May 11, 2018

Dominion Energy (NYSE: D)

Stock falls on recent news

CURRENT PRICE:	**$64.70**
RATING:	**HOLD**
PRICE TARGET:	**N/A**
CURRENT YIELD:	**5.2%**

EPS Estimates - Non-GAAP

	DEC 17A	DEC 18E
1Q	$0.97	$1.14A
2Q	$0.67	$0.76
3Q	$1.04	$1.01
4Q	$0.91	$1.00
	$3.59	**$3.91**

Trading Data

52-WEEK PRICE RANGE:	**$85.30-$62.31**
SHARES OUTSTANDING:	**650.5(M)**
MARKET CAP:	**$42,087(M)**
AVG. DAILY TRADING VOLUME:	**4.63(M)**
S&P 500:	**2,728**

Valuation Data

BOOK VALUE:	**$26.63**
PRICE TO BOOK:	**2.43x**
DIVIDEND:	**$3.34**

Highlights

- 1Q18 operating earnings $1.14/share vs. $0.97/share during 1Q17
- Earnings helped by mild weather & better merchant generation margins
- Interest rates, FERC ruling, and SCG situation hurts stock
- Affirmed 2018 operating earnings guidance of $3.80-$4.25/share
- Maintain HOLD rating

Company Summary

Dominion Energy, headquartered in Richmond VA, is one of the largest US electric utilities. The company has three operating units: Power Delivery, Power Generation, and Gas Infrastructure. Power Delivery operates D's regulated electric distribution, transmission and un-regulated retail business (gas & electric). Also, it provides electricity to 2.5 million customers in VA/NC. Power Generation operates the electric generation plants for D. Gas Infrastructure operates the natural gas pipeline/storage business and Dominion East Ohio. D recently purchased Questar adding regulated and unregulated gas businesses. On a combined basis, D now has 2.3 million natural gas utility customers in OH, UT, VA, WV, & WY, 1.3 million retail energy/energy related customer accounts in 13 states, 15,000 miles of gas gathering/storage/transmission pipelines and 51,000 miles of gas distribution pipelines. Also, D owns 6,600 miles of electric transimission lines and 26,200 MW of electrical production in 11 states. Since 2003 D has grown its dividend from $1.29/share to $3.34/share. 2017's operating earnings decreased to $3.59/share from $3.80/share during 2016.

For Important Disclosure information regarding the Firm's rating system, valuation methods and potential conflicts of interest, please refer to the last two pages of this report.

Recent Earnings

D reported 1Q18 operating earnings of $1.14/share vs. $0.97/share during 1Q17. The increase was due to improved merchant generation margins, farm-out transactions, normal weather patterns in the regulated service territory, and lower tax rates from the recent tax reform act. Partly offsetting these were renewable energy tax credits, higher financing costs, and additional shares of common stock. 1Q18 GAAP earnings decreased to $0.77/share from $1.01/share during 1Q17. When comparing the two quarters, operating revenues rose to $3.47 billion from $3.38 billion while total operating expenses increased to $2.59 billion from $2.31 billion as all expense categories saw higher costs. As a result, EBIT declined to $875 million from $1.08 billion.

SEGMENT RESULTS

Power Delivery reported 1Q18 operating income of $260 million vs. $252 million during 1Q17. The improvement came from lower than anticipated expenses and improved electric transmission results. Operating expenses rose slightly to $309 million from $307 million as increases in DD&A ($153 million vs. $145 million) and Other taxes ($47 million vs. $45 million) more than offset a decrease in Other Operations/maintenance ($108 million vs. $116 million). Reported segment income improved to $156 million from $125 million due mainly to lower taxes. Adjusted EBITDA improved to $423 million from $414 million and Power Delivery's contribution to D's overall earnings rose to $0.24/share from $0.20/share.

Total delivered GWh rose 8.0% to 22,162 GWh from 20,527 GWh. This occurred from sales increases in Wholesale (+24.5%), Residential (+15.1%), Commercial (+5.1%), Industrial (+4.5%), and was partly offset by a decrease in Government/Other (-5.3%).

Power Generation's 1Q18 operating income rose to $535 million from $484 million during 1Q17. The increase was due to improved margins in the merchant generation business reflective of colder weather. Operating revenues improved to $1.86 billion from $1.66 billion and outpaced a rise in operating expenses to $1.38 billion from $1.17 billion. Higher operating expenses were due to increases in electric fuel/other energy-related purchases (+$124 million), purchased electric capacity (+$31 million), DD&A (+$9 million), and other operation/maintenance (+$1 million). Adjusted EBITDA improved to $748 million from $695 million and Power Generation's contribution to D's overall earnings increased to $0.54/share from $0.41/share.

Total merchant generation sales to the NEPOOL merchant fleet rose to 4,629 GWh from 4,624 GWh while sales to the PJM Merchant fleet decreased to 1,657 GWh from 2,189 GWh.

Gas Infrastructure reported 1Q18 operating income of $383 million vs. $374 million during 1Q17. The increase occurred as higher operating revenues outpaced higher operating expenses. Operating revenues rose to $1.23 billion from $1.17 billion and operating expenses increased to $845 million from $793 million. Operating expenses rose due to increases in purchased gas (+$39 million), electric fuel/operating expenses (+$32 million), DD&A (+$11 million), other taxes (+$8 million), and were partly offset by a decrease in purchased gas (-$33 million). Adjusted EBITDA improved to $612 million from $582 million and Gas Infrastructure's overall contribution to D's earnings rose to $0.50/share from $0.42/share.

Regulated natural gas delivery revenues and regulated gas transportation/storage revenues rose to $471 million from $448 million and to $186 million from $181 million, respectively. LDC natural gas deliveries increased to 271,142 mmcf from 243,689 mmcf and sold natural gas liquids declined to 19.0 million gallons from 19.6 million gallons.

Dominion Energy has a majority ownership of Dominion Midstream Partners (DM-$14.80). During 1Q18 DM generated distributable cash flow of $52.1 million, an 18% increase over 1Q17's distributable cash flow. However, a 3/15/18 announcement by the Federal Energy Regulatory Commission (FERC) had a negative impact on DM's share price and most US natural gas pipelines owned by master limited partnerships (MLPs). D immediately filed a motion for an expedited FERC hearing regarding this issue.

FERC announced MLPs could no longer recover an income tax allowance in cost of service rates. This potentially has two negative implications for D. If the announcement stands, then it will make it harder for D to monetize its midstream assets through DM. Second, if unable to monetize assets, then it would potentially lower the amount of cash flow going from DM back to D during the next few years.

RECENT DEVELOPMENTS

VA state regulators rejected D's request to create 6 new rate structures for its Virginia non-residential customers to pay for electricity produced by renewable energy sources.

D announced its intention of building at least eight new gas powered plants in VA during the next 15 years. Also, there are plans to increase its solar generation capacity by almost 50% above 2017 levels.

In efforts to strengthen its balance sheet, and reduce debt, D issued 20 million shares of common stock at a price of $67.85/share in connection with forward sale agreements. In addition to reducing debt, the proceeds will be used for general corporate purposes and provide support for its regulated growth investments.

D's Cove Point LNG shipped its first order of liquid natural gas on 3/2/18. This facility has the capacity to liquefy approximately 750 Mcf/day of natural gas.

Connecticut regulators requested D provide evidence to back up its claim that Millstone nuclear power plants are in danger of closing and need state subsidies.

SCANA/D MERGER UPDATE:

Last year D offered to buy Scana (SCG-$35.29) in an all stock deal worth approximately $14.6 billion. However, a major impediment has arisen over the cost overruns related to two nuclear reactors being built by SCG. Current costs are $12.8 billion with estimates of over $20 billion for completion. As a result, SCG decided to cancel this project, take a writedown of $2.8 billion, and pass it on to its SC customers in the form of higher rates-as a surcharge. This would be in addition to $2 billion in costs from this project already passed onto customers.

However, whether to pass this additional costs to customers has now entered into SC's political arena. South Carolina's House voted to reject the State Senate's proposed 13% tax rate for SC Gas & Electric, and proposed an 18% cut in the surcharge to shield SC customers from Scana's failed nuclear construction project. The Governor wants to repeal the act, allowing for this surcharge, which accounts for roughly 18% of customers' SCG bills. SCG said repeal of the surcharge could force it into bankruptcy.

D stated if the South Carolina legislature made it economically unfeasible to purchase SCG, then it would withdraw its offer.

The SCG/D merger was approved by GA state legislators

Our Thoughts

For years D's stock was rewarded with a high P/E ratio due to a low interest rate environment and an earnings growth plan of 6%-8% annually through 2020 from the company's acquisiton strategy and cash flow contributions from DM - which pleased Wall Street. However, D's stock recently fell from its mid-December high of $85.30/share to its current price of $64.70/share as investors have begun to doubt the 6%-8% earnings growth story for D. This occurred for three reasons: 1) interest rates began to rise following the Fed Reserves raising of short term interest rates, 2) problems arising with the purchase of SCG, and 3) FERC's ruling affecting the ability of D to monetize its assets in DM and receive a growing cash flow stream back from DM.

During the 1Q18 earnings conference call D affirmed its 2018 earnings guidance of $3.80-$4.25/share and believes the DM situation can be resolved in a favorable manner with potential clarity coming by the end of 2018. However, despite these positive comments, Wall Street is taking a "wait-and-see" attitude to see how the DM cash flow back to D situation plays out, and the situation with SCG merger. D's stock has fallen over 23% from last December's high and we believe has limited upside until either a) interest rates decline or b) there is a favorable outcome regarding DM &/or SCG. We continue to rate this stock a hold and believe patient shareholders will be rewarded with an attractive dividend yield of 5.2%.

Risks

There is no guarantee D will improve earnings/cash flow. Declining US electric sales volumes may hurt the company's revenues and profits. Rising interest rates, higher fuel prices, negative rate case decisions, tax issues, or rising operating costs could negatively impact D's earnings. D's stock may be adversely impacted by negative equity/credit markets, terrorist attacks, and failure to comply with Sarbanes Oxley guidelines.

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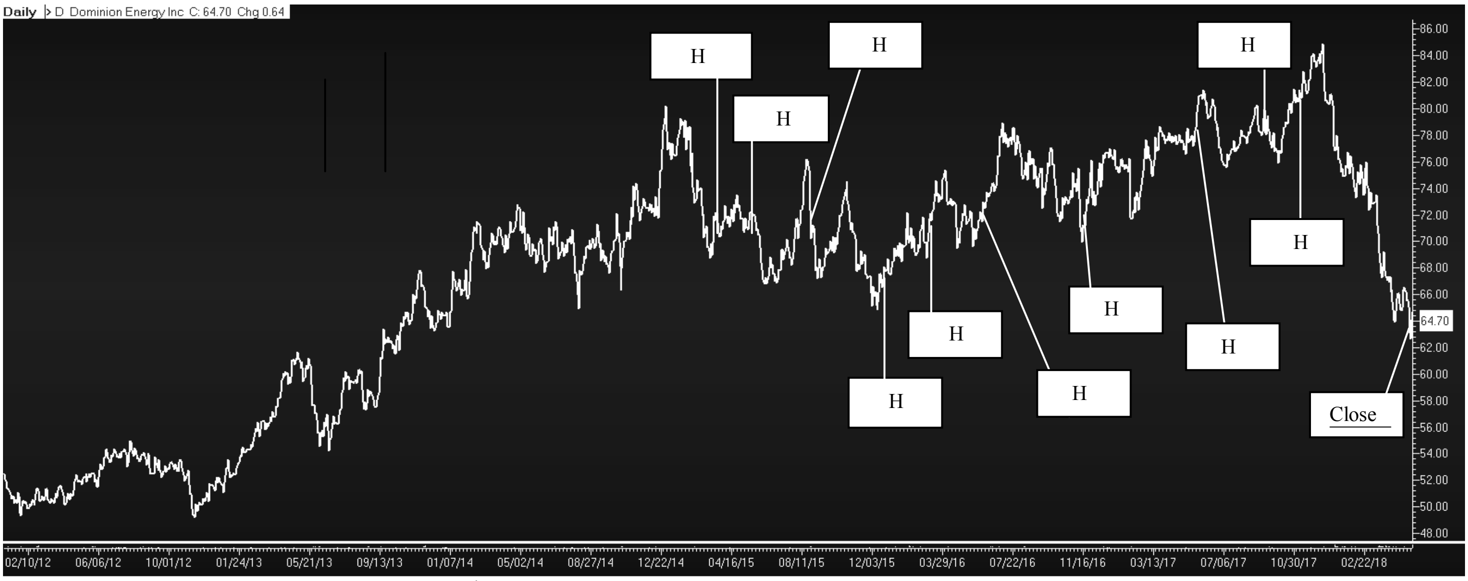
Dominion Resources
(in millions, except per share data)

	1Q17	2Q17	3Q17	4Q17	2017	1Q18	2Q18e	3Q18	4Q18e	2018e
Operating Revenue	$3,384	$2,813	$3,179	$3,210	$12,586	$3,466	$2,942	$3,215	$3,286	$12,909
Operating Expenses										
Electric fuel/other energy-related purchases	575	498	638	590	2,301	744	516	643	594	2,497
Purchased electric capacity	-17	-12	21	14	6	14	15	24	28	81
Purchased gas	305	112	24	260	701	340	141	109	243	833
Other operations & maintenance	738	779	649	709	2,875	796	758	747	716	3,017
Depreciation, depletion, & amortization	469	467	485	484	2,905	498	471	492	477	1,938
Other taxes	189	168	162	149	668	199	181	168	156	704
Total operating expenses	2,259	2,012	1,979	2,206	8,456	2,591	2,082	2,783	2,214	9,670
Income from operations	1,125	801	1,200	1,004	4,130	875	860	1,032	1,072	3,839
Other income	116	60	73	-84	165	100	67	97	82	346
Income before interest & income taxes	1,241	861	1,273	920	4,295	975	927	1,129	1,154	4,185
Interest & related charges	292	308	305	300	1,205	314	316	312	319	1,261
Income before income taxes	949	553	968	620	3,090	661	611	817	835	2,924
Income taxes	275	136	272	713	30	135	128	171	175	609
noncontrolling interests	42	27	31	21	121	23	22	37	24	106
Reported Earnings	$632	$421	$665	$585	$2,999	$503	$461	$609	$636	$2,209
Reported Earnings Per Share	$1.01	$0.67	$1.04	$0.91	$4.72	$0.77	$0.71	$0.94	$0.97	$3.39
Items excluded from operating earnings (net of taxes)	$21	$31	$7	$727	$709	$238	$33	$48	$25	$344
Operating Net Income	$611	$390	$658	$1,312	$2,290	$741	$484	$657	$651	$2,533
Operating Earnings Per Share-Diluted	$0.97	$0.67	$1.04	$0.91	$3.59	$1.14	$0.76	$1.01	$1.00	$3.91

Important Disclosures



11/27/09 $36.14 Initiate BUY
6/18/10 $42 Lower Rating to HOLD
Ratings:
Buy: B
Hold: H
Sell: S

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Steven Marascia owns shares of Dominion Energy

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