CAPITOL SECURITIES MANAGEMENT, INC. — EQUITY RESEARCH

October 27, 2020

CURRENT PRICE:	**$82.46**
RATING:	**HOLD**
PRICE TARGET:	**N/A**
CURRENT YIELD:	**4.6%**

EPS Estimates - Non-GAAP

	DEC 19A	DEC 20E
1Q	$1.10	$1.09A
2Q	$0.77	$0.82A
3Q	$1.18	$0.89
4Q	$01.18	$0.61
	$4.24	**$3.41**

Trading Data

52-WEEK PRICE RANGE:	**$90.89-$57.79**
SHARES OUTSTANDING:	**839.4(M)**
MARKET CAP:	**$69,217(M)**
AVG. DAILY TRADING VOLUME:	**2.96(M)**
S&P 500:	**3,391**

Valuation Data

BOOK VALUE:	**$31.53**
PRICE TO BOOK:	**2.62x**
DIVIDEND:	**$3.76**

Dominion Energy (NYSE: D)

Transitioning to New Business Model

Highlights

- 2Q20 operating earnings of $0.82/share vs. $0.77/share during 2Q19
- Terminated Atlantic Coast Pipeline Project
- Shifting towards a "greener" generation mix
- Reducing annual dividend to $2.50/share from $3.76/share in 2021
- Maintain HOLD rating

Company Summary

Dominion Energy, headquartered in Richmond VA, is one of the largest US electric utilities. The company has five operating units: Dominion Energy Virginia, Gas Transmission/Storage, Gas Distribution, Dominion Energy South Carolina, & Contracted Generation. D purchased Questar, in 2016, adding regulated and unregulated gas businesses. D recently completed its purchase of SCANA. On a combined basis, D now has 3.3 million natural gas utility customers in OH, SC, UT, VA, WV, & WY, 7.5 million total energy/energy related customers in 18 states. Also, D owns 10,200 miles of electric transmission lines and 31,000 GW of electrical production. Since 2003 D has grown its dividend from $1.29/share to $3.76/share. Management recently announced it was selling its gas gathering/storage/pipeline assets to Berkshire Hathaway (BRK.A-$311,012.91).

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 2Q20 GAAP earnings of ($1.14)/share vs. $0.05/share during 2Q19. The lower quarterly earnings were primarily the result of impairment charges ($2.8 billion pre-tax) associated with the termination of the Atlantic Coast Pipeline and net gains on nuclear decommissioning trust funds. Total operating revenue fell to $3.59 billion from $3.97 billion due to the covid-recession and milder weather. Operating expenses decreased to $3.05 billion from $4.51 billion, mainly due to lower purchased gas costs and electric fuel/other energy-related purchases. When comparing the two quarters, operating earnings rose to $0.82/shshare from $0.77/share. Three D's five operating units improved quarterly profits and results were hampered by unfavorable weather trends during 2Q20. The improved results came from Dominion Energy Virginia ($0.52 vs. $0.49), Gas Distribution ($0.10 vs. $0.08), Contracted Generation ($0.03 vs. $0.02), with a decline in Dominion Energy South Carolina ($0.09 vs. $0.12), and flat results in Gas Transmission/Storage ($0.22 vs. $0.22).

SEGMENT RESULTS (2Q20 vs. 2Q19)

Dominion Energy Virginia: Reported operating earnings of $437 million vs. $393 million. Improvement results came from falling expenses ($1.11 billion vs. $1.31 billion) more than outpacing a decline in revenues ($1.81 billion vs. $1.94 billion). The decrease in operating expenses came from lower electric fuel/other energy-related purchases (-$168 million), purchased electric capacity (-$21 million), other operations/maintenance (-$21 million), and were partly offset by higher DDA (+$8 million) and other taxes (+$2 million).

Gas Transmission/Storage: Reported operating earnings of $184 million vs. $177 million. The higher results came from lower expenses (-$188 million), offsetting a revenue decrease (-$178 million), and was aided by a decline in interest expense (-$55 million). Lower expenses during 2Q20 resulted from a decrease in purchased gas (-$139 million), other operations/maintenance ($-27 million), electric fuel/other energy-related purchases (-$12 million), DD&A (-$7 million), and other taxes (-$3 million).

Gas Distribution: Reported operating earnings of $87 million vs. $66 million. The increase came from slightly higher revenues ($402 million vs. $400 million) and lower operating expenses ($313 million vs. $321 million). Lower expenses during 2Q20, was the result of a decrease in other operations/maintenance ($-8 million), other taxes (-$2 million), purchased gas (-$1 million), and were partly offset by higher DD&A (+$3 million). Improved segment results were also helped by lower interest charges (-$5 million), income taxes (-$4 million), and by higher other income (+$2 million).

Dominion Energy South Carolina: Reported operating earnings of $75 million vs. $95 million. The decrease resulted from lower revenues ($635 million vs. $703 million) which were offset by lower operating expenses ($485 million vs. $532 million). Results were also helped by higher other income (+$1 million), lower interest charges (-$2 million), but hurt by higher income taxes (+$2 million).

Contracted Generation: Reported operating earnings of $21 million vs. $13 million. The increase occurred as lower operating expenses ($225 million vs. $231 million) partly offset lower revenues ($243 million vs. $253 million. Helping these results were reduced interest charges (-$5 million) and a tax benefit (+$9 million) during 2Q20.

Corporate & Other: reported operating earnings of ($1,973 million) vs. ($690 million). Revenues decreased ($230 million vs. $368 million) and operating expenses fell to $877 million from $1.03 billion. However, the ACP charge was the largest contributor to this segment's decrease in operating results.

CANCELLATION OF THE ATLANTIC COAST PIPELINE (ACP)

D, along with Duke Energy (DUK-$93.06), announced the termination of the Atlantic Coastline Pipeline (ACP) project. Continued legal challenges and cost overruns for the pipeline caused ACP's cancellation. Despite a recent positive ruling for the ACP this past summer, by the US Supreme Court, many legal obstacles remained from opposition groups, potentially creating more delays in the pipeline's construction and higher completion costs.

Originally, D and DUK, estimated ACP's total construction cost would be approximately $4 billion -$4.5 billion. However, recognizing the increased time delays, and rising materials costs, the estimated completion cost for this pipeline rose to $8 billion -$8.5 billion, and thus negatively changed the economics of ACP's operation.
Given these factors, D and DUK, announced the cancellation of the ACP. For its portion of the project, D took a pre-tax charge of $2.8 billion during 2Q20. Management stated it will replace the anticipated revenue from the ACP with "green" energy project revenues such as wind, solar, etc.

SHIFT IN BUSINESS MODEL:

For many years, D formed its business model, & future earnings growth, on natural gas and the ACP. However, given the termination of the ACP, D is now shifting its business growth model from natural gas assets to "green" energy generation. As a result, D announced it was selling its gas assets to Berkshire Hathaway (BRK.A-$311,012.91) in a deal valued at $9.7 billion, which included the assumption of $5.7 billion of debt. D plans to use the proceeds will be used to buy back up to $3 billion of its common stock and invest in "green" generation. Further, D believes, after this business shift, 90% of its future operating earnings will come from state-regulated businesses in 5 states: VA, NC, SC, OH, & UT.

Additionally, management stated the annual dividend in 2021 would be reduced to $2.50/share, from $3.76/share due to the absence of revenues from gas assets sold to Berkshire Hathaway, and in order for D to maintain its balance sheet strength. The company intends to payout 65% of its earnings to shareholders as dividends. D further stated it believes these moves could allow the company to grow 2021 earnings by 10%-11% (aided by share repurchases) and afterwards generate annual earnings growth of 6.5%.

Our Thoughts

While 2Q20 earnings were in line with expectations, the big quarterly news was D's abandonment of the ACP and selling its gas assets for $9.7 billion to Berkshire Hathaway (BRK.A-$311,012.91). The asset sale to BRK.A included Dominion Energy Transmission, Carolina Gas Transmission, Questar Pipeline, 50% interest in the Iroquois Gas Transmission System, legacy gathering/processing operations, farmout acreage, and a 25% stake in the Cove Point LNG facility. The ACP cancellation, and subsequent gas asset sale to BRK.A, marks a definitive shift in D's operating strategy.

For many years, D focused its earnings growth strategy on natural gas and natural gas assets. The conveyance of this strategy paid off for shareholders as Wall Street rewarded this stock with a higher price-to-earnings multiple, versus its utility peers, based on this growth story. However, the narrative has now changed, given the sale of its gas assets to Berkshire Hathaway, and D has now developed a new earnings growth strategy based on "green power". Thus far, it appears Wall Street likes this new narrative as D's stock still possesses a high price-to-earnings multiple compared to its peers, despite the reduction of its annual dividend to $2.50/share from $3.76/share.

We continue to rate D a HOLD as the shares currently trade at 24.2x our 2020 earnings estimate of $3.41/share. However, given D reduced its dividend, it becomes imperative for management to grow earnings through its new business strategy. If unsuccessful, then Wall Street investors may become disappointed with the company's new growth strategy, which could cause the elimination of the high price-to-earnings multiple given D, and in our opinion, potentially create selling pressure in this stock.

Risks

There is no guarantee D will improve earnings/cash flow. Shifting its business strategy towards “green” generation may not grow future earnings as outlined by management, could be looked upon unfavorably by Wall Stree,t and result in heavy selling of D’s stock. 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, negative interest rate markets, tax issues, or rising operating costs could negatively impact D's earnings and stock price. 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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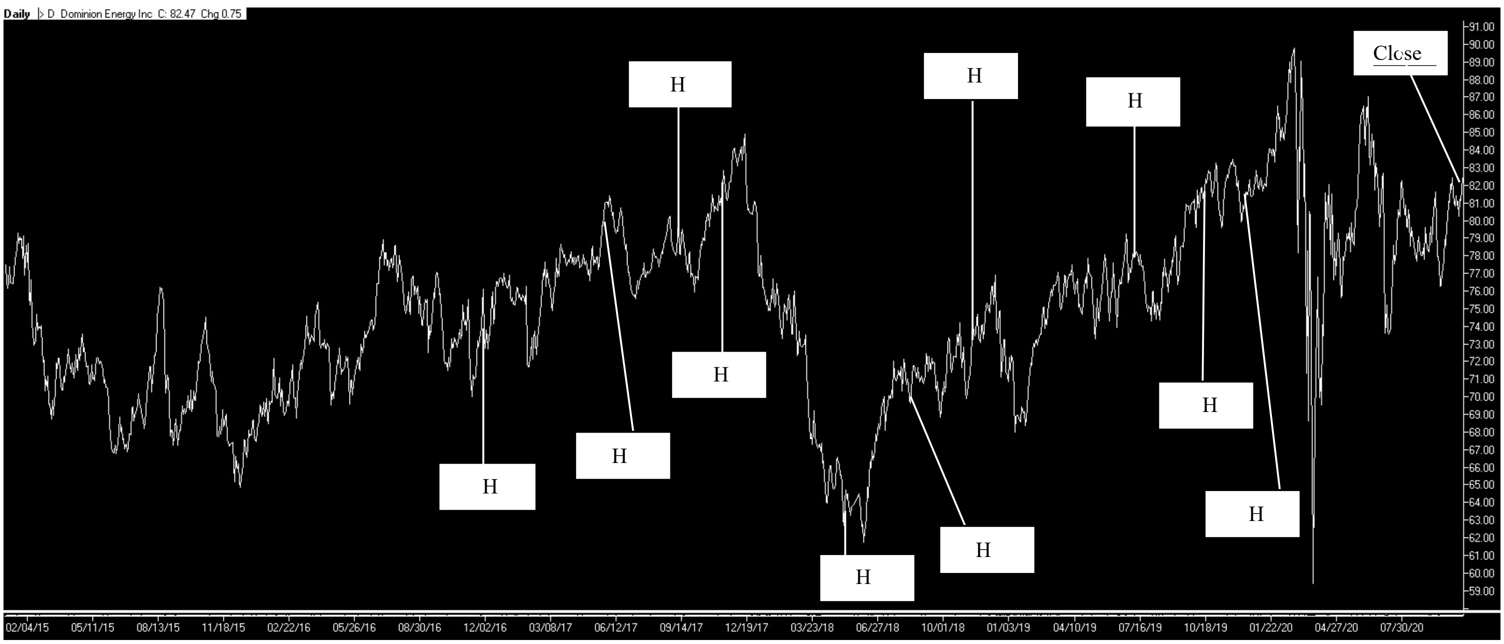
Equity Research

Dominion Resources
(in millions, except per share data)

	1Q19	2Q19	3Q19	4Q19	2019	1Q20	2Q20	3Q20e	4Q20e	2020e
Operating Revenue	$3,858	$3,970	$4,269	$4,475	$16,572	$4,496	$3,585	$4,056	$4,227	$16,364
Operating Expenses										
Electric fuel/other energy-related purchases	791	718	774	655	2,938	668	505	598	628	2,399
Purchased electric capacity	39	24	11	14	88	2	11	14	27	54
Purchased gas	730	227	153	426	1,536	427	74	126	404	1,031
Other operations & maintenance	1,837	1,595	1,095	1,154	5,681	1,811	1,526	1,545	1,496	6,378
Depreciation, depletion, & amortization	651	661	679	664	2,655	673	673	675	676	2,697
Other taxes	292	284	243	221	1,040	284	256	243	227	1,010
Total operating expenses	4,340	3,509	2,955	3,124	13,938	3,865	3,045	3,201	3,458	13,569
Income from operations	-482	461	1,314	1,341	2,634	631	540	855	769	2,795
Other income	388	92	173	333	986	-399	-1,779	128	205	-1,845
Income before interest & income taxes	-94	553	1,487	1,674	3,620	242	-1,239	983	974	960
Interest & related charges	469	452	451	401	1,773	490	449	456	456	1,851
Income before income taxes	-563	101	1,036	1,273	1,599	-258	-1,688	527	518	-901
Income taxes	114	43	51	173	381	19	556	69	79	723
noncontrolling interests	-3	-4	-10	-1	-18	-31	-37	-17	-37	-122
Reported Earnings	($680)	$54	$975	$1,099	$1,448	($270)	($1,169)	$441	$402	($596)
Reported Earnings Per Share	($0.86)	$0.05	$1.17	$1.32	$1.73	($0.34)	($1.41)	$0.53	$0.48	($0.74)
Items excluded from operating earnings (net of taxes)	$1,553	$565	$8	$111	$1,999	$1,201	$1,875	$305	$111	$3,492
Operating Net Income	$873	$619	$967	$988	$3,447	$931	$706	$746	$513	$2,896
Operating Earnings Per Share-Diluted	$1.10	$0.77	$1.18	$1.18	$4.24	$1.09	$0.82	$0.89	$0.61	$3.41

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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