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+++ presentation

Operator^ Good day, ladies and gentlemen, and welcome to the Black Hills Corporation Third Quarter 2021 Earnings Conference Call. My name is Josh, 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 2021 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 will be attending the EEI Financial Conference starting November 7 in Hollywood, Florida. Materials for our investor meetings will be posted on our website prior to the start of the conference.

Leading our quarterly discussion today are Linn Evans, President and Chief Executive Officer; and Rich Kinzley, Senior Vice President and Financial Officer.

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 10-Q files 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. Good morning, everyone, and thank you for joining us. I'll begin on Slide 4. But before I discuss our key achievements for the third quarter, I'd like to start by recognizing our dedicated Black Hills team. Working together, we delivered strong operational and financial results, and we served record peak customer loads, and we delivered quarter-over-quarter earnings that were up 21% compared to last year. We have a great team, and I value and appreciate them very much.

Our Board recently approved a 5.3% increase in our dividend, achieving 51 consecutive years of dividend increases. This represents one of the longest streaks in our industry. And naturally, we're quite proud of this accomplishment and the growth that it reflects. We also made excellent progress on our regulatory initiatives, including our 3 rate reviews and Winter Storm Uri cost recovery. And finally on this slide, early in the quarter, we published our updated and our comprehensive corporate sustainability report, along with our new and expanded ESG disclosures. We continue to make solid strides communicating our sustainability focus, including our achievements and our goals for the future.

Slide 5 lays out our financial outlook. Given our success in delivering strong operational, financial and regulatory performance in the second and third quarters, we're increasing the lower end of our 2021 earnings guidance range by $0.05 per share. We're also maintaining our 2022 earnings guidance range, and we continue to target a 5% to 7% average earnings growth for 2023 through 2025 and at least 5% annual dividend growth.

Slide 6 lays out our regulatory progress with a focus on regulatory rate reviews, our investment rider requests and Winter Storm Uri cost recovery. We've made good progress on our regulatory strategy this year, achieving constructive and productive outcomes. We've reached a unanimous settlement agreement with all parties for our Colorado natural gas rate review that will provide $6.5 million in new annual revenue. We anticipate new rates being effective January 1, 2022, pending final approval of the settlement.

We also received approval for a new 3-year system safety and integrity rider, which is a critical mechanism to help us provide ongoing safe and reliable service to our Colorado gas customers for years to come. In Kansas, we also reached a unanimous settlement agreement for our rate review, which includes the renewal of our 5-year safety focused capital investment rider. The settlement benefits customers through a net neutral base rate impact. In addition, we're pleased that the settlement provides federal and state tax reform benefits to customers, a timely benefit for our Kansas customers given current high natural gas commodity prices. In Iowa, we're working through the regulatory process and hope to achieve a resolution by year-end, with final rates effective in the first quarter of 2022.

Shifting to our Winter Storm Uri cost recovery process. We filed our recovery plans in all states by the second quarter. We've already obtained approvals for Nebraska Gas and South Dakota Electric, and we're collecting interim rates for Arkansas, Iowa and Wyoming Gas. At Wyoming Electric, Uri-related costs will flow through their normal cost adjustment mechanism.

We also recently received a positive settlement for Wyoming Gas and we're currently engaged in settlement discussions for Kansas Gas. We expect to complete our Uri cost recovery filings either during the fourth quarter or in the first quarter of next year, and we remain confident we will recover the costs submitted in our applications.

Looking forward, we're preparing for our next rate reviews for Arkansas Gas and Wyoming Electric. We're planning to file a rate review for Arkansas Gas late this year. For Wyoming Electric, we'll file by midyear 2022 as required by a prior settlement agreement from several years ago.

Moving to Slide 7. To enable continuing growth in Wyoming, we're excited to announce a 285-mile electric transmission expansion project that we're calling Ready Wyoming. As proposed, the project will provide many benefits for our customers. Among those benefits are enhancing resiliency through further interconnection of our Wyoming and South Dakota electric systems, expanding access to existing third-party transmission systems and providing access to new energy markets and additional renewable resources. Importantly, the project will also increase overall transmission capacity, allowing us to serve the growing Cheyenne community. The project's expanded access and capacity will allow us to better serve growth in technology businesses like data centers and blockchain and crypto miners, which I'll discuss in more detail in a later slide.

The project will also enable and benefit renewable energy expansion both through expanded access for existing renewable resources and for new wind and solar projects in the Cheyenne region. We're working toward filing for approval of the project in the first quarter of 2022. And following approval, we plan to construct the project in several phases or segments spanning 2023 through 2025.

Moving to Slide 8. We have refreshed and increased our 2021 through 2025 capital investment program by $149 million to a total of $3.2 billion. In doing so, we firmed up nearly $300 million in projects that were placeholders in last quarter's forecast. This $3.2 billion forecast includes incremental investment for the Ready Wyoming project. This is a robust plan, and there are certain other investment opportunities we're aggressively pursuing, including other potential transmission projects and what we call capital-light growth opportunities that may arise.

I'll note that our current base capital forecast does not include potential transmission or renewable generation assets that may derive from our South Dakota and Wyoming Integrated Resource Plan or from our clean energy plan to be filed in Colorado next year. To help evaluate additional opportunities to lower cost for customers, we joined several others utilities in the Western U.S. to form the Western market exploratory group. This group will explore the potential for developing an organized wholesale market in the Western interconnect while also reviewing transmission expansion opportunities and other possible grid solutions.

In Cheyenne, we continue to experience strong load growth, including growth from data centers and related businesses. For perspective, the peak demand day for Wyoming Electric increased from 192 megawatts in 2014 to 274 megawatts this past summer. That's a 43% increase during that period. With our entrepreneurial approach, combined with our Ready Wyoming transmission project, we're optimistic about recruiting more technology-oriented business into Cheyenne and Wyoming. As an example, this summer, our growth team received numerous requests to serve crypto mining businesses. You may recall Wyoming was an early leader in passing legislation to support blockchain and crypto mining businesses, and we already have an approved blockchain interruptible service tariff in place. In response to the multitude of crypto mining inquiries, we issued a reverse request for proposals in August. That RFP resulted in a very robust response. We recently narrowed the bidders list and we've selected finalists for contract negotiations.

We also continue to be very optimistic about ongoing population migration into our service territories. Both our electric and gas utility service territories are seeing accelerating customer growth, and we continue to witness ongoing customer growth trends.

Finally, we demonstrated our discipline throughout the pandemic and after Winter Storm Uri to manage costs, and we're also fostering ongoing sustainable cost savings through innovation and continuous improvement. You'll hear more about these efforts in the near future as we discuss our company-wide energy forward program.

Moving to Slide 9. We're fully engaged on sustainability for our communities. We made significant progress toward our carbon intensity reduction goals listed on this slide. In 2020, we already achieved a 30% reduction at our electric operations and a 33% reduction in our gas utility since 2005. Our forward emission goals are not based on aggressive assumptions or technology that doesn't currently exist. Our Midwest culture is to be true to our word, and we have published goals that we expect to meet or exceed based on existing assets and current technologies because our goals are reliant upon current technology, there's potential upside for acceleration in our carbon reduction goals.

As technologies advance, and as cost decline for renewables and battery storage, we're confident in our emissions goals. We're also watching technologies for potentially reducing carbon emissions from our existing plants, which could accelerate achieving our emission goals. One of our defined steps to meet our 40% reduction goal by 2030 within our electric operations will be the conversion of our Neil Simpson II coal-fired power plant to natural gas. We'll also add renewable generation and battery storage resources to achieve our emissions goals.

For our natural gas utilities, we expect to reach a 50% reduction by 2035. We'll do that through continued pipeline replacement programs and additionally, emission reduction strategies such as damage prevention, expanded lead detection and energy efficiency. We're adopting process improvements such as vacuum technology for gas system blowdowns. We're also integrating more renewable natural gas in our system with several projects already in service and many more in development. And we voluntarily committed to reduce methane emissions through our participation in the EPA Methane Challenge and the ONE Future coalition.

Looking to the future, we're supporting research to advance emissions reduction technologies. We're participating in a feasibility study to test the viability of using hydrogen and natural gas generation at our Cheyenne Prairie Generating Station. We're also supporting the University of Wyoming's research program for turbine firing technologies that would further reduce emissions. We've invested alongside our peers in a carbon capture research project and other emerging clean energy technologies.

Our goal in fostering innovation is to find more efficient and affordable ways to deliver energy with lower emissions, which will benefit our communities and our stakeholders. I encourage you to visit the sustainability link on our investor website to read more about our sustainability progress and our commitments. In August, we published new SASB and NGSI disclosures as well as our 2020 sustainability reports and other refreshed and more comprehensive disclosures.

Slide 10 is a graphic that shows the decarbonizing trends in our generation fleet. We've been upgrading our fleet for nearly a decade, beginning with the retirement of 123 megawatts of 4 older coal-fired power plants in 2013 and 2014. Since that time, we've added 282 megawatts of owned wind generation and another 132 megawatts of wind energy through power purchase agreements with a number of other renewable projects in flight.

Looking forward, and as I stated previously, we already announced that the Neil Simpson II coal-fired power plant will be converted to natural gas in 2025. The remainder of the time line shows how we expect to meet carbon reduction goals by converting or replacing the remaining coal-fired power plants over the next 2 decades.

This time line could very easily be influenced by generation and emission technology advances and cost declines. In our cold weather geography having immediately available, reliable and dispatchable generation capacity is an absolute must, as we demonstrated during Winter Storm Uri when we experienced no outages.

Slide 11 lists recent achievements by our team, and I'm pleased with our team's engaged mindset toward continuously improving our operations, especially in regard to safety, reliability and the customer experience in our workplace culture. Our dedicated team at Cheyenne Prairie Generating Station was recently awarded OSHA's highest worksite safety recognition, Star status. This recognition is no simple task. It required a multiyear rigorous audit and approval process to be recognized as a leader in the prevention of hazards, and a focus on continuous improvement of safety and health management systems.

Very well done, and thank you to the team in Cheyenne, Wyoming and all who supported and continue to support those efforts. I'm happy to note this is our second time achieving this recognition with the Cheyenne Prairie team joining the Pueblo Airport Generating Station team in Colorado as OSHA recognized industry leaders in safety. We're also industry leaders in reliability with all 3 of our electric utilities recently listed in the upper half of the top quartile for reliability, as measured by SAIDI.

This remarkable achievement reflects years of diligent effort by our team in executing our customer-focused operations and investment strategy. We also continue to improve our customer experience, achieving a JD Power ranking of second overall by our gas utility in the South region. Also, our year-to-date Net Promoter Score through mid-October was approximately 64, an improvement from 60 in 2020 and notable improvement from a score of 42 4 years ago. I already mentioned our great workplace and engaged team. I'm pleased to report we were named for the second consecutive year to Achiever's 50 Most Engaged Workplaces.

We survey our employees about every 18 months to understand how we're doing and how we can improve as a team. This anonymous survey is conducted by a third party and returned strong scores as compared to our industry, especially in regard to safety, company values and management effectiveness.

Finally, on this slide, we were named a Veteran-Friendly Employer of the Year at Wyoming's 2021 Safety and Workforce Summit. The award recognized our success in recruiting, hiring and providing an environment that supports veterans in the workforce, a focus we're honored to have in recognition and thanks for the service of our veterans and our respect for their valuable experience and discipline.

Before I turn it over to Rich, as you can see, we've made excellent strategic progress and delivered strong operational and financial results, and we look forward to finishing the year strong to deliver results for all our stakeholders.

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

Richard W. Kinzley^ Very good. Thanks, Linn, and good morning, everyone. Slide 13 summarizes earnings per share for the third quarter. We delivered EPS of $0.70 compared to $0.58 in Q3 2020, a 21% increase. Positive financial results were driven by new rates, strong customer growth and usage and mark-to-market gains. On a consolidated basis, weather was not a major driver of earnings compared to normal, but was unfavorable compared to Q3 2020, which experienced a $0.05 benefit compared to normal.

Slide 14 illustrates the detailed drivers of change in net income quarter-over-quarter. All amounts listed on this slide are after tax. The main drivers compared to last year were $1.5 million of gross margin improvement from new rates and riders, $2.8 million of increased margin from customer growth and higher usage per customer, especially in our electric utilities. And $4.8 million of mark-to-market gains for both wholesale energy and natural gas commodity contracts. We continue to manage O&M closely with a minimal quarter-over-quarter increase.

DD&A increased as a result of our capital investment program and interest expense increased as a result of higher debt balances mainly due to the impact from Winter Storm Uri. The improvement in other income expense over the prior year was driven by lower benefit costs, market impacts of nonqualified deferred compensation expense and benefits from company-owned life insurance. Additional second quarter detail on segment earnings can be found in the appendix. And you can also find additional details on year-over-year changes in gross margin and operating expenses in yesterday's earnings release and in our 10-Q that will be filed later today.

Slide 15 shows our financial position through the lens of capital structure, credit ratings and financial flexibility. We have a manageable debt maturity profile and are committed to maintaining our solid investment-grade credit ratings. At the end of September, we had more than $500 million of available liquidity on our revolving credit facility. In July, we amended and extended our revolving credit facility with similar terms through July 2026. And in August, we issued $600 million of notes due in 2024.

Proceeds from the notes were used to repay our term loan balance and other short-term indebtedness. The new notes are repayable after 6 months, providing flexibility to pay down proportionately alongside increased cash flows from Winter Storm Uri cost recovery plans. The weighted average length of recovery we requested in our regulatory plans is 3.7 years.

New debt and deferred recovery of fuel cost for Winter Storm Uri temporarily increased our debt to total capitalization ratio to 62% at the end of March, and it remained at that level through the end of September.

As we recover storm costs, repay debt and execute on our equity offering program, we expect to reduce our debt to total capitalization ratio. We continue to target a debt to total cap ratio in the mid-50s within the next 2 to 3 years.

During the third quarter, we issued $23 million through our at-the-market equity offering program for a total of $63 million year-to-date. We expect to issue a total of $100 million to $120 million in both 2021 and 2022. The increase in 2022 compared to what we previously disclosed is mainly related to the increases in our capital forecast.

Moving on to our dividend on Slide 16. Last week, we delivered on our dividend growth target with our Board approving a 5.3% increase in our quarterly dividend. For 2021, the quarterly dividend achieved 51 consecutive years of dividend increases, one of the longest track records in our industry and a record we're quite proud of. Over the last 5 years, we have increased our dividend at an average annual rate of 6.4%, and we anticipate increasing our dividend by more than 5% annually through 2025, while maintaining our 50% to 60% payout ratio.

In closing, we thank you for your interest in Black Hills. We're pleased with how our team responded in the second and third quarters in meeting our financial objectives and overcoming the challenges presented by Winter Storm Uri. We've made excellent progress on our regulatory activities, increased and clarified our capital investment program and enhanced our ESG disclosures. Once again, we've shown our ability and agility to continue delivering solid financial results and strategic progress.

And with that, we're happy to take your questions.

+++ q-and-a

Operator^ (Operator Instructions) Our first question comes from Ryan Greenwald with Bank of America.

Ryan Greenwald^ Maybe to start, can you talk a bit more about the scale of Ready Wyoming, how this could interrelate to projects and regional peers and drive overall contribution for the business?

Linden R. Evans^ Yes, we can. It's a 285-mile transmission line that essentially closes a loop in South Dakota and Wyoming that will interconnect our two transmission systems between those 2 utilities and also in our Gillette Energy Complex.

So we have a very good opportunity for us to help control customers' rates and costs going forward. It will also help us with the resiliency quite a bit. And importantly, it will open up new regions and new geographic areas where we think we could, in the future, either interconnect other renewable resources by third parties or hopefully, projects that we will do ourselves in support of our IRP in South Dakota and Wyoming. So we see it as a really great opportunity for us to help our customers, improve reliability and resiliency and provide an opportunity for our shareholders as well.

Ryan Greenwald^ Great. And then any additional color at this point that you guys can provide in terms of the magnitude of load interest relating to the Cheyenne blockchain RFP?

Linden R. Evans^ Not yet, Ryan. We're still in negotiations. So we'd probably keep those to ourselves here for a bit. We had a very strong response to our reverse RFP. Our opinion was when the Chinese began to stop crypto mining in China, a lot of that starting to onshore, if you will, or come to the U.S. And so this past summer, as I indicated in my opening comments or direct comments, we were getting quite a few calls. And so we thought the best way to manage this was to do the reverse RFP, get the responses back and then narrow that down to a list that we're now negotiating with. So we're excited about the opportunity. You might recall, as I said again in my comments, Wyoming has 7 pieces of legislation they put in place a few years ago, really makes it a great place for crypto miners and things of that nature. So we're optimistic about where this might take us.

Operator^ (Operator Instructions) Our next question comes from Brandon Lee with Mizuho.

Wayne Lee^ Just a question on the Neil Simpson conversion from coal to gas. Do you expect any change in the dispatch of the plant? Any change in heat rates? And I guess, what are your thoughts on doing that to the remaining fleet? Could you convert your coal plants to gas at the end of the year?

Linden R. Evans^ No, we don't expect any real change in heat rate. We think we can make it a dispatchable unit, continue to support the climate that we live in with this cold climate and backing up renewable generation, et cetera. And in terms of other units, it will be an opportunity. We have not completely studied that, whether or not we would convert those. But we believe that it's certainly possible. And I would go so far to say it's likely that we could do that to those other plants as well.

Wayne Lee^ Okay. Great. And then I just have another question on gas and purchase power costs, which have kind of increased lately. Do you think that, that will impact any of your -- well, how much do you think that will impact customer bills going into the winter? And then also, does that impact the Arkansas rate filing next year in any way, given that you're also looking to seek recovery on Winter Storm Uri cost in that state?

Linden R. Evans^ Yes. Thank you for that question, Brandon. We're always very focused on customer rates. It's something that we're very focused on. In fact, that's why we're careful with what capital we spend, we prioritize that capital, et cetera. We are certainly aware of the increasing gas prices, especially in the near term, this particular winter. We've been very aggressive communicating with our customers about that impact so that they can prepare themselves for that likely reality.

We're also noticing that gas prices out further than that seem to be pulling back a bit. I've had a phrase around here and with our Board that nothing cures high prices like high prices in this industry. So we'll see what happens with those long-term prices. But right now, the capital that we have invested and the rate reviews that we have planned, we will continue to go forward with those because we think those are necessary to serve those customers in a reliable and safe manner.

So we'll be prudent as always. We watch our cost very closely. In my direct comments, we mentioned Energy Forward program. We are gearing up a very formal program after 2 years of very aggressive cost cutting within this organization, kind of ~~poison~~ forced upon us because of the pandemic and then secondly, because of Uri, and we've exercised those muscles pretty hard. And now we want to convert those muscles into some long-term opportunities for us to control costs that we have with customers.

So we think that's going to give us opportunity as well to make sure that our rates are as low as they possibly can. We also serve really growing territories where the denominator and the people that are paying our rates is increasing fairly dramatically for our territory. And we have very low unemployment, anyone who, in my opinion, wants a job in our territory can have one and earn pretty good money. So we see the fundamentals and the basics still remaining real strong for this business and for our territories.

Operator^ Our next question comes from Brian Russo with Sidoti.

Brian J. Russo^ Could you maybe outline some of the key milestones that we should be looking for in the IRP approval process that at some point, you might have a greater level of confidence to add some of that investment to your 5-year capital plan?

Linden R. Evans^ Well, as you might recall from the IRP, we're going to be adding some renewables and some battery storage later on, 2024 and 2025. So I would watch for next year, we would start to issue RFPs for those. I think that will be our first step there. We'll see if we have hearings or any public input in front of the commissions. I understand we've not had any comments. So it's not entirely sure we'll have a hearing, if you will, before the Wyoming Commission nor the South Dakota Commission. So I think the next step could be barring any kind of hearing or public input we might have will be us issuing RFPs, which we'd expect to start doing next year.

Brian J. Russo^ Okay. Got it. And I'm curious, what's different with this Ready Wyoming project you announced versus what was outlined in the IRP? Is it just timing that -- and demand or need to do Ready Wyoming first rather than include it in the IRP? Just curious what the strategy was there.

Linden R. Evans^ We kind of see them as separate projects. So the transmission is a stand-alone project that will give great benefit to our customers. It allows us to take third-party cost out, keep rates stable for our customers and provide a shareholder opportunity. So we see that while they are related, they are -- they can be and are separate projects for us, but one will certainly influence the other.

Operator^ And I'm not showing any further questions at this time. I would now like to turn the call back over to Linn Evans for any further remarks.

Linden R. Evans^ Well, thank you, Josh, and thank you, folks, for your interest in Black Hills. I want to pause one more time and just say a great thank you to our team. I'm very proud of how they have stepped up, especially the past 2 years through a pandemic, Storm Uri. We delivered 2 extremely solid quarters. So thank you to them for their operational focus, your financial focus and your regulatory progresses, excellent outcomes.

Real proud of the fact that we continue to clarify and increase our capital forecast. So thank you very much for that. And I just want to take the time to also recognize our regulatory team working very hard doing a very nice job advancing many regulatory initiatives. So we're very confident in our future, and we look forward -- and we just appreciate the delivery of the Q1 -- Q2 and the Q3 earnings. We're looking forward to 2022 already, very focused on that. Please take the time if you have an interest to go to our website, look at the EEI presentation we'll be putting out there relatively soon. Safe travels to those of you who will see EEI, and we're looking forward to safe meetings there. So thank you very much, and have a great Black Hills Energies safe day.

Operator^ Thank you. Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.