Black Hills Corporation (BKH)

Updated August 7th, 2018 by Jonathan Weber

Key Metrics

Current Price:	$60	**5 Year CAGR Estimate:**	8.3%	**Volatility Percentile:**	53.2%
Fair Value Price:	$61	**5 Year Growth Estimate:**	4.6%	**Momentum Percentile:**	14.3%
% Fair Value:	98%	**5 Year Valuation Multiple Estimate:**	0.5%	**Valuation Percentile:**	64.5%
Dividend Yield:	3.2%	**5 Year Price Target**	$77	**Total Return Percentile:**	53.8%

Overview & Current Events

Black Hills Corporation is an electric utility that provides electricity and natural gas to customers in Colorado, Iowa, Kansas, Montana, Nebraska, South Dakota, and Wyoming. Black Hills was founded in 1941 and currently trades with a market capitalization of $3.2 billion. The company is headquartered in Rapid City, SD.

Black Hills obtains roughly 20% of its electricity from renewable sources. The rest is generated from natural gas. Black Hills seeks to further increase the amount of electricity it obtains from renewable sources, partially due to state requirements. Colorado, for example, has set a 30% renewables requirement for 2020.

Black Hills reported its most recent quarterly results on August 6. The company reported earnings per share of $0.45, a 7% increase from the prior year's level. Black Hills also was able to grow its revenues by 4% year over year, to $356 million. Black Hills' management has stated that the company is on target to achieve profits within the company's earnings per share guidance of $3.30 - $3.50.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$0.18	$2.32	$1.66	$1.01	$1.97	$2.61	$2.89	$2.83	$3.13	$3.36	***$3.40***	***$4.25***
DPS	$1.40	$1.42	$1.44	$1.46	$1.48	$1.52	$1.56	$1.62	$1.68	$1.81	***$1.90***	***$2.20***

Black Hills' profitability has been rather volatile over the last decade. Overall, earnings-per-share have grown by 4.7% annually since 2009, which is not an especially bad growth rate for a utility. At the same time growth is not overly impressive here, either.

Black Hills' growth over the coming years depends on several factors. One of these are rate reviews. Another is the expansion of the company's existing assets via new pipelines and utility infrastructure. During the second quarter of 2018, for example, Black Hills received approval for a new 60 MW wind power project. The company also is planning to build new electric transmission lines as well as natural gas pipelines to service its customers.

Rate reviews will allow Black Hills to recover investments into its existing systems, thereby more or less guaranteeing increasing revenues, which should lead to rising profits down the road.

We believe that earnings per share will continue to grow at a mid-single digits growth rate over the coming years. On a year-over-year level, profit growth will remain somewhat unpredictable.

Black Hills has grown its dividend relatively in line with its earnings. Since 2008 the dividend growth rate averaged 5.5% annually. In contrary to earnings growth, dividend growth has been very reliable and without any meaningful swings.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	-	9.9	18.1	31.1	17.1	18.2	19.0	16.1	22.3	19.7	***17.6***	***18.0***
Avg. Yld.	4.2%	6.2%	4.8%	4.6%	4.4%	3.2%	2.8%	3.5%	2.9%	2.7%	***3.2%***	***3.1%***

Profits of Black Hills have been in a very wide range over the last decade, and so was Black Hills' valuation. Shares have been trading for a single-digits earnings multiple, but were valued at very high valuations during some years as well.

Right now shares of Black Hills trade at a little less than 18 times this year's expected earnings. We do not expect any meaningful changes to Black Hills' valuation over the coming years. Shares look relatively fairly valued right here. Black Hills offers a 3.2% dividend yield, coupled with a reliable dividend growth history this is attractive for income investors.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	16.4%	18.6%	17.6%	16.9%	20.6%	20.4%	19.1%	17.4%	15.9%	16.8%	***17.0%***	***18.0%***
Debt/A	68.9%	67.3%	70.4%	70.7%	67.0%	66.5%	68.1%	68.3%	75.3%	74.3%	***73.0%***	***71.0%***
Int. Cov.	-	2.4	1.8	1.6	2.5	2.6	3.8	3.6	2.5	3.0	***3.0***	***3.0***
Payout	-	61.2%	86.7%	145%	75.1%	58.2%	54.0%	57.2%	53.7%	53.9%	***55.9%***	***51.8%***
Std. Dev.	49.2%	33.3%	24.3%	27.3%	18.4%	19.0%	18.9%	26.3%	22.9%	14.5%	***17.0%***	***18.0%***

In the above table we see typical numbers and ratios for an asset-heavy utility: Due to the high amount of assets, the gross profit to assets ratio is relatively low. Black Hills finances a relatively high portion of its assets via debt, which is an opportune move in order to boost the company's return on equity.

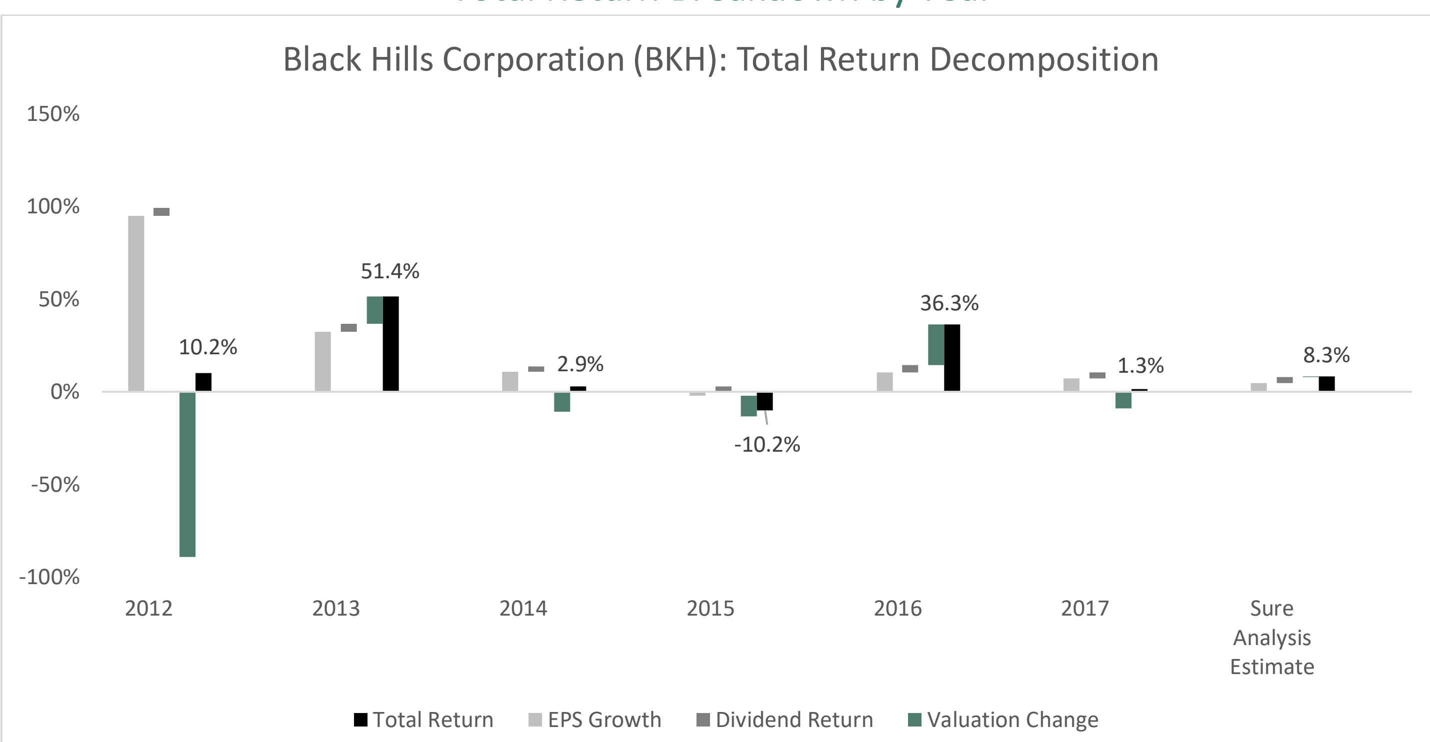
Black Hills' interest coverage ratio has ranged from 2 to 4 since 2012. Demand for electricity is not cyclical, thus Black Hills will remain profitable under almost all circumstances. This means that the relatively low interest coverage ratio is not problematic. Because of its debt burden, rising interest rates could become a headwind for Black Hills in the future.

The fact that demand for electricity is not cyclical, and that customers tend to stick with their provider means that Black Hills operates a relatively fool-proof business model. The company will also be able to weather recessions and economic downturns. This creates appeal for the more conservative members of the investment community.

Final Thoughts & Recommendation

Black Hills operates a relatively unspectacular business, but even such companies can deliver solid total returns under the right circumstances. Through some earnings growth, an above-average dividend yield and some valuation expansion potential Black Hills should be able to deliver high-single-digits annual returns over the coming five years. For income investors seeking exposure to the industry shares are a potential buy, even though we liked them more in the $50s.

Total Return Breakdown by Year



Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.