then we only have a couple of minutes left, but shifting to balance sheets and, you know, you just ~~used~~ issued equity early this year. Maybe, Rich, can you give us a sense of what targets are you-- financial targets are you focused on, particularly as it relates to your credit rating?

RICH KINZLEY: Sure. Well, interestingly, S&P reaffirmed our BBB-plus rating with a stable outlook in April, So well into the pandemic, which I think is a nice sign. That's kind of what we want to be, you know, that BBB-plus, ideally. BBB we can live with, but BBB-plus ideally.

And, you know, the downgrade threshold from S&P from BBB-plus to BBB for us is 12% on FFO. We're well north of that. We're in the 14% to 15% range. So we feel pretty comfortable about that. As long as we're running in that range, we're going to maintain our credit ratings.

From a capitalization perspective, with that equity issuance and then, of course, the contribution from earnings in the first quarter, our debt-to-total cap got down to about 57.5%, so a nice reduction from where we were at year end. We do want to keep moving that toward the mid-50s over the next couple, three years.

From a equity issuance perspective, we're done for this year, as we indicate in our guidance. We've talked about probably $25 million to $50 million next year based on our disclosed capex, then if we increase those forward year capex numbers for each dollar of increased capex, we'll probably add roughly $0.25 of equity to help fund that and keep our balance sheet strong. So, hopefully, that answers your question.

SHELBY TUCKER: Yeah I guess it seems to me, at least, the FFO, that number that has been-- the bogey seems to be on the higher side, I'm guessing, because you also own IPP and coal mining business. How do you think about the portfolio today, particularly now that you've signed the contract with Wygen I?

RICH KINZLEY: Well, I think the rating agencies understand, Shelby, that our non-regulated businesses, being the coal mine and power gen segment, are essentially an extension of our electric utility. They're contracted fully with our electric utilities, and so that's how we portray it, and that's how we feel it's just part of the electric utilities. So I don't know that, from a metrics perspective, that affects us too much. I think the portfolio is where we want it, you know, utility focused.

SHELBY TUCKER: OK, well, with that, we actually just ran out of time. So Linn and Rich, thank you so much for your insights today. I really appreciate as usual. Hopefully, you'll have a chance to get together in person, very soon, in fact. I think the last trip I did was with you guys in person, so--

LINN EVANS: It was. Yeah, for us, too. For us, too.

SHELBY TUCKER: So, but, hopefully, we'll have a chance to do that pretty soon.

LINN EVANS: We look forward to it. Thank you so much for your commitment. Take care. Bye.

SHELBY TUCKER: Bye, bye, Thanks.

RICH KINZLEY: Thanks, Shelby. Bye.

SHELBY TUCKER: Bye.