



Fitch Upgrades Black Hills Corp to 'BBB'; Outlook Positive

Ratings Endorsement Policy

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Fitch Ratings-New York-10 May 2013: Fitch Ratings has upgraded the Issuer Default Rating (IDR) of Black Hills Corporation (BKH) to 'BBB' from 'BBB-' and affirmed the IDR of its lead subsidiary, Black Hills Power, Inc. (BHP) at 'BBB'. The rating Outlook for both entities is revised to Positive from Stable. A complete list of ratings follows at the end of this release. Approximately \$750 million of long-term debt is affected by today's rating action.

In addition, Fitch has affirmed the short-term IDR of BKH and BHP at 'F3'.

Black Hills Corporation Upgrade

The upgrade of BKH's ratings reflects considerable progress in management's strategic plan which has downsized BKH's non-regulated business segment while redeploying capital into regulated or similar investments. The completion of the \$500 million 380 megawatt (MW) natural gas fired generation complex near Pueblo Colorado achieved commercial operation on Jan. 1, 2012 contributed strongly to earnings in 2012. While the monetization of the majority of BKH's Bakken energy interests for cash proceeds of approximately \$230 million allowed for deleveraging with the early redemption of \$225 million of relatively high coupon, 6.5% debt. Fitch expects management to achieve further progress in its debt structure as the \$250 million 9% debt approaches maturity in 2014.

Fitch sees substantial improvement in credit metrics over the next few years driven by the combination of higher earnings, reduced debt and substantially lower interest expenses. The Positive Outlook reflects this expected improvement.

KEY RATING FACTORS

- Significantly improved business and financial profile;
- Constructive regulatory environment across its utility portfolio in seven contiguous upper Midwest and Rocky Mountain states;
- Substantially improved credit metrics to be achieved over the next two years;
- High degree of financial and operational integration amongst BKH's various subsidiaries.

Significantly Improved Business and Financial Profile

Substantially all cash flows and earnings are derived from regulated activities or investments that are under long-term contract to BKH's utilities. Following the sale of Enserco, BKH's energy marketing business in March 2012, non-regulated investments consists of a legacy upstream energy exploration and development business. Fitch considers BKH's coal and competitive generation businesses which are largely contracted to BKH's utilities as possessing relatively low risk.

Capex will peak in the 2013 to 2014 time period as BKH completes the build-out of its \$237 million, 132 MW natural gas fired Cheyenne Prairie Generating Station to be owned jointly by sister utilities BHP and Cheyenne Light Fuel and Power (not rated by Fitch). The plant is expected to achieve commercial operation by the fourth quarter of 2014.

BKH also has limited exposure to environmental rules to be enacted in 2015 as its coal-fired generation is relatively new and already meets proposed federal standards. Environmental capex is estimated by management at less than \$10 million over the next three years.

Constructive Regulatory Environment

BKH operates regulated electric and natural gas utilities in seven states all of which allow for pass through of commodity and/or purchased power costs and many features other riders or recovery mechanisms that enhance timely recovery of expenses and invested capital. Transmission investments are regulated by the Federal Energy Regulatory Commission (FERC). The diversity by regulated jurisdiction further enhances the predictability of cash flows and minimizes the effects of exogenous factors.

Authorized return on equity (ROE) across its state jurisdictions ranges from 9.6% to 10.5%, about average for the industry.
Improved Credit Metrics

BHPD-EL14-034-000025

Fitch expects higher earnings, reduced debt levels, and significantly lower interest expense to produce strong and improving credit measures over the next few years. The redemption of the \$225 million of 6.5% notes results in annual interest expense savings of \$14.6 million in 2013. Fitch models a further \$10 million interest expense reduction, to be fully achieved in 2015, from the upcoming maturity of 9% notes due in 2014.

Along with further growth in regulated investments, Fitch expects EBITDA to Interest coverage to improve from 3.4x in 2012 to 5.0x over the 2013 - 2015 forecast period. Funds from operations (FFO) to debt, which already benefits from the debt reduction in 2012, are expected to remain relatively stable and average 22% over the same time period.

Financial and Operational Integration

BKH's utilities are individually relatively small and share centralized treasury functions with working capital financed through a money pool. While BHP as well as its sister utility Cheyenne Light Fuel and Power issue long term debt in their own names, the utilities purchased in 2008 including the four natural gas LDCs and Colorado Electric are held in a second tier holding company, Black Hills Utility Holdings, Inc. which is largely financed by intercompany advances from BKH.

Fitch considers BKH's liquidity adequate. BKH's \$500 million bank credit facility contains cross default covenants if BKH or its subsidiaries failed to make timely payments of debt obligations.

Along with jointly owned power plants and contracted purchase agreements by the utilities for coal from BKH's coal subsidiary and power purchase agreements from the competitive generation subsidiary, Fitch considers BKH's various subsidiaries to be highly integrated amongst themselves.

Given the strong parent and subsidiary linkage, Fitch rates BKH on a consolidated basis and equalizes the ratings of BHP with those of BKH.

Black Hills Power

BHP has displayed a consistently strong and stable financial profile and on a standalone basis, one that is slightly stronger than its parent. BHP has a conservative capital structure with equity representing 54% of capitalization at December 31, 2012 and EBITDA to Interest and FFO to Debt at 5.0x and 26.7%, respectively, compare well to rating category peers. Given the strong degree of financial and operation integration between BHP and other BKH operations, ratings are aligned with those of BKH.

RATING SENSITIVITIES

--Realization of expected financial improvement with EBITDA to Interest above 5.0x and FFO to Debt in the low 20% range could result in a positive rating action.

Following the recent debt reduction, failure to maintain the capital structure at present levels could result in negative rating action. Increased capital investment in the upstream energy business that altered the risk profile or resulted in greater leverage, could result in a downgrade.

Fitch has upgraded the following ratings with a Positive Outlook:

Black Hills Corp.

- Long-term IDR to 'BBB' from 'BBB-';
- Senior unsecured debt to 'BBB' from 'BBB-'.

Fitch has affirmed the following ratings with a Positive Outlook:


Black Hills Corp.

- Short-term IDR at 'F3'.


Black Hills Power, Inc.

- Long-term IDR at 'BBB';
- First Mortgage Bonds at 'A-';
- Short-term IDR at 'F3'.


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Applicable Criteria and Related Research

- 'Corporate rating Methodology'(Aug. 8, 2012);
- Recovery ratings and Notching Criteria For Utilities' (Nov. 12, 2012);
- 'Parent and Subsidiary Rating Linkage' (Aug. 8, 2012);
- '2013 Outlook: Utilities, Power, and Gas' (Dec. 7, 2012).

Applicable Criteria and Related Research

Corporate Rating Methodology
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Parent and Subsidiary Rating Linkage
2013 Outlook: Utilities, Power, and Gas

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