



# Black Hills Corporation (BKH)

Updated November 8<sup>th</sup>, 2018 by Jonathan Weber

## Key Metrics

<b>Current Price:</b>	\$63	<b>5 Year CAGR Estimate:</b>	7.4%	<b>Volatility Percentile:</b>	34.3%
<b>Fair Value Price:</b>	\$62	<b>5 Year Growth Estimate:</b>	4.6%	<b>Momentum Percentile:</b>	65.8%
<b>% Fair Value:</b>	102%	<b>5 Year Valuation Multiple Estimate:</b>	-0.4%	<b>Growth Percentile:</b>	29.0%
<b>Dividend Yield:</b>	3.2%	<b>5 Year Price Target</b>	\$77	<b>Valuation Percentile:</b>	52.1%
<b>Dividend Risk Score:</b>	A	<b>Retirement Suitability Score:</b>	A	<b>Total Return Percentile:</b>	41.9%

## 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 \$3.4 billion. The company is headquartered in Rapid City, SD.

Black Hills reported its third quarter earnings results on November 6. The company was able to generate revenues of \$322 million during Q3, which represented a decline of 4.1% compared to the revenues of Q3 2017. The company generated earnings-per-share of \$0.42 during the quarter, a decline of ~20% from \$0.52 during the previous year's quarter. A decline was expected, though, and Black Hills actually increased its guidance for 2018. The company now expects earnings-per-share of \$3.35 - \$3.50 for FY 2018. Black Hills also announced earnings-per-share guidance numbers for 2019 and 2020 – the company forecasts EPS of \$3.35 - \$3.55 and EPS of \$3.50 - \$3.80, respectively. Even though it is unusual for a company to give out guidance for two future years this announcement shows Black Hills' management's confidence. We have increased our FY 2018 estimate to reflect the guidance change.

Black Hills has increased its quarterly dividend to \$0.505 per share on November 5. This represents a 6.3% increase, slightly more than the 5.5% average dividend growth rate over the last couple of years. During the third quarter Black Hills' credit rating was upgraded to BBB+ by S&P Global, which could lead to an improved access to capital markets.

## Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>EPS</b>	\$0.18	\$2.32	\$1.66	\$1.01	\$1.97	\$2.61	\$2.89	\$2.83	\$3.13	\$3.36	<b>\$3.43</b>	<b>\$4.29</b>
<b>DPS</b>	\$1.40	\$1.42	\$1.44	\$1.46	\$1.48	\$1.52	\$1.56	\$1.62	\$1.68	\$1.81	<b>\$1.90</b>	<b>\$2.20</b>
<b>Shares</b>	39	39	39	44	44	45	45	51	53	54	<b>60</b>	<b>65</b>

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 a bad growth rate for a utility, but not an overly strong growth rate, either.

Black Hills' growth over the coming years depends on several factors. One of these factors are rate reviews, which drive revenues and profits per kWh. Another factor is the expansion of the company's existing assets via new pipelines and utility infrastructure. During the third quarter of 2018, for example, Black Hills agreed to acquire a 50% stake in a wind farm in Colorado for \$16.3 million. 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.

## Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
<b>Avg. P/E</b>	-	9.9	18.1	31.1	17.1	18.2	19.0	16.1	22.3	19.7	<b>18.4</b>	<b>18.0</b>
<b>Avg. Yld.</b>	4.2%	6.2%	4.8%	4.6%	4.4%	3.2%	2.8%	3.5%	2.9%	2.7%	<b>3.2%</b>	<b>3.1%</b>

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Black Hills' valuation has traded in a relatively wide range over the last decade, as earnings-per-share have also been cyclical. Black Hills trades at a small premium relative to how the company's shares were valued in the past, and to what we deem a fair valuation for Black Hills' shares. The small multiple compression headwind will be more than made up for by Black Hills' dividend which yields 3.2%, which is more than one and a half times as much as the broad market's yield.

## 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%	<b>17.0%</b>	<b>18.0%</b>
Debt/A	68.9%	67.3%	70.4%	70.7%	67.0%	66.5%	68.1%	68.3%	75.3%	74.3%	<b>73.0%</b>	<b>71.0%</b>
Int. Cov.	-	2.4	1.8	1.6	2.5	2.6	3.8	3.6	2.5	3.0	<b>3.0</b>	<b>3.0</b>
Payout	-	61.2%	86.7%	145%	75.1%	58.2%	54.0%	57.2%	53.7%	53.9%	<b>55.4%</b>	<b>51.3%</b>
Std. Dev.	49.2%	33.3%	24.3%	27.3%	18.4%	19.0%	18.9%	26.3%	22.9%	14.5%	<b>17.0%</b>	<b>18.0%</b>

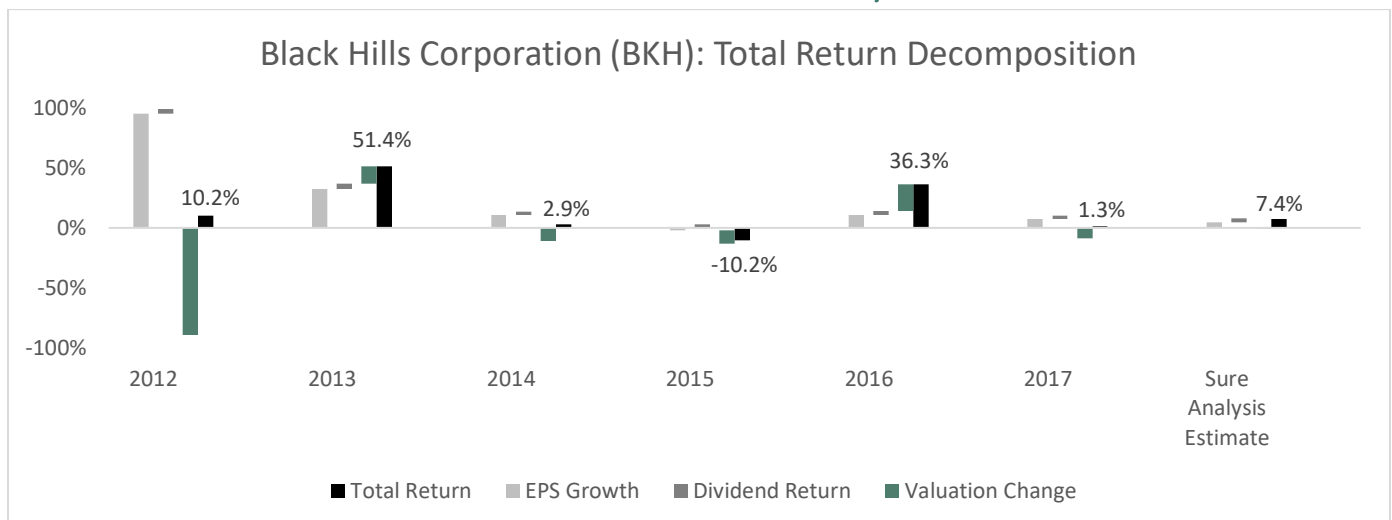
In the above table we see typical numbers and ratios for an asset-heavy utility. Due to the high amount of assets, the gross profit to assets ratio is relatively low. Black Hills finances a relatively high portion of its assets via debt. This is an opportune move in order to boost the company's return on equity. The relatively predictable cash generation means that the company is not overleveraged. 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 should also be able to weather future recessions and economic downturns, which creates appeal for the more conservative members of the investment community.

## Final Thoughts & Recommendation

Black Hills is a relatively small utility that has generated solid, yet unspectacular, earnings-per-share growth rates during the past. Its yield is substantially higher than that of the broad market, and the dividend has grown very consistently in the past. The business is relatively recession-proof, which means that Black Hills could be a good choice for risk-averse investors. Due to the too-high valuation, Black Hills earns a hold recommendation from Sure Dividend at current prices.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	1006	1270	1220	1272	1174	1276	1394	1261	1539	1680
Gross Profit	556	617	653	356	439	438	453	481	613	662
Gross Margin	55.3%	48.6%	53.5%	28.0%	37.4%	34.3%	32.5%	38.1%	39.8%	39.4%
Operating Profit	148	170	183	186	250	259	264	300	336	417
Operating Margin	14.7%	13.4%	15.0%	14.6%	21.3%	20.3%	18.9%	23.8%	21.8%	24.8%
Net Profit	105	82	69	50	102	117	131	-32	73	177
Net Margin	10.4%	6.4%	5.6%	3.9%	8.7%	9.2%	9.4%	-2.5%	4.7%	10.5%
Free Cash Flow	-183	-76	-325	-217	-32	-30	-83	158	-134	102
Income Tax	-29	33	22	18	60	63	67	79	59	73

## Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	3380	3318	3712	4127	3729	3838	4246	4627	6542	6659
Cash & Equivalents	168	113	16	22	15	8	21	441	14	15
Accounts Receivable	357	274	172	97	100	113	118	79	135	123
Inventories	118	123	63	84	78	88	91	87	104	113
Goodwill & Int. Ass.	364	358	357	357	357	357	357	363	1308	1307
Total Liabilities	2329	2233	2611	2918	2497	2554	2892	3161	4812	4839
Accounts Payable	289	229	147	105	84	130	124	90	152	161
Long-Term Debt	1207	1216	1440	1628	1320	1479	1618	1930	3314	3326
Shareholder's Equity	1051	1085	1100	1209	1233	1284	1354	1466	1615	1709
D/E Ratio	1.15	1.12	1.31	1.35	1.07	1.15	1.19	1.32	2.05	1.95

## Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	3.6%	2.4%	2.0%	1.3%	2.6%	3.1%	3.2%	-0.7%	1.3%	2.7%
Return on Equity	10.4%	7.6%	6.3%	4.3%	8.4%	9.3%	9.9%	-2.3%	4.7%	10.7%
ROIC	5.4%	3.6%	2.8%	1.8%	3.8%	4.4%	4.6%	-1.0%	1.7%	3.5%
Shares Out.	39	39	39	44	44	45	45	51	53	54
Revenue/Share	26.33	32.82	31.20	31.74	26.64	28.72	31.25	27.85	28.89	30.48
FCF/Share	-4.80	-1.97	-8.30	-5.41	-0.73	-0.68	-1.87	3.49	-2.52	1.86

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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