



August 15, 2018

CURRENT PRICE: \$70.25
RATING: HOLD
PRICE TARGET: N/A
CURRENT YIELD: 4.8%

EPS Estimates - Non-GAAP

| | DEC 17A | DEC 18E |
|----|---------------|---------------|
| 1Q | \$0.97 | \$1.14A |
| 2Q | \$0.67 | \$0.86A |
| 3Q | \$1.04 | \$1.01 |
| 4Q | \$0.91 | \$1.00 |
| | \$3.59 | \$4.01 |

Trading Data

52-WEEK PRICE RANGE: **\$85.30-\$62.31**
 SHARES OUTSTANDING: **653.8(M)**
 MARKET CAP: **\$45,930(M)**
 AVG. DAILY TRADING VOLUME: **3.85(M)**
 S&P 500: **2,818**

Valuation Data

BOOK VALUE: **\$27.66**
 PRICE TO BOOK: **2.54x**
 DIVIDEND: **\$3.34**

Dominion Energy (NYSE: D)

2Q18 Earnings & SCG merger/situation

Highlights

- 2Q18 operating earnings \$0.86/share vs. \$0.67/share during 2Q17
- Earnings helped by weather, LNG, taxes, & no Millstone outage
- Scana merger completion still unsettled
- 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 transmission 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.

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EQUITY RESEARCH

Recent Earnings

D reported 2Q18 operating earnings of \$0.86/share vs. \$0.67/share during 2Q17. The improvement was due to normal weather in the regulated service areas, absence of a Millstone Power Station refueling outage, the commercial operation of the Cove Point LNG project, and the positive impact of the recent tax reform. Offsetting these positives were lower renewable tax credits, higher electric capacity expense, increased financing costs, and more outstanding shares of common stock. 2Q18 GAAP earnings rose to \$0.69/share from \$0.62/share. When comparing the two quarters, operating revenues improved to \$3.09 billion from \$2.81 billion while total operating expenses rose to \$2.35 billion from \$2.06 billion. As a result, EBIT increased to \$927 million from \$861 million.

SEGMENT RESULTS

Power Delivery reported 2Q18 operating income of \$246 million vs. \$259 million during 2Q17. This occurred as revenues declined slightly to \$534 million from \$537 million, while operating expenses rose to \$288 million from \$278 million. The rise in expenses came from other operations/expense (\$88 million vs. \$87 million), DD&A (\$155 million vs. \$149 million), and other taxes (\$44 million vs. \$41 million). Reported segment income improved to \$145 million from \$127 million due to lower interest charges and taxes. Adjusted EBITDA declined to \$410 million from \$422 million and Power Delivery's contribution to D's overall earnings rose to \$0.23/share from \$0.20/share.

Total delivered GWh increased 5.9% to 20,789 GWh from 19,641 GWh. This occurred from higher deliveries to Residential (+8.9%), Commercial (+6.5%), Wholesale (+4.7%), and Governmental/other (3.7%) while being partly offset by Industrial (-2.5%).

Power Generation's 2Q18 operating income increased to \$436 million from \$348 million as operating revenues rose to \$1.64 billion from \$1.51 billion due to favorable weather. This was offset by a rise in operating expenses to \$1.20 billion from \$1.16 billion as the unit saw higher costs in electric fuel/other energy-related purchases (\$586 million vs. \$491 million) and purchased electric capacity (\$23 million vs. +\$12 million). These were partly offset by lower expenses from lower other operations/maintenance (\$371 million vs. \$446 million), DD&A (\$177 million vs. \$181 million), and other taxes (\$45 million vs. \$55 million). Adjusted EBITA improved to \$639 million from \$554 million and Power Generation's overall contribution to D's earnings rose to \$0.42/share from \$0.38/share.

Total merchant generation sales to the NEPOOL Merchant Fleet increased 16.5% to 4,859 GWh from 4,170 GWh and PJM Merchant Fleet sales decreased 19.2% to 1,594 GWh from 1,973.

Gas Infrastructure reported 2Q18 operating income \$289 million vs. \$210 million during 2Q17. This occurred as a rise in operating revenues (\$922 million vs. \$764 million) more than offset an increase in operating expenses (\$633 million vs. \$554 million). The expense increase came from electric fuel/other energy-related purchases (\$30 million vs. \$2 million), DD&A (\$157 million vs. \$128 million), other operations/maintenance (\$312 million vs. \$250



million), and other taxes (\$71 million vs. \$66 million). These were partly offset by a decrease in purchased gas (\$63 million vs. \$108 million). Adjusted EBITDA rose to \$534 million from \$423 million and Gas Infrastructures contribution to D's overall earnings increased to \$0.38/share from \$0.26/share.

Regulated Gas revenue sales rose slightly to \$151 million from \$150 million and revenues from regulated gas transmission/storage was flat at \$148 million. Natural gas deliveries increased to 176,317 mmcf from 157,405 mmcf and natural gas liquid sales declined to 20.5 million gallons from 22.7 million gallons.

Dominion Energy has a majority ownership in Dominion Midstream Partners (DM-\$15.95). During 2Q18 DM generated distributable cash flow of \$49.3 million, a 21% increase over 2Q17's level. On 6/29/18 the Board of Directors exercised its IDR reset election option outlined in the partnership agreement. By restructuring these IDRs, management believes it could make it easier to increase DM's distribution rate. Additionally, FERC recently clarified an earlier decision regarding income tax allowances, which eases potential revenue declines for MLPs. While DM & D both welcomed this clarification they are still uncertain as to the potential drop-down of assets by D into DM stating this will depend on future financial market conditions related to MLP assets. Additionally, management said they are examining the financial structure of DM and may make a decision during the next 3-6 months.

RECENT DEVELOPMENTS

The 4th US Circuit Court of Appeals vacated two permits for the building of the Atlantic Coast natural gas pipeline. D responded to this news saying it could address the issues raised by the court and expects to work with the Federal agencies to get the permits reinstated for the 600 mile pipeline.

Following the US Appeals Court permit decision, FERC issued a halt on current construction of the Atlantic Coast pipeline until the two vacated permits issue can be resolved.

FERC did approve construction of the Atlantic Coast Pipeline to begin full construction in North Carolina.

JPMorgan Chase is helping D to find potential buyers for two power plants in PA and RI. These are the natural gas-fired Fairless and Manchester Street plants, both part of the merchant generation fleet. D is seeking approximately \$1.5 billion from the sale.

The Cove Point LNG plant is scheduled to undergo a maintenance shutdown this fall. The facility has been in full operation since this past April and has annual potential capacity of 5.25 M metric tons per year. Japanese companies (Tokyo Gas & Kansai Electric Power) have signed contracts to buy 2.2 metric tons/year from Cove Point under long term contracts.



D will provide funding to GE Hitachi (GE-\$12.22) to support development of the BWRX-300, a small nuclear reactor.

The 1,588 megawatt Greenville County combined-cycle power station is 95% complete and is expected to be in commercial operation by YE18.

D recently filed its first regulatory filing of the Virginia's Grid Transformation & Security Act. The goal of this act was to increase renewable and smart grid technology designed for a more secure and efficient energy grid. D filed for phase I which includes \$900 million of investments towards grid reliability, resiliency, and security.

SCANA/D MERGER UPDATE:

Recently D offered to buy Scana (SCG-\$37.17) in all stock deal worth approximately \$14.6 billion. Due to cost overruns at two nuclear reactors, being built by SCG, the question of who would pay for these cost overruns has become a factor in the proposed merger.

The South Carolina legislature approved a temporary 15% rate reduction for customers of SCG and directed the State Commission to put it into effect. This was contested in court and a Federal judge ruled SCG's appeal for an injunction, against this rate reduction, saying the argument for the injunction was not presented properly, thus SCG will approach the court again. The rate reduction, if allowed to stand, could potentially cost SCG \$270 million per year and may cause D to reconsider the economic viability of the proposed merger.

Meanwhile, the merger with D was approved by SCG shareholders. The deal was also approved by the Federal Trade Commission, FERC, and the Georgia Public Service Commission.

Our Thoughts

A nice earnings report for D as the company reported 2Q18 operating earnings of \$0.86/share vs. \$0.67/share during 2Q17. Meanwhile, 2Q18 GAAP earnings rose to \$0.69/share from \$0.62/share. The improvement was due to normal weather in the regulated service areas, absence of a Millstone Power Station refueling outage, the commercial operation of the Cove Point LNG project, and the positive impact of the recent tax reform. Offsetting these positives were lower renewable tax credits, higher electric capacity expense, increased financing costs, and more outstanding shares of common stock.

Despite the good earnings report investors are still concerned about the outcome of the proposed merger with SCG as the proposed rate cut of 15% could deter D from completing the deal. It appears the outcome could be decided by a court decision on the implementation of the proposed rate cut. Another concern is FERC suspending construction of the Atlantic Coast Pipeline based on the 4th US Circuit Court of Appeals vacating two building



permits. However, D believes it should be able to rectify this problem with Federal authorities and restart construction of the pipeline.

During the 2Q18 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, given the recent clarification of FERC's MLP ruling. We continue to rate this stock a HOLD and believe patient shareholders will be rewarded with an attractive dividend yield of 4.8%. Furthermore, management believes growth of overall earnings will allow for dividend increases in the future.

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/regulatory rulings, 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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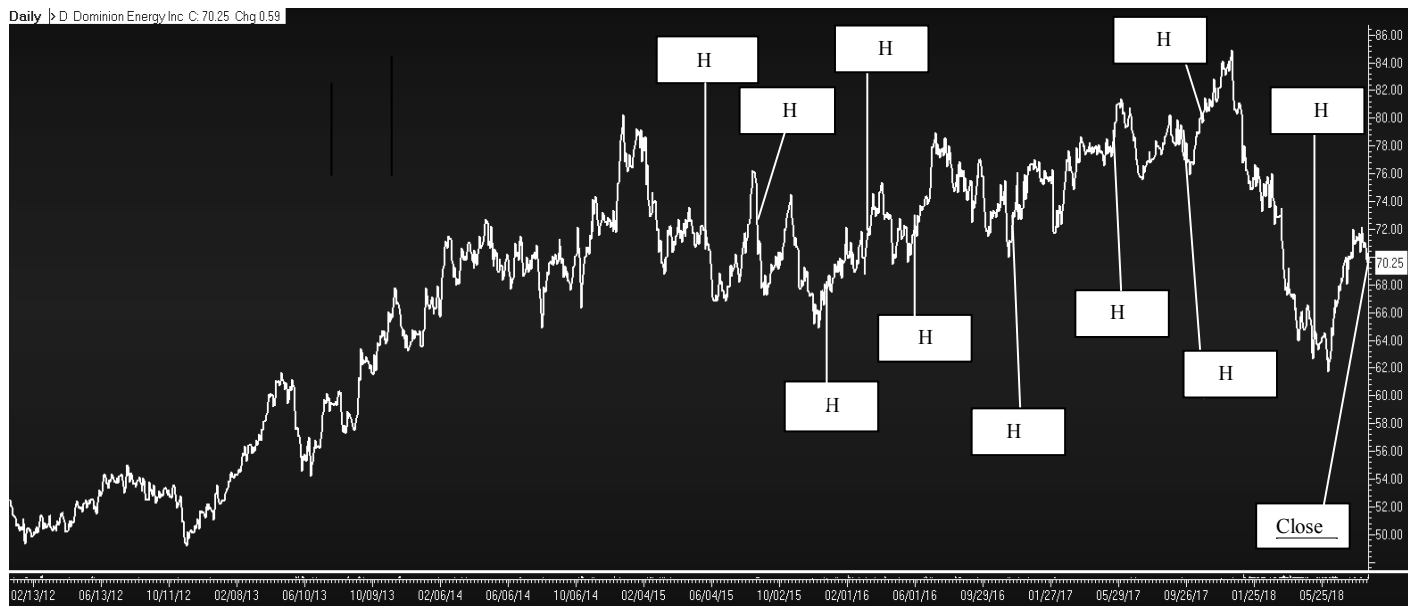
EQUITY RESEARCH

| Dominion Resources (in millions, except per share data) | | | | | | | | | | |
|--|---------|---------|---------|---------|----------|---------|---------|---------|---------|----------|
| | 1Q17 | 2Q17 | 3Q17 | 4Q17 | 2017 | 1Q18 | 2Q18 | 3Q18e | 4Q18e | 2018e |
| Operating Revenue | \$3,384 | \$2,813 | \$3,179 | \$3,210 | \$12,586 | \$3,466 | \$3,088 | \$3,215 | \$3,286 | \$13,055 |
| Operating Expenses | | | | | | | | | | |
| Electric fuel/other energy-related purchases | 575 | 498 | 638 | 590 | 2,301 | 744 | 623 | 643 | 594 | 2,604 |
| Purchased electric capacity | -17 | -12 | 21 | 14 | 6 | 14 | 23 | 24 | 28 | 89 |
| Purchased gas | 305 | 112 | 24 | 260 | 701 | 340 | 64 | 109 | 243 | 756 |
| Other operations & maintenance | 738 | 779 | 649 | 709 | 2,875 | 796 | 1,007 | 747 | 716 | 3,266 |
| Depreciation, depletion, & amortization | 469 | 467 | 485 | 484 | 2,905 | 498 | 463 | 492 | 477 | 1,930 |
| Other taxes | 189 | 168 | 162 | 149 | 668 | 199 | 166 | 168 | 156 | 689 |
| Total operating expenses | 2,259 | 2,012 | 1,979 | 2,206 | 8,456 | 2,591 | 2,346 | 2,783 | 2,214 | 9,934 |
| Income from operations | 1,125 | 801 | 1,200 | 1,004 | 4,130 | 875 | 742 | 1,032 | 1,072 | 3,839 |
| Other income | 116 | 60 | 73 | -84 | 165 | 100 | 185 | 97 | 82 | 464 |
| 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 | 361 | 312 | 319 | 1,306 |
| Income before income taxes | 949 | 553 | 968 | 620 | 3,090 | 661 | 566 | 817 | 835 | 2,869 |
| Income taxes | 275 | 136 | 272 | 713 | 30 | 135 | 88 | 171 | 175 | 569 |
| noncontrolling interests | 42 | 27 | 31 | 21 | 121 | 23 | 29 | 37 | 24 | 110 |
| Reported Earnings | \$632 | \$421 | \$665 | \$585 | \$2,999 | \$503 | \$449 | \$609 | \$636 | \$2,197 |
| Reported Earnings Per Share | \$1.01 | \$0.67 | \$1.04 | \$0.91 | \$4.72 | \$0.77 | \$0.69 | \$0.94 | \$0.97 | \$3.37 |
| Items excluded from operating earnings (net of taxes) | \$21 | \$31 | \$7 | \$727 | \$709 | \$238 | \$111 | \$48 | \$25 | \$4,422 |
| Operating Net Income | \$611 | \$390 | \$658 | \$1,312 | \$2,290 | \$741 | \$560 | \$657 | \$651 | \$2,609 |
| Operating Earnings Per Share-Diluted | \$0.97 | \$0.67 | \$1.04 | \$0.91 | \$3.59 | \$1.14 | \$0.86 | \$1.01 | \$1.00 | \$4.01 |



EQUITY RESEARCH

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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