Black Hills Corp (Q1 2023 Earnings)

May 04, 2023

Corporate Speakers:

- Linden Evans; Black Hills Corporation; President, Chief Executive Officer & Director
- Kimberly Nooney; Black Hills Corporation; Chief Financial Officer, Senior VP & Treasurer

Participants:

- Andrew Weisel; Scotiabank; Analyst
- Brendan Naeve; Mizuho; Analyst

PRESENTATION

Operator^ Thank you, and good morning, everyone. Welcome to Black Hills Corporation's First Quarter 2023 Earnings Conference Call. You can find our earnings release and materials for this call on our website at www.blackhillscorp.com under the Investor Relations heading. Leading our quarterly earnings discussion today are Linn Evans, President and Chief Executive Officer; and Kimberly Nooney, Senior Vice President, Chief Financial Officer and Treasurer.

Also in attendance today are Marne~~i~~ Jones, Vice President of Electric Utilities and Todd Jacobs, Vice President of Growth and Strategy. Before we begin today, we would like to note that Black Hills will be attending the American Gas Association Financial Forum the week of May 21. Our leadership team will be meeting with investors at the conference and the investor presentation will be posted on our website prior to the conference.

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 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 SEC 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 Evans^ Thank you, Dave. Good morning, everyone, and thank you for joining us. Before I begin my comments, I also want to welcome Marne~~i~~ and Todd this morning. Going forward, they will be participating in our earnings calls and will help respond to your questions. They are great leaders, and I'm confident you will appreciate their perspectives. I'm starting on Slide 4. Our team delivered a solid quarter. We're reaffirming our guidance, and we have 4 key takeaways for you today. We're managing O&M to achieve our guidance range. Our operational performance continues to be excellent. We're strengthening our balance sheet, and we're advancing our growth initiatives. As also indicated on this slide, our triple-R theme~~ing~~ for this year is resilient, reliable and ready, with each being emblematic of Black Hills and our team.

First, I'm especially proud of our team's operational performance for safety and reliability. Our team and systems continue to perform outstandingly reliably serving customers during record cold temperatures and through continued customer growth while supporting our ability to deliver solid financial results. Our generation availability and reliability enabled strong wholesale energy sales that benefited customers and shareholders.

Second, we made excellent progress strengthening our balance sheet and enhancing our liquidity. With strong cash flows and our financing activities, we fully repaid our commercial paper borrowings. Kimberly will cover our financial progress and her update, so I won't steal all over thunder. And third, we successfully advanced our growth initiatives. Those initiatives included success on our 2023 capital program, and we started providing energy to the largest blockchain customer in the state of Wyoming, while advancing our transmission project, Ready Wyoming. We also achieved key milestones as we advanced our electric resource plans in Colorado and South Dakota.

Our financial outlook on Slide 5 is consistent with our fourth quarter disclosures. We reaffirmed 2023 earnings guidance in the range of $3.65 to $3.85 per share, and we remain confident in our long-term EPS growth rate of 4% to 6% and our target dividend payout ratio of 55% to 65%. Slide 6 provides our regulatory update. We have one active rate review for our Rocky Mountain natural gas pipeline in Colorado, where we filed a settlement agreement for an annual revenue increase of $8.2 million with an ROE range of 9.5% to 9.7% and a capital structure of 50% to 52% equity. We're waiting for the administrative law judge's decision on the settlement, and we anticipate new rates will be in place during the third quarter.

We're currently preparing rate reviews for Colorado gas and Wyoming gas to file during the second quarter, and we expect to file an additional natural gas rate review later this year for a jurisdiction that we'll announce following our discussions with regulators. At Wyoming Electric, we also put new rates in place along with a new transmission investment and expense rider. This new rider will be beneficial as we start the construction of our 260 mile ready Wyoming transmission line later this year.

Slide 7 describes our electric resource plans for Colorado and our plans for our jointly dispatched South Dakota and Wyoming system. In total, approximately 500 megawatts of new renewable and battery storage resources are planned. These additions will support our goals to reduce electric utility emissions 40% by 2030 and 70% by 2040 off a 2005 base. We achieved key milestones for both plans during the quarter. Starting with South Dakota, at the end of March, we issued a request for proposals for 100 megawatts of renewable generation to be in service by mid-2026, with initial bids due this month. The RFP is structured as a build transfer providing for utility ownership.

This aligns with our informed view that customers are better served over the long term when the utility owns the generation assets, providing customers with a benefit of depreciation and keeping the obligation to serve close to home. In Colorado, we received commission approval of a unanimous settlement agreement for our clean energy plan. We will begin the RFP process by midyear for 400 megawatts of renewable resources to be in service between 2026 and year-end 2029. Our approved settlement allows for Black Hills to own up to 50% of the new resources or 200 megawatts. By our next earnings call in August, we expect our bidding process to be underway in Colorado and to have received initial bids for South Dakota. This should give us a realistic idea of the capital investment that will be additive to our base capital plan.

Slide 8 illustrates our base capital forecast and summarizes our long-term growth plan. We're investing in the core needs of our customers, enhancing our infrastructure with incremental projects and pursuing other profitable growth opportunities. Our base capital forecast remains consistent at $3.5 billion through 2027 or an average of $700 million per year. In 2023, we're managing CapEx to approximately $600 million as we strengthen our balance sheet and make investments to maintain a safe and reliable system. Our 2024 capital plan is currently about $800 million, reflecting ready Wyoming transmission construction and intentional project deferrals. Please note this page does not include additional projects from our electric resource plans that I just mentioned.

The capstone to our growth plan is our pursuit of capital-light opportunities, new margin streams and innovative solutions and efficiencies in how we do business, and Slide 9 lays out those customer-focused growth initiatives in 5 key areas: transmission and storage, data centers, blockchain, RNG and a culture of organizational effectiveness and efficiency. An example of a strategic infrastructure project is our Ready Wyoming transmission expansion, our 260 mile project in South-eastern Wyoming. We continue to pursue other incremental transmission opportunities, and we're always evaluating other needs such as natural gas pipelines and storage projects. Data centers and blockchain are capital-light projects that provide recurring earnings streams.

We're especially optimistic about long-term growth in serving hyperscale data centers. Our existing and new potential data center customers have communicated robust energy demand growth plans for operations in the Cheyenne, Wyoming area and an especially attractive data center location. Also in Cheyenne, our first blockchain customer is in service and continues to ramp up their energy intake. We're optimistic that success with this blockchain mining customer will be a scalable model for other prospects going forward.

Renewable natural gas is another sweet spot of growth for us in our agriculture rich territories. We've already placed 6 RNG interconnects into service, and we're nearing the finish line on 3 additional interconnects this year with an additional interconnect expected to be online in 2024. Our team is also actively working with counterparties on a variety of projects to expand our RNG offerings and business. And as we continue to integrate more RNG into our system, this will help our gas utilities achieve our net 0 by 2035 target. We're also fostering ongoing sustainable cost savings through innovation and continuous improvement in how we do business and how we serve our customers through our Energy Forward initiatives.

Slide 10 illustrates the strong customer and population growth in our service territories versus the overall state population growth in the United States average. The ongoing population migration into and across our service territories continues to drive organic growth with 5.8% growth in customer count since year-end 2017. The strongest regions of growth in our territories include the Colorado front range. The prime growth areas in Northwest Arkansas, Rapid City and the surrounding Black Hills region ~~in~~ and Cheyenne, Wyoming. Cheyenne also boasts excellent commercial growth from data center and blockchain activity that are above and beyond what is reflected in these growth rates. You'll also note that our other states are experiencing similar steady customer growth.

In closing, I'm pleased with the results of our team's strategic execution, including operational excellence, a stronger balance sheet and progress on our resource plans and growth initiatives. Our financial results have us on track to achieve our 2023 guidance, and we're already hard at work towards second quarter progress. With that, I'll turn the call over to Kimberly for the financial review. Kimberly?

Kimberly Nooney^ Thank you, Li~~y~~nn, and good morning, everyone. I'll begin my comments on Slide 12 with earnings per share compared to the same period last year. We delivered EPS for the first quarter of $1.73 compared to $1.82 last year. Results were driven by new rates and rider recovery revenue, a planned gain on sale of our noncore Northern Iowa wind power assets, customer growth and wholesale energy sales. These results were tempered by negative mark-to-market adjustments on our nonutility natural gas commodity contracts, higher operating costs, increased interest expense due to higher interest rates and impacts from the issuance of new shares.

Slide 13 highlights the after-tax drivers of change in net income year-over-year for Q1 2023 compared to Q1 2022. Higher utility margins were driven by $0.12 of EPS from new rates and investment riders, $0.05 of EPS from customer growth and usage and $0.03 of EPS from wholesale energy sales, which were reduced by $0.08 per share of mark-to-market losses on nonutility commodity contracts within our natural gas utilities. Compared to normal, weather provided a $0.03 EPS benefit in Q1 2023 compared to a $0.06 benefit in the same period last year.

O&M expenses increased 3.6% year-over-year, driven by the inflationary impacts on labor costs and benefits, higher materials, fuel and outside services, and planned maintenance for our electric generation assets. These impacts were partially offset by the gain on sale of the Northern Iowa wind power assets. While total debt was consistent with last year, interest expense increased due to higher interest rates. Additional details regarding our financial results are available in our earnings release and 10-Q released yesterday.

Slide 14 summarizes our progress during the quarter to strengthen our credit metrics and liquidity through strong operating cash flows, disciplined capital investment and execution on our financing plan. Significantly higher first quarter cash flows from operations were driven by recovery of winter storm ~~yearly~~ uri costs and higher gas costs in late 2022, and new rates and rider recovery revenue.

As Li~~y~~nn mentioned regarding our capital plan, we continue to manage our capital investment program to approximately $600 million for 2023 to achieve our credit metric targets. On the financing front, our team executed our strategy to strengthen our balance sheet and enhance our liquidity position by issuing $350 million in senior unsecured 5-year notes, which we used to repay our short-term borrowings on our credit facility. Additionally, consistent with our earnings guidance, we issued $27 million of new shares through our at-the-market equity program in the first quarter.

Slide 15 displays our financial position due to the lens of credit quality, capital structure and liquidity. We improved our net debt to total capitalization from 60.8% at year-end to 58.9% by quarter end. And at the end of April, we had $109 million of cash with no short-term borrowings on our $750 million revolving credit facility, providing nearly $860 million of available liquidity. We are very intentional about strengthening our balance sheet and maintaining our credit ratings. We will continue to execute on our equity issuance strategy and expect to leverage future cash flows to reduce the amount of debt we intend to refinance this fall. Our progress puts us well on our way to achieving our target credit metrics.

Slide 16 displays our industry-leading dividend increase track record. A dependable and increasing dividend is a critical component of our strategy for growing long-term value for shareholders. We expect to continue our 52-year track record of dividend increases with the increases in line with our long-term EPS growth rate as we target a long-term payout ratio of 55% to 65%.

I'll finish my remarks on Slide 17. Recognizing the current macroeconomic environment, we remain confident in our strategy and our long-term growth opportunities. Our first quarter financial results set the stage for a successful 2023 and beyond. With that, we'd be happy to take your questions.

QUESTIONS AND ANSWERS

Operator^ Thank you. As a reminder, (Operator Instructions) Our first question comes from Andrew Weisel with Scotiabank. You may proceed.

Andrew Weisel^ Thank you. Good morning, everyone. A couple of questions for you here. The first one is FFO to debt. I know you were at 12% last year, and the target is

14% to 15%. Can you tell us what the trailing 12 months would look like after 1Q, how soon you expect to get to 14%, and what are the biggest drivers will be to get there?

Kimberly Nooney^ Yes, absolutely. So we have, as you know, three agencies within our portfolio, Moody's, S&P and Fitch. We've hit our targets for two of the three as of the end of March 31. So we're in excellent shape there. So we're in good standing with Fitch and Moody's, we're working towards achieving S&P's targets by the end of this year.

Andrew Weisel^ Okay. meaning 14% or higher by the end of 2023?

Kimberly Nooney^ Yes. Our focus is late this year, early next year, getting to the 14% for S&P.

Andrew Weisel^ Okay. And the biggest drivers of the improvement there?

Kimberly Nooney^ Yes. The cash position that we're in has been a significant benefit to those calculations.

Andrew Weisel^ Okay. Great. Next one, just to clarify something. The South Dakota and Wyoming IRP, the clean energy resources are now showing mid-2026 versus previously 2025. What explains that delay there? Is that timing of the RFP or supply chain delays, or what's going on there?

Linden Evans^ I don't think there's any real significant thing causing that particular delay. That's the timing of when we think we'll have approval of the RFPs and the plan that we will propose to the commission. We anticipate the Colorado PUC, Andrew, will make that decision in early 2024, late first quarter, maybe even in the early second quarter. So we will be issuing those RFPs mid this year. We'll get those RFPs back, and then we start the process of them getting the approved plan through with the commission. We anticipate, again, that approval will be kind of first quarter 2024, and then we'll start construction thereafter. And so this timing of all that would probably put us right into that early 2026.

Andrew Weisel^ Okay. Very good. Then if I could squeeze one last one in here on O&Ms. You talked about cost cutting to achieve the guidance range. Can you give some examples? And how much of that would be onetime versus recurring in nature?

Linden Evans^ Well, it will be a little bit of both, Andrew. We do have levers that we have pulled and that we are pulling with respect to internal cost, external costs. We're being very cost conscious. Some of the more lasting elements that will take us into the future are the elements or the savings that we are finding efficiencies through our Energy Forward program. We have a number of things, what we call quick wins, that we put in place now that there a low hanging fruit where we can help ourselves be more efficient and unlock those efficiencies. And then we have teams of people who are unlocking efficiencies that will be more longer term. So we believe we have sufficient levers that we will be within our guidance and all of our team is focused on making sure that happens.

Operator^ Our next question comes from Brendo~~a~~n Lee~~Naeve~~ with Mizuho.

Brend~~a~~on ~~Naeve~~Lee^ Just a quick question on the wind power assets that you sold. Does that reduce your equity needs for the year? Is that what the goal was?

Kimberly Nooney^ It does not. It was roughly an $18 million cash impact, so pretty immaterial to the overall portfolio, especially when you think about our credit quality and credit metrics.

Brendan ~~Naeve~~Lee^ And can you talk about the process? Was it an inbound inquiry? Or were you kind of shopping that asset around?

Linden Evans^ It's something that we started probably more than a year ago. We had it in our guidance for last year that we thought we'd actually sell that asset. We did an essentially reverse RFP. We put it up for sale, had a strong interest in it. We thought we might close that transaction last year. But due to some closing requirements, rights of way, things of that nature and other approvals that we needed that moved into first quarter of this year.

Operator^ And this concludes the Q&A session. I'd now like to turn the call back over to Linn Evans for any closing remarks.

Linden Evans^ Well, thank you very much for joining us this morning. We appreciate your interest in our organization. We have made great progress in Q1, serving our customers with reliability and safety. Thank you to my team for doing that, our team. We strengthened our balance sheet and we executed very well on our growth opportunities. And we look forward to seeing several of you, if not many of you at the AGA Financial Forum later this month. And again, thank you for your interest in us and have a Black Hills Energy safe day. Thank you.

Operator^ Thank you. This concludes today's conference call. Thank you for participating. You may now disconnect.