

Black Hills

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12:25 p.m. ET**

Kevin Cole: Black Hills is up next, with Dave Emery and Tony Cleberg. Black Hills has been a great recommendation for us. It's been up about 100% over the last 18 months or so. It's been a good stock with our focus now on continued execution on the regulated utility and then as well on the Mancos Shale play. With that, Dave Emery.

Dave Emery: Right. Thanks, Kevin. Good morning, everyone, and also good morning to anyone who is following us by webcast this morning. We appreciate your attendance. This presentation does contain some forward-looking statements as defined by the SEC. Please refer to all of our publicly filed documents before making any investment decisions in Black Hills.

Quick agenda for today. I'll cover an overview of recent highlights. Tony Cleberg, our CFO, will cover some financial updates, and then I'll talk a little bit about the forward strategy piece, and then we'll wrap it up with some Q&A.

From a Company standpoint, I mean, we started in 1883 in the Black Hills, Deadwood, South Dakota, serving electricity. We've been around ever since. Pretty proud of our track record of delivering great returns for shareholders. Last year top performing company in our sector and certainly the long-term performance has been very good as well.

We're comprised of two separate divisions. Our Regulated Utilities group and our Nonregulated Energies group, both -- essentially the Utilities is comprised of electric utilities and gas utilities. The Nonregulated Energy group has coal mining, oil and gas, and nonregulated power generation. I'll talk more about those in a minute. It looks like we're involved in a lot of things. We look at it pretty simply. It's fuel, it's generation, and it's electric and gas distribution.

The electric side, we've got 200,000 electric customers and about 35,000 gas customers in our Cheyenne Light utility, which is our only dual fuel service territory. Pretty straightforward on the gas side, around 530,000 customers or so in four states -- Colorado, Kansas, Iowa and Nebraska.

Nonregulated Energy side, our power generation currently consists of three different assets, one which will be sold, the other two under contract to ourselves. Stories behind all of those, but either we sold generation to another company and then bought the utility, or then in the case of Colorado, we were following competitive bidding rules there and we bid a facility into our own RFP at our Pueblo Airport generation station.

Oil and gas, operate San Juan, Powder River Basin and the Piceance Basin, and have about 86 or 87 Bcf of reserves. That's really not what that company is about. We've got tremendous shale gas outside (should be upside). I'll talk more about that in a little bit.

Finally, on the coal mine, our coal mine is integral to our utilities, and it's a mine mouth facility. All our generation is at the mine mouth, or most of our coal-fired generation is, and we're able to deliver fuel to the pulverizers in the plants for under \$1 one million BTUs. So, it's a great advantage to us but an integral part of our utility. We don't view it as a commercial coal mining enterprise, per se.

Highlights for the year. We ended up the year very strong. In fact, exceeded our guidance range. We had a very cold December. The weather was pretty cooperative this year. We had a slightly colder than normal year period, or better than normal year period for weather compared to last year, which was very mild. 2012 (should have said 2013); it was a very good year. That's good for most of our businesses, certainly good for the utilities. It does cause some operational problems and some slowdowns at the coal mine and oil and gas, and some things like that.

Highlights in our utilities mostly revolve around rate case activity and resource planning activity. Black Hills Power and Cheyenne Light have both filed rate cases in Wyoming for the Cheyenne Prairie Generating Station, which we are currently constructing in Cheyenne, Wyoming. Both of those cases are in various stages of discovery now. Black Hills Power will also file a case in South Dakota here in the next month or so. All three of those cases will relate to that power plant.

Some of you may be aware, but in October we had the worst storm that we've ever experienced in the Black Hills, and literally three to five feet of snow the first few days of October, and had our worst system experience ever, where we lost almost two-thirds of our customers for some period of time. We did receive an accounting order in South Dakota where we were able to categorize all the incremental O&M costs as a regulatory asset. And then in the next rate case, which we're just getting ready to file, we'll propose the amortization schedule for those costs.

In Colorado we've been working on an electric resource plan. We did get an initial written decision from the Colorado Commission which will allow us to add a 40 megawatt gas turbine at our Pueblo Airport Generating Station. We're in the final stages there. There is an appeal time period which is basically about up, and then we expect the final written order from the Commission here soon, which will allow us to begin construction on that plant. Probably going to be a couple of years down the road before it's in service.

Skipping to the oil and gas section here, we completed two wells in our Mancos Shale project this year, both of which were part of the transaction where we farmed in acreage from another company, drilled two wells on their acreage, and in exchange for that we earned 20,000 additional net acres of leasehold there. Both of those wells are producing. Part of that transaction was a strict confidentiality agreement, so we're not at liberty to discuss specific well results, although both wells are producing and we're pleased with what we're seeing so far.

On the corporate side, I think the big news is two items, really. We did a \$525 million financing here in the last couple of months. Cleaned up a lot of high-priced debt, some project finance, paid off some bonds early. That will have some great implications for next year on interest cost savings. And then we increased our dividend here a couple of weeks ago for the 44th consecutive year. That's a track record we're extremely proud of.

And then, finally, on the credit rating side, Moody's here recently raised us to Baa1. That's the second upgrade from Moody's this (should have said within the past year) year. And we've also

been upgraded to BBB by both Fitch and S&P during the year. So, great progress on the credit front. With that, I'll turn it over to Tony to talk about financials.

Tony Cleberg:

Thank you, Dave. 2013 was a really good year for us. In fourth quarter we grew 3%, and for the year from an earnings as adjusted we grew 17%. The 3% in the fourth quarter doesn't sound like a lot, but if you look back a year ago, we had a strong fourth quarter and we were up 48%. So, if you look at both periods, we're still producing very strongly. As Dave said, December was a great month for us. We exceeded our earnings guidance by \$0.05 on the high side, and so that was a real positive, but it really had to do with the December weather.

This is a reconciliation of the GAAP earnings to earnings as adjusted. We had several special items during the quarter. We hope we've really cleaned this schedule up from a future standpoint. We got rid of some high-priced debt, we got rid of swaps, and we -- the debt was both from a project standpoint and from an early call on 9% notes that were due in May '14.

So, if you just take a look, as I mentioned, the \$2.45 compared to the \$2.09. Now, the one thing about the \$2.09, and this is just a little bit of history, we had an extremely mild winter in 2012. And we were basically \$0.13 behind our budget coming out of the first quarter. And so what we did is we really sucked it up in the last three quarters and got back to almost the midpoint of our guidance range. I think this is important to know, just to understand our type of organization of what we will do to get there, to really suck it up and make sure that we deliver on our commitments. So, the \$2.09 was midrange, \$2.45 was a little higher than our upper end range. We certainly like the 17% year-over-year growth.

From an income statement standpoint, I'm not going to go through all of these items. You do see our operating expenses are up, and the real driver there is, again, we -- about a third of it we sucked it up in the prior year and just really conserved, so we put back those expenses. We're getting ready for some rate cases and we wanted to get those expenses in our rates.

In addition, we had sizable incentive compensation increases, and a lot of that has to do with a 44% increase in stock price during the year, so we're absolutely aligned with the shareholders. The stock price goes up, we get paid more, which I think is in the best interest of our shareholders.

The other thing I'll comment and share is on the EBITDA. You can see just a slight decrease year-over-year from the [402] to [399]. And the real driver there is when we sold the Williston Basin, we sold -- our EBITDA went down just for that by about \$22 million for the year. So, we sold that at \$227 million over a 10 times EBITDA. Of course we sold -- and if you look at oil and gas companies, you realize that that's a significant premium. And, in effect, we've taken that money and we're building the Cheyenne Prairie Generating Station. We're able to build that by issuing no equity and just using our balance sheet now. So, that was a real good change in our asset mix.

The main point of this revenue and operating income is we are predominantly a regulated utility. If you just look at our gas utilities and our electric utilities, they produce 88% of our operating income for the year. So, we like being a regulated entity. It's taken us a long time to get there. We've sold a number of other assets along the way over the last five, six years, or even seven, and we're predominantly a regulated utility now. As Dave said, our coal mines and our IPP really support our utility strategy. The oil and gas gives us some upside, and Dave will talk more about that. We think we have a strong upside in the Mancos Shale.

Our rate base was generally flat during the year. This is an estimate of our rate base at year end. And this does not include what we have for Cheyenne Prairie Generating Station at this point in time. That goes into service October 1, 2014, and will be included in the rate base at that point in time.

You might say why were you flat? Well, we have certain opportunities because we have a number of different entities, and in effect we had a loss on one of those entities, a tax loss. And because of the bonus depreciation and all those kinds of things, we had a deferred tax asset, and as we go down, the deferred tax asset actually amortizes. As you look out further and think about not just us but all of the utilities, we're going to have a gradual upward pressure on the rate base because it's going to go up as the deferred tax liabilities get utilized.

Capital structure, we're at a debt-to-capital at the end of the year about 53%, and we believe this gives us ample room to finish our construction projects. And, in effect, once we get the new Cheyenne generation plant in the rate base, credit metrics will again improve. As Dave said, we had great luck with the rating agencies in the last year, got upgrades by all three to BBB flat and now we've gotten an upgrade to Baa1 by Moody's.

This is a chart that we put together and this is our EPS as adjusted over the last number of years, and it projects to the midpoint of our guidance range next year. And oftentimes people say utility growth is going to be 4% to 6%, or 4% to 7% per year. I would just say that we would be really disappointed with that type of growth.

Earnings guidance, we did reaffirm our guidance. It's out there at \$2.50 to \$2.70 next year, and the assumptions are in the appendix, if you want to go through those. So, with that I'm going to turn it back to Dave.

Dave Emery:

Thank you, Tony. From a strategic perspective, we've been focused primarily on about five goals. All of those really revolve around being an industry leader in about everything we do. We want to be an industry leader in operational performance, certainly earnings growth, as Tony just alluded to earlier. We think we have tremendous earnings upside opportunity through our Mancos Shale. 44 consecutive years of dividend increases is one of the longest streaks in the industry. And then, finally, from a credit rating perspective, we've met our goal of at least maintaining a BBB from all three agencies here in the last 12 months or so. So, feel pretty good about where we're at on the path towards those key strategic objectives.

I'll hit them pretty high level here, but from an operating performance perspective, we're really focused on almost every operating metric you can think of, and we want to be top quartile or top decile. I mean, we're really focused on how can we run our existing business as good as possible? Reliability, certainly, one. Our safety record; we've put a huge effort into safety over the last several years, have tremendous progress made there. You know, 63% reduction in accidents, way below industry average numbers there. And a lot of different customer metrics regardless of who publishes those. We're very consistently at top quartile or better performer.

Look at things like power plant availability. In this day and age where you're worried about rate pressure and having to replace plants with new facilities, that they're expensive because of environmental regulations and things like that, giving another 5% or 10% availability out of your facilities every year is big. Big for customers and obviously big for shareholders as well, something we think we're pretty darn good at.

Also, our plant construction, we construct a lot of power plants. Safety record is absolutely phenomenal. I mean, we've completed a couple of projects with hundreds of thousands of man hours in the project and had, like, one accident, for example. So, we're pretty proud of that.

On the earnings growth side, Tony talked about this and showed you the trajectory. You know, the 13% or so growth rate over the last five years. This is what's driving it -- very strong capital spending across our subsidiaries; heavy on the utility side, some pretty solid non-reg spending as

well. But the key is that our spending is far outstripping our DD&A rate, which is what is causing the growth.

This slide just itemizes that growth by subsidiary, breaks out a little bit of the electric CapEx, so you can see where the spending is. Not really anything new on the total numbers, but it just gives you a little more detail.

Finally, this next slide, the strategic objectives, earnings growth, this major utility project. These are a subset of the projects on the prior page, but some of them go beyond the 2016 time period of that forecast, and so we itemized some of those so you can see at least the ones we know with some certainty are coming. We at least try to set those forth for you to see.

As Tony said, though, one of the primary drivers of our short-term earnings growth is going to be our Cheyenne Prairie Generating Station and a \$222 million facility under construction in Cheyenne, Wyoming right now. We are on schedule and on budget for an October 1 in-service date. Everything is going exceptionally well there, which is fortunately becoming a habit for us in our plant construction. We have a great track record there and an excellent safety record on that project as well. Only one minor incident to date in all the man hours we have on the project.

Switching gears here a little bit to regulatory updates. I talked about these, most of these already on the rate cases for Black Hills Power and Cheyenne Light related to the Cheyenne Prairie generating station. I think one thing is worth pointing out, and that is our strategy related to rate cases around new power plant construction. We take a little different approach there, where almost every time we build a power plant we will file a case about when we start construction, either right before or right after. The point of that is to go through and catch up, if you will, any other cost increases, corporate cost allocations, incentive comp, all of those things that aren't related to the power plant itself, and really get that all caught up to current levels of expenses.

Then when we file the plant case, it's really just about the plant, which is a pretty straightforward case. You know what it costs to operate. We operate a bunch of them and we know what it costs to build. So, it's a pretty simple case. Even though they're large, it simplifies things. A lot less to debate and discuss in testimony and with the Commission and staff. So, that's a strategy we've deployed. So, in both Black Hills Power and Cheyenne Light over the last year, we've completed rate cases as the setup, now we're filing the cases for the plant itself.

And the other thing that's important, I think, on the Cheyenne Prairie generating station, in both Cheyenne, Wyoming -- both Wyoming and South Dakota, we implemented financing riders, construction financing riders for the plant in both jurisdictions. That was a first in both states. It essentially allows us to gradually phase in, if you will, our rates during construction, pay for the financing costs, which reduces the overall cap costs a little bit, but better for rate payers. Certainly easier to handle the rate shock of a large increase when the plant comes in service that way. And that was a first time approach in both of those states, so we're pretty proud of that.

Cheyenne Light has an opportunity in the next couple of years to purchase our share of the Wygen I coal plant. We have a power purchase agreement between our nonregulated generation subsidiary in Cheyenne Light that's in place. Under that agreement, Cheyenne Light has the option to buy and rate base that plant. If you think about it, the power purchase agreement, that price is escalating every year. At some point it will be more advantageous for Cheyenne to buy that facility and to own it. That will happen sometime in the next two years here, and the discussions we've had with the commissioners in Wyoming is once it's rate-neutral to rate base that facility we'll exercise that option.

Pretty substantial difference between what the purchase price is, which is essentially replacement cost, and what our existing book value is, which means when we do that, there would be a fairly substantial book gain. Isn't a big deal, but it certainly strengthens the balance sheet, additional equity, if you will.

I think I've talked about all the other regulatory things. On the oil and gas side, our strategy there is primarily driven around proving up the value of our Mancos Shale gas assets in both the San Juan and Piceance Basins. A little bit of limited oil exploration in addition to that, but the primary focus is on the Mancos. This year upcoming in '14, we expect to drill at least another six horizontal Mancos wells. In the Piceance Basin, continue to improve the infrastructure around that program and evaluate results, which will hopefully help us prove up the value of that.

We've disclosed this before, but with our holdings in the two basins, we have an estimated 2.2 trillion cubic feet of gas resource potential net to Black Hills. This does not include the extra 20,000 acres we just earned for drilling the two Mancos wells we drilled this year (2013). So, another substantial increase in that number. Obviously, a big prize that we're working to value.

On the credit rating side, we already talked about this, but literally in the last three years we've received -- or last year we've received a total of three and now four upgrades from the various agencies. We're really where we want to be from a credit rating perspective. Pretty pleased with our financial performance.

Finally, on the dividends, our 44-year track record is something we're very, very proud of. And as you'll see here, we increased the amount of dividend raise in 2013. We went from a \$0.02 increase up to a \$0.04. Before 2008, we had been at a \$0.04 increase. We reduced it, one, we had just closed the Aquila acquisition in 2008. Also, in the middle of the recession then had a very ambitious capital spending program, so we cut it back to \$0.02, but maintaining the growth record was pretty important to us. We have since then upped that back to the \$0.04 a year increase with \$1.56 for '14 equivalent annualized number.

The scorecards are too busy to read here, but this is something that I think we feel is important for us to basically demonstrate and hold ourselves accountable to you, our shareholders. We set out at the beginning of every year what strategic goals and objectives we plan to do that year, and then we update you every quarter on our progress. This is the '13 scorecard, we have a new one for '14, which, of course, we're just getting started on. But it's a discipline that we've imposed on ourselves here for about the last seven or eight years. I think it's been very effective from a communication with shareholders perspective. With that, we'd be happy to answer any questions, if anybody has any.

Kevin Cole: Great. Thanks, David. I guess we have a short time, so I guess I'll stick it to Mancos. Can you help, I guess, frame out what you think the value opportunity is there and kind of the path to actually see what's in the ground and see what it's worth?

Dave Emery: Yes. I mean, the primary thing with the Mancos is really determining, obviously, what the real value of that asset is. And in order to do that we still think we have several things left to do. One of those is determine the optimum well design. So, there are other operators in the basin that are drilling there. We're watching what they're doing, we're sharing information, but it's how do you drill a well? How long of a horizontal lateral? How many frac jobs do you pump per well? That's key, because it drives your capital investment side of things.

The other one is we want to drill enough wells on our acreage. I don't think this takes a lot of wells, maybe 10 or 12 total, but we want to drill enough wells that we've proven up the entire aerial extent of our acreage position, so we've proven that all of it is equally prospective. We're

pretty confident in that because we have very good well control for our geology, and we know where the sand is, but we want to prove it, if you will.

The other question that's real critical to economics, particularly at low gas prices is, where are the liquids-rich portions of our acreage? So, a part of our acreage is pretty liquids-rich; part of it, like the San Juan Basin, is pretty dry. We need to drill a few more wells in there to really determine what areas are going to be more liquids-rich, really drives an economic decision there as far as where are you going to drill. The numbers with the liquids are much, much better, obviously, than the dry gas.

And then, finally, it's well spacing. So, the numbers that I showed you that come to the 2.2 trillion cubic feet of reserves estimated, those are based on 160 acres per well. Other operators have already applied for and received approval to go to 80s in New Mexico, which would double that resource potential number. And it's very conceivable you could go all the way down to 40- acre spacing, which would quadruple that number. So, that's a very key decision for us.

Our plan is to drill enough wells by the end of this year that by early next year, when we kind of announce our year-end results, hopefully we'll have a real good handle on all of those things except for maybe the spacing question. I don't know if we'll have enough wells drilled yet to really answer that well spacing question, but we should know optimum well design, hopefully have a pretty good handle that our acreage is productive everywhere, have a little better handle on where the liquids value is.

Once we get to that point, and the key is what do we want to do with the play? If you look at the number of wells it would take to develop, it is 400 to 500 wells just based on the 74,000 acres in 160-acre spacing, that's a huge number at \$10 million to \$12 million a well. We're not going to keep that and drill it all, we wouldn't look like a utility company anymore. So, then what are the choices? Well, we could sell it all, we could sell a basin, we could keep a basin. If we had a use of cash, for example, we could bring in a 50% partner in a basin and use the proceeds to build another power plant or something. If we don't have any use of cash, we could bring in a partner and have a capital carry going forward in that basin, or any combination of those things. We want to make that decision at that time in the context of every other opportunity available to us. It might be an acquisition opportunity, it might be a power plant, whatever, that would influence what course we would choose to pick at that time.

Kevin Cole: And the timing for that is probably early '16, but '16 for --

Dave Emery: Probably. Again, I think we'll have a fairly good handle on what we think the play is worth at least on 160-acre spacing a year from now. So, somewhere between then and maybe a year after that I think we'll know the full value, but I think within a year we should have a pretty good handle. And depending on the opportunity, might be able to make the choice at that time. Might need to wait a little for spacing, depending on what the opportunity is.

Kevin Cole: Great, thanks. It seems like all the excitement around the Mancos is kind of taking away from your regulated story. Can you talk a little bit about the state of the economy and the amount of load growth you're expecting, and just your ability to continue to grow your earnings and your rate base in the high single digits to low teens?

Dave Emery: Yes, you bet. One of the things, and Tony showed it on our growth rate slide there, we've been investing heavily in our utilities and we've got great territories. If you look at South Dakota and Nebraska, for example, the second and third lowest unemployment rates in the country. Wyoming is not too far behind. We've got pretty good load growth in certainly our South Dakota and Wyoming electric utilities. Black Hills Power is slow and steady but typically grows at a 1% to

2%, sometimes a little greater than that, but it's very steady even during the downturn. Cheyenne, Wyoming is growing considerably faster than that. We're seeing a lot of businesses moving into Cheyenne, some of them from the front range Colorado because of the difference in tax structure and some of that. Also seeing a lot of database expansion in Cheyenne. Microsoft, for example, just put on a large datacenter there. Datacenters are big loads, very reliable loads, and so continue to expand that, I think, bodes well for the future.

On the gas side, our growth is pretty slow and steady but in a couple of states, Colorado, for example, the growth is picking up pretty fast again. Our Nebraska utility is growing pretty well. So, we're pretty confident in our ability to keep up a growth rate in our utility. As Tony said, we'd be disappointed if we're in that 4% to 5% range that a lot of our peers are talking about. We don't want anywhere near that rate.

Kevin Cole: Great. With that, we're out of time. Thank you.

Dave Emery: Thank you.