NorthWestern Energy Group, Inc.

Third Quarter 2023 Earnings Call

Presentation

Travis Meyer
Director of Corporate Finance & Investor Relations Officer

Good afternoon, and thank you for joining NorthWestern Corporation's financial results webcast for the quarter ended September 30, 2023. My name is Travis Meyer. I'm the Director of Corporate Development and Investor Relations Officer for NorthWestern. Joining us today to walk you through the results and provide an overall update are Brian Bird, President and Chief Executive Officer; and Crystal Lail, Chief Financial Officer. [Operator Instructions]

NorthWestern's results have been released, and the release is available on our website at northwesternenergy.com. We also released our 10-Q premarket this morning.

Please note that the company's press release, this presentation, comments by presenters and responses to your questions may contain forward-looking statements. As such, I'll direct you to the disclosures contained in our SEC filings and in safe harbor provisions included in the second slide of this presentation. Please also note this presentation includes non-GAAP financial measures. Please see the non-GAAP disclosures, definitions and reconciliations also included in the presentation today.

The webcast is being recorded. The archived replay of today's call will be available for one year beginning at 6:00 p.m. Eastern today and can be found in the Financial Results section of our website.

With that, I'll turn the presentation over to NorthWestern's CEO, Brian Bird.

Brian Bird
CEO, President & Director

Thanks, Travis. First of all, we just completed our Board meetings for the third quarter in here in South Dakota. As a matter of fact, last night, we celebrated the 100th birthday of NorthWestern Public Service. Many of you may remember in 2012, we celebrated the 100th birthday of the Montana Power Company, so now all of our business has achieved 100 birthdays. In fact, actually, it will be this November 27 will be the actual date because back on 11/27/1923, 3 employees from the Albert Emmanuel Company incorporated NorthWestern Public Service Corporation.

And just a little bit more history there. This company owned many utilities in the Ohio, Pennsylvania and other Midwestern states. And the reason that they name this NorthWestern Public Service Company, is because after its incorporation, it was the group of assets that were most NorthWestern of all the assets they own, so a little bit of history to start for the quarter.

The highlights certainly have to do with providing guidance both for '23 and '24. I think from '23's perspective, our diluted earnings per share, $3 to $3.10 per share; for 2024, $3.42 to $3.62. Crystal will give more color on the guidance of each of these and also on our long-term growth rates. Regarding those long-term growth rates, we are increasing our long term, I think, 5 years, rate base and earnings per share growth rate targets to 4% to 6%.

Much of this now hinges upon unanimous approval of a constructive multi-party settlement in the Montana rate review, resulting an electric and natural gas increases of $67.4 million and $14.1 million, respectively, as rates go in effect November 1, 2023.

And I know Crystal will talk about this more but I'll stop for a second just to point out, first and foremost, I think we had a very constructive settlement between all of those intervening parties that provided revenue requirement testimony and rate review. So that was also constructive in and of itself.

But I think how the commission handled this case and certainly, if you have the opportunity to listen in or listen in on Wednesday we're had an opportunity to listen in by connecting to a link, you should listen in. We were extremely impressed with the slide presentation that was provided to the commission.

And just the comments from the commissioners in terms of the sincerity, how they look at their jobs and their role to balance the needs of that customers for sure, but also the needs the financial health of the utility. And noting that there are federal and statutes associated with that. And in many aspects that go into their decision making, it was impressive and well done.

So we feel very, very good about it. I think you've heard me say in the past. I feel good about the alignment, certainly in the governor's offer, legislature and the commission. I think what's happening from my perspective, there's certainly an observation by all of those parties. How important it is the product, the service that we provide our customers from electric and gas perspective.

And there are many challenges that we faced to provide that service in the future in terms of capacity and other needs. And I think people understand in order for to do that, we have to be a financially strong company. And I think yesterday or Wednesday's outcome certainly that resonated with me as I heard the Commissioner's vote. And it wasn't lost on us too, that it was a unanimous 5-0 vote. So -- and we feel very, very good about that outcome.

Earlier in the year, we get also approval to move forward with the holding company from all our jurisdictions, including Montana. And we actually, during the quarter, we effectuated the first phase of that holding company reorganization. Talk a little bit more about that later on in the presentation. During the quarter, we also finished up our ATM program. We issued $63 million of the remaining $75 million closing on our equity distribution agreement. And we declared dividends of $0.64 per share payable December 29, '23 for shareholders of record as of December 15, 2023.

And with that, I'm going to hand it over to Crystal to walk through the financial matters.

Crystal Lail
VP & CFO

Thank you, Brian, and I echo your comments on coming up on the 100-year anniversary. We've been here for about 20 years of that. I feel pretty privileged to work here and work with the team. So it's a pretty full accomplishment in getting to celebrate with those in this community and here on last night was wonderful.

So with that, my comments today, I will discuss our third quarter results. We'll also provide more commentary as Brian alluded to, with regard to our release of 2023 and 2024 earnings guidance, along with a bit of detail on our financing plans and how we're thinking about that going forward.

So Slide 5 first, for the quarter, on a GAAP basis, we had an improvement of $1.9 million or a $0.01 increase. On a non-GAAP basis, that was an improvement of $4.2 million or $0.05 or 11.4% versus the quarter in 2022.

To give you a bit more detail on that, turning to the quarterly variance, I'll take you to Slide 8. Among the major items, when you look at the drivers for the quarter, you see margin improvement, which added $0.11. And that was offset by the continuing trends between depreciation and interest expense and importantly, also $0.03 of dilution from our share issuance.

For a bit more detail on the quarter and how margin that $0.11 has shaped up, I'll move you to Slide 9. You can see we have an improvement of $0.10 driven by interim rates in Montana. I would also tell you for the quarter, we saw cooler summer weather. It was also wet across our service territories, a bit of variance there between the months.

But I would remind you that last year in Q3, up and much of the Pacific Northwest saw a very warm hot weather. So definitely a variance driving the year-over-year results here.

On the silver lining of that, I would tell you that that provides some tailwinds on our PCCAM. There's 2 pieces to that PCCAM. If you recall last year, for the full year, that was about $0.10 of drag to us, but in Q3, we definitely saw detriment there. The absence of that detriment this year was helpful and also importantly and I'll speak to the rate review in a bit more detail coming up here.

But the adjustments that PCCAM-based even through interim rates were very significant for us. So all of that resulted in from a PCCAM perspective, $0.05 of improvement over the quarter in 2022. But the other side of that weather is it also impacted driving lower sales volumes for us versus prior year and notably also lower demand for our transmission. Think about demand across our lines, moving power to the West about south and west, north and west, less demand for that this quarter. So between those 2, that's about a $0.06 drag to earnings, so offsetting some of that improvement from interim rates.

Turning to Slide 10 on operating costs. You will see that we were relatively flat for the quarter versus the prior year. And you'll note that going through the first 6 months of the year, we have seen a bit of increase there. So that's putting our year-to-date back in line with our expectations of how we expected the year to shape up.

Slide 11 really gives you a full look of how we performed for the quarter, adjusting out that non-GAAP piece. I just mentioned how weather in Q3 for us this year was unfavorable. So you'll see we've added back on a net income basis, about $700,000. So $29.3 million of GAAP earnings adjusted to $30 million on a non-GAAP basis. And remind you that in prior year that was favorable weather we were adjusting out. So that creates a $0.04 swing in results for the year. And you can see there on a non-GAAP basis, again, a $4.2 million increase or 16.3% for the quarter.

Slide 12 provides a bit of detail on our cash flows. And I would note here, we've been committed to our investment-grade prior rating and improving our FFO to debt. And you can see currently a significant improvement in cash flow from operations here with important changes to our PCCAM and also the base rates even captured from an interim rate basis.

And you can see that improvement of less cash outflows. Think of it that way versus '22 is very significant as we move back towards delivering growth and making sure our balance sheet is strong to where it should be.

So that leads me to Slide 13 and talking about the Montana rate review. Brian already mentioned how critical that was and also how constructive the one session was. We expect base off that direct order that the final rates will be effective November 1. And we've made a compliance filing to trigger that with the commission.

Those final rates will be an adjustment from interim rates increasing. So think interim rates are detailed previously, a little over $30 million. We'll go to the final adjustment on a base rates basis of $81.5 million between electric and gas. And we are pleased with that outcome. While we acknowledge that we don't receive a true-up back to the date of interim rates, we do keep the interim rates. I think the 39% that we've been collecting along, I think there's been a bit of confusion as to how that would work.

So making sure we're clarifying here that effective November 1, we go to the final rates incorporating the $81.5 million. And there's no adjustments to the interim rates that we collected so far on a base rate basis.

We are certainly pleased with the outcome. And again, how the commission went about working through the order and working through what we believe is a very constructive settlement amongst the intervening parties. We do need to see a final order, however, but once we see that and based off the direct order that we have reviewed and the tenor of the work session at this point. We don't expect that we would appeal the outcome of that docket.

But we also think and very importantly, that it provides a solid foundation for how we move forward. And I'll address that in a couple of minutes here on how we're thinking about our growth and outlook. But that is certainly what allowed us to give guidance here this quarter with our update to you and [in report]. And with that, I will also talk about our South Dakota rate review, which we filed earlier this year in June.

Slide 14, you've seen the details of this. And the update here is that we are working with commission staff. In South Dakota, commission staff is advocacy staff. We've been answering data requests, great questions from them on our operations and testing us appropriately as to the costs that we've included.

And I would tell you that we expect we're winding down that rate or the data request process and should be moving into hopefully settlement discussions here as we're into Q4. I would also remind you that in South Dakota, there's a 6-month waiting period before interim rates would be available to us, which would put sometime in mid-December. And we're hoping to work with the Commission prior to that to move this case along. And that case is critical to our outlook as we think about 2024 and moving forward.

So with that, I would turn you to Slide 15 and thinking about our earnings outlook here, we are initiating guidance for 2023 as Brian mentioned, with a range of $3 to $3.10 and for 2024, a range of $3.42 to $3.62. Importantly, at the same time, we are also revising our long-term growth outlook, increasing our earnings growth range on a long-term basis to 4% to 6%. And I would frame that growth in 2 pieces. One is we're deploying capital, growing rate base that supports our customers and does the right thing to keep them in the service that they would expect and delivering capital deployment as we should, while we're also focused on improving our earned returns in our jurisdictions and focusing on delivering to the shareholders. So both of those pieces are how we will drive growth moving forward.

I would also tell you how we're thinking about the capital plan here. And we do expect to provide more of an update on that. But critically, in this environment, our current capital plan is sized to contain no equity in the current 5-year plan, absent any opportunities incremental to that plan.

So our financing of the plan will be driven by cash from operations and debt, but again, no equity in the plans in the current 5-year plan has contemplated. And part of what that is, is we are firmly committed to maintaining our investment bring credit ratings and targeting FFO to debt of greater than 14% in 2024. And the thing that I would mention here is we certainly have plenty of capital to deploy. And our discipline around that capital allocation is focused on what we need to do on the system, balanced by our balance sheet and maintaining strong financial health and also delivering earnings at the same time.

So to conclude my comments, I would note that we've provided a substantive update to how we're thinking about our outlook, followed by -- or followed upon a solid regulatory execution. The headwinds that we've had in the last couple of years, we've navigated those and have stabilized with concluding our 2023 results here.

You can see the midpoint of our '24 guidance provides what we believe is a stable platform for growth and to achieve our long-term growth that we're laying out here. We also believe we offer a solid return potential with our earnings growth and dividend yield with the fundamental driver being the things that should be, which is continued investment in the system to serve our customers and focusing on improving our [other] accounts.

So with that, I will turn it back to Brian.

Brian Bird
CEO, President & Director

Thanks, Crystal. Crystal mentioned investment on the left-hand side, near the top here shows a 5-year history of capital investment. As you can see, over time, we've ramped up our investment as we need to over $2.1 billion over this 5-year period and nearly a 16% CAGR associated with that.

The level of investment on a going-forward basis, this is 2023 through '27, 5-year forecast. Its $2.4 billion, the 2/3 of that is on the T&D side of our business. That investment doesn't include other supply opportunities or other opportunities that may result. As a matter of fact, we will update our '24 to '28 capital plan at the EEI Conference. As Crystal pointed out this is consistent with our rate base growth of 4% to 6% and again, finance that out the need for equity.

Moving forward, you guys, I'm sure, have been following on the HoldCo. We're trading today with the same ticker, but we're now a NorthWestern Energy Group. And I think I'll give you the 5 reasons why? We did the holding company. Though I'm sure many of you certainly know all of these.

First and foremost, it's a common industry structure, all but one of our peers have a holding company. Number 2, it provides great flexibility for financing options. 3, from an individual utility jurisdiction, we certainly lined up our assets and debt obligations with our legal entity structure. 4, we protect customers ultimately in these entities or these jurisdictional entities with ring fencing. And 5, it allowed us to exit from a bankruptcy stipulation where 20 years has since passed. It was no longer relevant. But certainly important for us to enter into this bankruptcy -- into this holding company in order to remove ourselves from the bankruptcy stipulation, so certainly pleased with how that's come about on October 2.

We entered in the first phase of that, which is effectively establishing the holding company itself. All assets currently sit within NorthWestern Corporation, which reports up to the NorthWestern Energy Group on Phase 2. It's on the 1st of the year in early 2024. We'll now separate assets that are within NorthWestern Corporation into really 2 parts.

NorthWestern Corporation will hold our Montana assets and some regulated subsidiaries associated with that. We'll also have our South Dakota and Nebraska assets under NorthWestern Energy Group and some largely unregulated, very small non-regulated subsidiaries under NorthWestern Energy Group as well. So I just think it's putting in place a structure. It's common in the industry, and again, gives us much more flexibility.

Lastly, I'd just say, certainly, the new name of the holding company, but same ticker, same shareholders, same stock plan, same Board of Directors, same executive team, same policies. And so we're essentially -- from an employee perspective, it looks very the same as it has been in the past except for obviously the many people worked really hard to put this in place. And obviously, phase 2 here is still in process. And once even we execute that there will be things we'll need to do in 2024.

And I think we're excited about having this. It's been a long journey. We way back, I think it was in 2008-2009. We first brought up the concept of a holding company in front of the Montana Commissioners and we placed to be really struggled with that concept. Other jurisdictions were comfortable moving forward. But we're certainly pleased earlier in the year being able to get that approval and to move forward and moving on from there.

And with that, just again, concluding thoughts before we hand over to Q&A. Certainly, Crystal shared her sentiments as well. And again, I think we feel very, very good about how our settlement was dealt with. But we still have a lot of execution we need to do on a going-forward basis.

But I feel very, very good about how we're set up to perform in 2024, certainly not only for our shareholders on this earnings call, but certainly equally important our customers and our stakeholders.
So with that, I'll open it up for Q&A.

Question and Answer

Travis Meyer
Director of Corporate Finance & Investor Relations Officer

[Operator Instructions] And we will take our first question from Jonathan Reeder at Wells Fargo.

Jonathan Reeder
Wells Fargo Securities, LLC, Research Division

Yes. So in terms of the equity, is it safe to assume that the new 5-year plan that you'll presumably roll out at EEI will be self-funded as well, in other words no equity, absent larger projects, such as new generation or something coming into the fold?

Crystal Lail
VP & CFO

Yes, Jonathan, and happy Friday afternoon. I'll take that one. And yes, it is safe just and we're sizing our capital plans consistent with no equity as we think about those current plans.

Jonathan Reeder
Wells Fargo Securities, LLC, Research Division

Okay. I figured that would be the case, that you wouldn't say no, I can need it today and then 2 weeks later changes.

Crystal Lail
VP & CFO

I still left that but not be a good move from that, so, no.

Jonathan Reeder
Wells Fargo Securities, LLC, Research Division

So moving over to some regulatory stuff. I think you've typically reached settlements in South Dakota. Do you expect that that will be the case again this time around? Or is the size of the request large enough that the key parties will want to fully litigate it?

Crystal Lail
VP & CFO

I would certainly expect that we will continue to work with staff from an advocacy perspective and would expect that we would reach a settlement there.

Jonathan Reeder
Wells Fargo Securities, LLC, Research Division

And then last one for me is I know you just completed the Montana rate case and congratulations on that outcome. But just wanted to see if you're still thinking that the rate case cadence could be every 2 years or does the onetime adjustment for Yellowstone County under the settlement allow you to push out the next Montana filing a little longer?

Brian Bird
CEO, President & Director

Yes, Jonathan, I think I'd say this. I mean, we have to evaluate what's the best way to start get recovery of our costs at of Yellowstone. Obviously, we'll continue construction into 2024 with the hopes of having it done this before summer peak, certainly in the third quarter.

But if we have to look at the best way to recover our costs and in fact that that means filing a rate review with known and measurable so that would have to be come into play. I think the one thing to keep in mind here that what we just had an outcome on Wednesday was a 2021 test year, right?

And we're approaching 2024. Our investment continues to go up. Our costs continue to go up, including interest expense. And so there's continued pressure here. And as Crystal mentioned earlier, we want to earn as close to our authorized returns as we possibly can and that is the order delivered.

What we're committing here today, we need to stay on top of that. But we need to certainly think through that. There's another alternative to try to collect costs on the Yellowstone we can think about. But we have to consider all of that in very short order to be quite frank.

Travis Meyer
Director of Corporate Finance & Investor Relations Officer

We will take our next question from a telephone line with the last 4 digits of 5805.

Tanner James
BofA Securities, Research Division

This is Tanner James stepping in for Julien at Bank of America. Given the pretty constructive rate increase outcome and you're guiding -- you upgraded the guide from -- on the low end of your long-term EPS CAGR. What are the different factors you observed that could help you get to the top end of your stated annual growth range? Is the growth rate fairly linear or is it more lumpy perhaps depending on rate case timing?

Crystal Lail
VP & CFO

Tanner, this is Crystal. I'll take a shot at it and then Brian can paddle on here. But we certainly everyone will acknowledge we've been lumpy in the past. And when you have a historic test period across our jurisdictions, lack as kind of a formulary or future looking, I think we will continue to be lumpy.

And certainly, as you think of what drives us into the upper end of our range versus lower, it will be how that recovery is time that will do that. And then, the other piece is any opportunities incremental to what we're doing here, obviously would push us upward in that range.

Brian Bird
CEO, President & Director

I would say this, I think we're already demonstrating a tad and lumpy this year. We used 2022 as a base year, obviously. And obviously, when you look at '23's results and then the guide to '24, that in and itself demonstrates lumpiness.

I think that previous question from Jonathan in terms of cadence here, which is hard. And obviously, we could offset in other jurisdictions when we're coming in for rate reviews. But I just think it is going to be a tad lumpy.

Tanner James
BofA Securities, Research Division

And you stated in your investment program that it's sized for no equity issuance unless there's future generation capacity additions or other strategic opportunities. What could other strategic opportunities look like? Is there anything you guys would actively consider on that front?

Brian Bird
CEO, President & Director

Yes, it's a great question. I think we continue to look at transmission investment opportunities and something like that that could come into play. And we just need to understand also those opportunities, the ability to -- how quickly we could recover those costs as well, have to come into play, so things like that.

Travis Meyer
Director of Corporate Finance & Investor Relations Officer

We'll take our next question from Jamieson Ward at Guggenheim.

Jamieson Ward
Guggenheim Securities, LLC, Research Division

So first of all, just quickly, congratulations on a great result there, wanted to ask specific to the HoldCo, because a few of my other questions have been asked already, so we'll pass those. So basically, now that you have a HoldCo, should we read anything into the zero equity issuance plan associated with your current capital plan as implying that HoldCo leverage like many or all of your peers.

How HoldCos' have done will be a source of funding that will allow you to go from being an equity issuer in recent years to no longer being one, while still kind of maintaining the same CapEx profile or is there something else to read into there?

Crystal Lail
VP & CFO

Jamieson, it's Crystal. I'll take that one. And I would say, no, there's nothing to read into that. My comments on our structure are this. We're still the same company in the capital structure. We don't anticipate being different than it was before. We've always carried a degree of debt on our revolver to finance our [indiscernible] programs. We will continue to do that, but no intention to look at the capital structure in a different way.

Our thoughts on equity in the plans are 2 things. It's got to -- if you're going to issue equity, currently in this environment and where utilities are trading, I think it's really got to be for accretive growth. And so, regardless of the HoldCo structure or not, our plan is to issue equity when it makes sense and when investors will see the growth that's behind that.

And absent that sizing our capital plan to make sure we're keeping customer bills in mind and keeping our balance sheet in mind, but also keeping the ability to keep the life on and the cash flow in mind it's a challenge. But we think it's important in the current environment to have no equity in the plan regardless the structure.

Jamieson Ward
Guggenheim Securities, LLC, Research Division

Got you. And in the case that you do end up making use of leverage at the HoldCo for one reason or another as time goes on. It's something that you have available to you. Do you have any concerns around the commission eventually including double leverage?

Crystal Lail
VP & CFO

You're way ahead of me, Jamieson. Our message to commission and the ring fencing we set out is same company. It's the structure every other utility uses and certainly, HoldCo leverage is no longer free as it was for a while or close to term-free. So we have no intentions there. The message we've given our commissioner filings is any of our unsecured borrowings are not in our capital structure. And none of this changes as well. The legal restructuring changes any of that, message to the commission on how we think about our capital structure.

Jamieson Ward
Guggenheim Securities, LLC, Research Division

And that's that for HoldCo question. Just I had -- well, I guess, 2 more quick ones here. One was just how many years does the no equity commitment last? I know the question was asked earlier about whether when you go forward the 5-year plan? Would you be changing the messaging and you said you wouldn't be doing that.

But just wondering if you can give us any additional color on how long that might hold for.

Crystal Lail
VP & CFO

Jamieson, I think your question is all similar to Jonathan, which we'll definitely hold for 3 weeks until the EEI, but that's my sarcasm coming through. As we think about our current 5-year plan, there's no equity in that. I would tell you very candidly, every year, we're going to take a look at that. We're going to take a look at what financing makes sense and what our opportunities are in the plan.

But as we plan out that current 5-year plan and what we will roll forward the EEI on the CapEx side, we intend to hold to the no equity as long as the current environment looks like it does. But we will continue to evaluate that and update you guys on an annual basis like we always do.

Jamieson Ward
Guggenheim Securities, LLC, Research Division

And then the timing of rig cases has already answered, lumpiness is answered. Last I have is, were there any asks that you had in this case, which in hindsight. It might not have been the right time for. But anything that you might potentially reincorporate into your next rate filing and look to maybe achieve, accomplish or add to your regulatory tools at that point in time?

Brian Bird
CEO, President & Director

That's a good question, James. I would say it this way. We tried some methods. We deviated from just the historical test year concept and just going with that. We tried some trackers. We believe all 3 of those make great sense.

We, obviously, through the settlement, got the deferral on our wildfire program, which is very, very helpful for us to obviously be able to allocate more dollars to that program. And we're going to have to continue to look at those types of trackers and other mechanisms to help us recover quicker.

And we believe, ultimately, over time, a little bit persuade not only the commission, but the intervening parties just from ability to make it an easier means to recover our costs and maybe allow us not to be as frequent of filers from a rate review perspective.

James, I want to thank you. You guys asked the hard questions. So we kind of want to make it hard for you to get in to ask yours. So you just said you that.

Travis Meyer
Director of Corporate Finance & Investor Relations Officer

And with that, we did with all of our questions. So if Brian, any closing comments?

Brian Bird
CEO, President & Director

Yes, I think from my perspective, Crystal mentioned 20 years, it would be my 20 years, December 3 in 2023 here. Travis has certainly been with us 20 years as well and 60 years from the 3 of us. The collective executive team, many of those folks have over 30 years, experienced, some new. But from my perspective, it's the people at this company that make this a great company. I certainly appreciate working with you too, but certainly reach out to all of our employees and thank them as well. It's a great company. Thank you.

Travis Meyer
Director of Corporate Finance & Investor Relations Officer
Thanks, Brian. With that, you may disconnect. And obviously, if there's, any other questions, please feel free to reach out. Have a good day and a great weekend.