NorthWestern Energy Group, Inc.

First Quarter 2023 Earnings Call

Presentation

Travis Meyer
Director of Corporate Finance & Investor Relations Officer

Thank you for joining NorthWestern Corporation's financial results webcast for the March 31, 2023, quarter ending. My name is Travis Meyer. I'm the 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, Vice President and 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 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 webcast will be available for 1 year beginning at 6 p.m. Eastern today and can be found in the Financial Results section of our website.

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

Brian Bird
CEO, President & Director

Thanks, Travis. We're actually speaking to you today from Billings, Montana. We have our Board meetings in our service territory primarily. And this particular trip to Billings has been also an opportunity not only to meet with our employees, but also to visit the Elliston County Generation Station, and it's approximately 2/3 completed as we've built that project. You know it's certainly in the pause at this point in time. But the Board, the management team and employees, a matter of fact, certainly understand the value that plant will have not just for the Billings area, but for Montana as a whole and demonstrate -- we'll continue to demonstrate our support. We'll talk about that more in a minute.

Regarding the first quarter, from a regulatory execution standpoint, we reached a constructive multiparty settlement on the Montana rate review. And I think you all know, we're currently pending a commission approval. We're hopeful that the sentiment will be approved. We also did receive final approval necessary for our holding company formation. We also safely executed our capital plan. During the first quarter, we invested nearly $150 million, and we're on track to invest a total of $510 million of capital this year in 2023. We also pointed out in the 10-Q that even with the delay in Yellowstone County, we do expect that, that plan will be ready to serve our customers by the end of 2024.

Driving reliability and affordability, we have announced an agreement with Avista to transfer its Colstrip ownership, 222 megawatts effective December 31, 2025. And I think as we conveyed, that transfer will be for $0 upfront. And lastly, a strong and growing service territories were overall 1.4% customer growth, that is better than industry average for the first quarter. We also have the lowest unemployment rates in the nation, not just better than the national average. We have from a national perspective, South Dakota is #1, Nebraska is #2 and Montana is #4 for lowest unemployment in the U.S.

The last thing I would just note, I'm very proud of our employees and their response to storms in our respective jurisdictions. In May of last year, our response in South Dakota to derechos. We had 2 of those during the month, 5 very high wind experience. And then in Montana, storms and flooding that occurred in various parts of Southern Montana and Yellowstone National Park. And our response to that was so phenomenal that we did receive an award from EEIs and our peers from an emergency response perspective. So we're very proud in terms of our employees' reactions to serve our customers. And so with that, I'll pass it over to Crystal.

Crystal Lail
VP & CFO

Thank you, Brian. I'll begin my comments on Page 4, but as Brian started us off with significant -- I think as we start off 2023, significant execution on both the operational side of doing what we do in a service territory that you'll hear me say we had significant weather in Q1, but also significant regulatory execution, driving a strong first quarter financially and then also the opportunity to conclude that first quarter sitting here in Billings and seeing that the key backbone of our system related to substations and also the under construction in the Yellowstone facility brings those things to a finer point.

From a Q1 execution, from a financial statement perspective, you see an improvement in net income versus Q1 of last year of $3.4 million or 5.8% and the improvement on both a GAAP and non-GAAP basis of just under 6% versus 2022. However, on an EPS basis, you'll see a reduction of $0.03, and that's really the effect of shares outstanding from our prior equity issuance. When you compare quarter-over-quarter, that's about a $0.09 drag or impact versus last year. So really strong financial performance.

And I'll give you a bit more color on Slide 5 as to what drove that. You can see the margin line, an improvement of 11.4% over first quarter of 2022, $289 million versus $259.4 million. And then you'll see that's offset by some pressure in operating costs, both at the OA&G level and then property taxes and depreciation, resulting in net income of $62.5 million for the first quarter of 2023 compared with $59.1 million in 2022 or $3.4 million or just under 6% that I have referenced, right, in my prior comments.

Slide 6 gives you the key drivers overall. Significant impacts quarter-over-quarter are improvement at the margin line that I just referenced. I'll give you some more color on that in a couple of slides later. Certainly driven by strong customer growth, weather and interim rates and then offset by operating costs. I would mention that the biggest drivers really on the OA&G side of that were generation and maintenance costs and labor and benefits. A bit on the generation maintenance side. Certainly, we saw colder weather in Q1, and that asks our generation facility some of them to run more, and those costs are not passed through an tracker. So we see an impact from that.

And then certainly, the inflationary pressures on labor and benefits. We're seeing some of that. You'll also see certainly us and everyone else, the interest expense line being higher than it was in the comparable first quarter of last year, and then depreciation, reflecting the assets that are serving customers.

The other thing I would highlight here is the tax line. You'll see about $0.06 of detriment related to -- we received a notice from the IRS in the first quarter related to a previously claimed AMT credit and had a resulting adjustment out of that of approximately $3.2 million. All of that resulting in what I mentioned earlier, which is a $0.03 reduction versus last year of Q1, but an overall improvement at the net income line versus the prior period.

On Slide 7, you'll see I just mentioned tax impact. It is an out-of-period impact. And so we've adjusted that out from a non-GAAP adjustment perspective. You'll see the $3.2 million on that slide. Also, we adjusted out favorable weather on a net income basis of $2.7 million. You'll see that brings our non-GAAP earnings to $63 million. That compares with the first quarter of last year where we had a small amount of unfavorable weather, resulting in $59.5 million in the prior period as compared on a non-GAAP basis.

Slide 8 provides more detail about margin, which I was alluding to earlier as the most significant driver in Q1. You'll see higher retail and natural gas volumes. Those 2 taken together are approximately $13.5 million of improvement against solid customer growth. And then weather in our jurisdictions and a lot of the country was warmer. I can tell you from where we sat, it was definitely colder. And so that was across Montana, South Dakota and Nebraska. So you see that impact in your first and third columns there.

The other thing I would highlight in the middle of there is the impact of Montana interim rates. And we'll talk a bit about the settlement that we've reached, but the interim rates were related to the settlement related to our base rates are certainly what's reflected in our financial statements here are lower than that settlement, but still a significant driver in Q1 of the impact of that of approximately $8.5 million.

And the other thing I will note here, and for those of you who have followed. So in fleet, we talk about the PCCAM, and I will say I generally negatively talk about the PCCAM. If you're in first quarter, we actually have a favorable experience. You'll see that last year, there was about $800,000 of expense recognizance related to the sharing portion of that PCCAM. During Q1 of '23, we actually have $5 million of favorable associated with that PCCAM. So quarter-over-quarter, that's a $1.3 million favorable adjustment.

What drove that payroll adjustment? I would point out the increase in base of the PCCAM amount that we received on an interim basis in October is the key piece of that. I think most of you who are familiar with that mechanism also know it's a noncalendar year basis, so it begins July 1, goes through June 30. So where we were at through December was a significant detriment to both our earnings, over $7 million last year, and our customers. And what happened in Q1 is a bit of a reduction to that deferred balance and certainly a reduction to the debt that we have taken. And so I would highlight that as a positive moment because I haven't had a chance to say that very often.

The other thing I would comment here is the continuing trend in the next column of transmission revenues where we see a favorable impact to our loads and our systems that, I think, position of strength with regard to transmission revenues in the future. And you can see a favorable impact of transmission revenues quarter-over-quarter of $1.2 million as well, all leading to what I alluded to, which is strengthened margin line versus last year of Q1. So the -- concluding at $285.1 million of gross margin in the business.

The next page, I would refer you to cash flow impacts. Again, here, this all comes back to both the combination of the items I just mentioned from a margin perspective, being customer growth and weather and then also interim rates, resulting in solid improvement in our cash flows. And the interim rates contributing to collecting our supply cost on a more timely basis, driving stronger cash flows for the quarter. And that improvement is noted here.

The other thing I would note is we did issue first mortgage bonds, all of that leading to significant liquidity as we close out Q1 here. The other thing I would mention is consistent with our prior comments is that we do expect to issue the remaining $75 million on our after-market equity program that's offsetting currently, and we'll do that in the back part of 2023.

So having covered the financial results, I'll turn my attention to the Montana rate review. We were able to reach a constructive settlement with the primary interveners from a revenue requirement standpoint and filed debt in early April. That was after filing rebuttal testimony in early March. And the comments I made earlier is that the interim rates were a significant positive to us from a cash flow perspective and margin perspective, but also as a reminder, those set the dates of which we would expect the settlement outcome to be retroactive to and is certainly driving improved metrics already.

You'll see the detail provided on Slide 10 gives you a view of our rebuttal revenue request versus what we had received through interim rates. And then the impacts of the settlement are noted in the far right column. The base rate settlement provides what we believe is a reasonable revenue requirement outcome with also adjustments for a very -- a variety of policy items as it relates to the settlement, including the ability to recover some degree of costs for the Yellowstone generating station once that is placed in service and also to defer certain costs related to our enhanced Wildfire program.

Again, the key of this settlement and what was presented to the commission over the last couple of weeks is what we believe is a fair outcome based on our cost of service and assets already serving customers and updating our rates to reflect that. The process with the commission was a well-run hearing, a hearing from all sides. We expect briefing to continue from that hearing, which concluded, I believe that was last week. My days are running together -- with briefing going through the months of May and June, and hopefully a hearing or a final decision on the commission sometime in the July, August time frame.

From a financial outlook perspective, I think you're all familiar with us not issuing guidance for 2023 due to the significant impact of the Montana rate review. With that, we still are not issuing guidance for the year, but I would point you to Slide 10 as to the impacts of that most significant item, again pending approval by the Montana Commission. And once we do have an outcome there, we will issue guidance for the period.

The other thing I would note is each year in Q1, we announced whether we expect to file a rate review. And we do expect to file in our South Dakota jurisdiction on the electric side. And that, as many of you know, we closed out the Bob Glanzer generating station last year, and we'll be coming into request recovery of that in our other assets. In addition, we remain on plan for our capital plan for 2023. You heard Brian mention some of the challenges with the construction at Yellowstone County, but we expect to remain on course for that to be in service in 2024. And then our overall targets from an EPS and rate base have remained unchanged.

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

Brian Bird
CEO, President & Director

Thanks, Crystal. Slide 12, speaking about capital investment, I think it's quite impressive when you look at the capital. The growth in our capital over the 5-year time period shown nearly 16% CAGR over that time period, a total of $2.1 billion. That high level of investment is going to need to continue on as we think about investment necessary for capacity, asset-light reliability, compliance. And much of that investment is in the transmission and distribution. Crystal just mentioned Yellowstone, but there are some other generation investment that is included in that plan. And any other new resources brought on is not included in that $2.4 billion. And until those assets are ever identified and they don't -- they are not included in our plan. But nonetheless, our forecast going forward is an increase in investment over where we were over the last 5 years. That investment level should continue to provide a rate base growth of approximately 4% to 5%.

The next slide, speaking to our supply update. Crystal also mentioned the Bob Glanzer station, 58-megawatt facility that was put in place in May of 2022 for a total cost of approximately $83 million. That plan has been dispatched even more than we anticipated. So we're extremely pleased with our ability to provide customer capacity to our South Dakota customers.

Speaking of capacity, that's exactly what we're trying to do with our Montana Yellowstone County Generating Station. The 175-megawatt facility went -- started construction in April of '22. We're about 2/3 of the way in terms of the investment at investing $173.5 million of the $275 million anticipated. And as I mentioned earlier, we anticipate that the plant will be in service during 2024.

Regarding IRPs. We did file our South Dakota IRP in September '22. That plan identified 43 megawatts of need, some of which is due to retirements and just incremental capacity, and we will be running a competitive solicitation in the '23-'24 time period associated with that IRP. In Montana, we'll be filing our IRP here at the end of April. And so stay tuned. You'll get a chance to look at that very, very soon.
And with that, I guess we'll turn it back over to Travis to help us handle any questions.

Question and Answer

Travis Meyer
Director of Corporate Finance & Investor Relations Officer

Thank you, Brian. [Operator Instructions] I think we'll take our first question from Julien at BofA.

Julien Dumoulin-Smith
BofA Securities, Research Division

Can you hear me now?

Brian Bird
CEO, President & Director

There we go.

Julien Dumoulin-Smith
BofA Securities, Research Division

All right. Sweet. Sorry about that. I apologize. You got to hit Accept when you unmute me here. I got excited. So just coming back to Yellowstone here in the time line, obviously, reaffirm, but can you talk a little bit about the legislative angle here, 971? Just what that could portend for the project and ultimately, maybe some of the construction-related items?

Brian Bird
CEO, President & Director

Yes. I would say this, that 2 pieces of legislation were introduced late in the session as a result of the decision regarding the air quality permit. And so I think what happened is people looked at that, and I'm sure some was thinking about Yellowstone County, but many were thinking about how this could impact other construction going on in the state. And there was a very quick move by the legislature. I believe 557 is already on its way to the governor, and 971 is in its third reading, I believe, is this afternoon. So I'm cautiously optimistic that 971 will fasten its third reading and ultimately be on its way to the governor.

I'd appreciate the state understanding what that ruling could have for the growth of Montana. And from -- I would argue that our ability to service that growth in terms of serving our customers. So we feel good about it. What does it do, Julien? Those 2 pieces of legislation, in combination, effectively should be able to allow us to expedite our ability to get a renewed or reissued air quality permit.

Julien Dumoulin-Smith
BofA Securities, Research Division

Right. And either way the time line is looking like 2024. And do you want to be any more precise than that?

Brian Bird
CEO, President & Director

Yes. I guess what I'd say this. I'm hopeful that if things could move quickly, we might be able to meet our summer peak, which is really what was our intent is with the plant. And obviously, we want to be able to meet the winter peak in 2024. So our hope is to be able to achieve both of those. But I'm cautiously optimistic that those things happen and it helps us expedite. But in either way, we feel confident that we'll get this thing -- construction going in again and having in service by the end of '24.

Julien Dumoulin-Smith
BofA Securities, Research Division

Excellent. And Brian, just if I can follow up on this. I mean, we've talked at various times about a new baseline for an outlook, and you reaffirmed here this 4% to 5% rate base outlook. Can you talk a little bit about EPS CAGR and maybe kind of the time line for adjusted net considering the newfound settlement and visibility coming on the Montana?

Brian Bird
CEO, President & Director

Well, Julien, I appreciate you asking me that question, but I believe that question is really appropriate for Crystal. I'm looking at her now to answer your question.

Crystal Lail
VP & CFO

Sure. Julien, a happy Friday afternoon. The question, I think, on everyone's mind is certainly our long-term outlook and EPS growth. And the key, I would say, there is the settlement we reached in the Montana case is critical to providing us visibility as to where we're headed, but I also don't want to front run the Montana Commission. And so you see in the materials here, what you've heard from us in the past. And once we receive an outcome from the Montana commission, we will certainly be updating everyone at where we think that growth looks like coming out of that rate review.

Julien Dumoulin-Smith
BofA Securities, Research Division

Okay. And considerably by next quarter, we could get some updated baseline for what that would look like, too, not just an update of the [indiscernible]?

Crystal Lail
VP & CFO

Indeed, I think what you're referring to is the question of what is our base period that we would be driving that growth off of. And I can tell you it won't still be 2020. We will refresh what the growth period is off of. And I think that most likely looks like 2022.

Julien Dumoulin-Smith
BofA Securities, Research Division

Excellent. Sorry, one last one. On the outlook, I mean your core retail sales looking quite solid here. Any commentary? I mean, Crystal, you alluded to it in your remarks here, but any further thoughts about just what supported the outlook here in the first quarter on the gas electric side?

Crystal Lail
VP & CFO

Certainly, other than don't jinx it, Julien, it was just a really solid first quarter. I think you -- we all know that there was a good solid customer growth in our service territory. We certainly saw that in -- we are both the winter and summer peaking utility, but certainly in the winter here, we saw significant usage trends there. So we'll be paying most attention to how those roll forward.

Julien Dumoulin-Smith
BofA Securities, Research Division

Excellent. Certainly, I don't want to jinx it. All right. I'll leave it there guys. Have a good one.

Brian Bird
CEO, President & Director

Thanks, Julien.

Travis Meyer
Director of Corporate Finance & Investor Relations Officer

We'll take our next question from Alex Mortimer at Mizuho.

Alexander Mortimer
Mizuho Securities USA LLC, Research Division

Beautiful. So you highlight the need for kind of increased generation, or I guess the generation shortfall kind of multiple times during the call and in your Q. So how do you look at potential upside on the CapEx side above what's in your forecast, just given the additional need for generation that you've highlighted?

Brian Bird
CEO, President & Director

Yes, I don't necessarily want to front run our IRP here too much, but I would tell you that one thing we've been talking about for years is just the deficit on capacity and that the ability of incremental Colstrip and the Yellowstone County Generating Station brings us to a level of sufficient capacity for a number of years. That doesn't mean that we have to stop there. Obviously, we're going to need incremental capacity in a relatively short term. And also, we have to -- as a commitment, start thinking about opportunities to invest in noncarbon-emitting resources and then commit it as a company not to invest in carbon-emitting resources in 2035 and beyond. And so we'll be doing planning beyond that, too. But I think there's still going to be some needs for some capacity investment in the latter half of this decade.

Alexander Mortimer
Mizuho Securities USA LLC, Research Division

Okay. Understood. And then quickly just to sort of round out the question on Yellowstone. Can you give some detail on sort of the scale of cost that you might be currently incurring with construction currently being halted? And then is there any concern that they could potentially be disallowed when you do eventually go to get this project into rates?

Brian Bird
CEO, President & Director

Yes, 2 things. First of all, Alex, I should have finished my first thought on your first question. I should remind you that in South Dakota, there will be incremental investment there from a capacity standpoint. I think we're looking at approximately 40-ish megawatts there. And then we're looking at long-term solutions in that state as well.

Back to what's happening at Yellowstone County from a delay perspective and how that could impact costs. Yes, there were going to be some costs of demobilization and the like. And from our perspective, we don't anticipate that's going to be for a very long time. We certainly hope not. But if there are incremental costs here, I would hope that the commission would understand that this was based upon a judge's decision that I think we had very little control over, and I hope that's how they look at it. So I will say there's always risk. They're going to be looking at any project that we have and think about it from a prudence perspective. But I'd like to think, particularly in the response we've seen in the legislature associated with the decision that I think they won't look upon this delay and very really towards NorthWestern at least. That's my hope and my view.

Alexander Mortimer
Mizuho Securities USA LLC, Research Division

Okay. Understood. Congrats on the quarter.

Brian Bird
CEO, President & Director

Thank you.

Travis Meyer
Director of Corporate Finance & Investor Relations Officer

Thanks, Alex. Appreciate it. Our call from Chris Ellinghaus at Siebert Williams Shank.

Christopher Ellinghaus
Siebert Williams Shank & Co., L.L.C., Research Division

Question about the rate case. I just wanted to sort of get your perception of this. There certainly were some disagreements from the interveners in their cross-examination and testimony. But the commissioners seem to be less contentious and maybe less voluminous in their line of questioning. Would you agree with that sort of perception?

Brian Bird
CEO, President & Director

I wouldn't say this. Chris, I believe that -- and I've been through quite a few rate cases at the commission. I thought the commission handled this extremely well. They allowed public -- tremendous amount of public contrary. They ran a good hearing. It was -- I thought the process is really well done throughout. I feel good about how the case has been handled.

Christopher Ellinghaus
Siebert Williams Shank & Co., L.L.C., Research Division

Okay. Great. Outside of the potential legislation, can you just sort of walk through what you would envision the Yellowstone process being in terms of reviewing or re-examining the air permit?

Brian Bird
CEO, President & Director

Yes. I think if you're saying excluding the legislation?

Christopher Ellinghaus
Siebert Williams Shank & Co., L.L.C., Research Division

Yes.

Brian Bird
CEO, President & Director

Yes, I think excluding the -- we'll have to do, and the DEQ also has to think this through, too. Obviously, it's -- the DEQ has issued air quality permit. And there's going to be some time associated with what we actually need to do from an evaluation standpoint, from a greenhouse gas perspective. And after that's done, there's reissue -- and this is my expectation. There would be a reissued permit. They would have a comment period and during that time period before the permit is actually issued. So it would be a time period that would have to take place if, in fact, they have to do that analysis again, sans the legislation.

Christopher Ellinghaus
Siebert Williams Shank & Co., L.L.C., Research Division

Okay. The South Dakota filing, I might have missed this, what Crystal was talking about it, but what's your anticipation of that filing time frame? And what do you see that process thereafter looking like?

Crystal Lail
VP & CFO

So from a timing perspective, Chris, I would say we'll file it sometime over the summer here. We're working through that. We'll turn our attention from the Montana rate review, which has been a little bit all encompassing to finalizing that filing. The South Dakota Commission, in the past, has run a very efficient process, and they've been very good to work with. So I would think that we'll be able to work with them on interim rates sometime in the latter part of the year and then progress the filing along.

Travis Meyer
Director of Corporate Finance & Investor Relations Officer

All right. We'll take our next question from a line that ends in 252E.

Unknown Analyst

Quick question. Just to understand the time line. If the legislation is adopted, when would you be able to -- in your best estimation, be able to recommence construction on Yellowstone?

Brian Bird
CEO, President & Director

Yes. I don't know exactly. I think the legislation is passed -- greenhouse gas wouldn't necessarily have to be a consideration. And so I think we still have to deal with the lighting issue. Obviously, DEQ would have to evaluate that and have a comment period, not knowing what that comment period is. But I hope it's a matter of a couple of months instead of multi-months, if you will. So that's my expectation as I sit here today.

Unknown Analyst

Got it. And then when the plant goes into commercial operations, do you have to wait for it to go into commercial operation to file for rate relief on the plant? Or what would be the timing of when you would file for rate relief?

Crystal Lail
VP & CFO

Crystal here. From a rate perspective, we do receive AFUDC on the plant while under construction. And so once that plant is in service and part of the settlement that we reached, we had asked for, I think most of you know, all reliability rider, we settled for something less than that. But we agreed that once that plant is serving customers, we could come in and ask for a reset on our PCCAM base because, of course, the cost today, we're buying the service on that Yellowstone will provide in the market. So we've reset that base but at the same time, get some recovery of the operating costs. And at that same time, work through the prudency evaluation of that plant if we choose to make that filing. So that was coincide with about the timing of in-service to again provide core recovery across on a timely fashion as it relates to the operating side of that, but importantly, recovery of the rate base would be subject to another rate filing.

Unknown Analyst

So the operating cost would somehow be incorporated into the PCCAM proceeding or?

Crystal Lail
VP & CFO

Yes.

Unknown Analyst

Okay. And then last question. Can you talk at all about sort of equity need beyond this year?

Crystal Lail
VP & CFO

We haven't given guidance beyond this year as to our financing plans. We mentioned, as I noted earlier, we'll finish out the ATMs planned. The thing I would just note overall there is we're looking to fund our capital plans on a self-funded basis absent when we have additional growth, things like Yellowstone or other opportunities that aren't based into our current capital plan. Those are the types of things that would push us into more equity needs.

Unknown Analyst

So should we not assume sort of continuing equity beyond this year? I'm not understanding what you're trying to say?

Crystal Lail
VP & CFO

Sure. I'll say it this way. We haven't given guidance past 2023 as to our equity needs.

Travis Meyer
Director of Corporate Finance & Investor Relations Officer

And with that, I think we've exhausted our Friday afternoon queue. I'll turn it back over to Brian for any closing remarks.

Brian Bird
CEO, President & Director

I just -- obviously, we're pleased to begin with the settlement. Again, we hope the commission gives it a good hard look, and hopefully, we get approval of that settlement so we can continue to do as we must, continue to invest in the Montana system and help it grow. And I think also we ultimately need to build the Yellowstone County plant for our customers. We need to have this incremental capacity from Colstrip to serve our customers. And ultimately, we believe we'll get to that point, and people appreciate will we're trying to do to serve our customers.
So with that, thank you all, and have a great weekend. See you.