HILLIARD LYONS

Electric Utilities
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COMPANY UPDATE / RATING CHANGE / ESTIMATE CHANGE

Key Metrics

D - NYSE (1/29/18)	$75.09
Price Target	$86.00
52-Week Range	$70.87 - $85.30
Shares Outstanding (mm)	643.9
Market Cap. ($mm)	$48,350
3-Mo. Average Daily Volume	3,193,000
Institutional Ownership	62.0%
Debt/Total Capital	65.4%
ROE (ttm)	14.1%
Book Value/Share	$24.47
Price/Book Value	3.1x
Indicated Dividend / Yield	$3.34 4.4%
Dividend Cycle	March, June, Sept., Dec.

EPS FY 12/31

	2016	Prior 2017E	2017	Prior 2018E	Curr. 2018E
1Q					
2Q					
3Q					
4Q					
Year	$3.80		$3.60	$4.00	$4.05
P/E	19.8x		20.9x		18.5x
Payout	74%		84%		82%

Note: Figures exclude non-recurring items

Revenue ($mm)

	2016	Prior 2017E	2017	Prior 2018E	Curr. 2018E
1Q					
2Q					
3Q					
4Q					
Year	$11,733		$12,586		$14,025

Company Description: *Dominion Energy is one of the nation's largest producers and transporters of energy, with a portfolio of approximately 25,900 megawatts of generation, 14,800 miles of natural gas transmission, gathering and storage pipeline, and 6,600 miles of electric transmission lines. Dominion operates one of the nation's largest natural gas storage systems with 1 trillion cubic feet of storage capacity and serves nearly 6 million utility and retail energy customers. Generation sources: Coal 46%, Nuclear 41%, Natural Gas 9%, Hydro and other 3%, Oil 1%.*

Dominion Energy

D -- NYSE -- Buy -- 2

Upgrading to Buy. Stock Offers Both Attractive Earnings & Dividend Growth Along With Yield.

Investment Highlights

- **We are upgrading our rating on Dominion to Buy from Neutral.** In our view, the recent 12% pullback in the stock represents an opportunity for investors looking for a combination of capital appreciation and an attractive dividend yield.
- **Earnings are expected to grow by a 6% to 8% rate from 2017 through 2020.** Earnings are expected to grow by at least 5% annually after 2020. This year's earnings are expected to grow by at least 10% from last year's $3.60 per share. Our revised 2018 earnings estimate is $4.05 per share.
- **Earnings could potentially grow by 8%+ if the company's proposed acquisition of SCANA Corp. is completed.** On January 3, Dominion and SCANA announced an agreement in which Dominion would acquire SCANA in a stock transaction valued at approximately $14.6 billion. The companies hope to complete the transaction later this year, but the deal will require both regulatory and shareholder approval.
- **Dominion recently raised its dividend by 10%.** Moreover, management expects to increase the dividend by 10% in both 2019 and 2020 as well. This is a well above industry average dividend growth rate. Dividends have been increased for 15 consecutive years.
- **The stock has an attractive 4.4% dividend yield.** This is an above average dividend yield for a utility with Dominion's growth profile.
- **We rate Dominion a Buy with an $86 price target.** We believe Dominion has an attractive fundamental outlook with several potential growth drivers. In our view, Dominion is an appropriate holding for investors seeking both capital appreciation and rising dividends. Our $86 price target implies a potential one year total return of 18%. However, we believe Dominion is also a suitable core holding for long-term accounts.

Note Important Disclosures on Pages 3 and 4.
Note Analyst Certification on Page 3.

Rationale for Rating Change

We believe the recent 12% pullback in Dominion's share price represents an opportunity for investors. In our view, the pullback is due to weakness in the electrics because of interest rate fears along with uncertainty surrounding the company's proposed acquisition of SCANA. Yet we believe Dominion is attractive in several respects. It offers both above industry average earnings and dividend growth while also providing an attractive current 4.4% dividend yield. While the current valuation is admittedly not compelling at 18.5x estimated 2018 earnings, we don't find it unreasonable for a premium quality utility with these favorable growth characteristics. We find it unusual for a utility with above average earnings and dividend growth to offer a 4.4% yield, and have raised our rating to Buy from Neutral.

Recent Results

Dominion reported fourth quarter operating earnings of $0.91 per share versus $0.99 per share in 2016's fourth quarter. Earnings were slightly above expectations. For the year, D earned $3.60 per share compared to $3.80 per share in in 2016. Earnings in 2017 were negatively impacted by unfavorable weather in its regulated utility service territory, a second Millstone plant refueling outage, a step down in solar investment tax credits, and a reduction of Cove Point import contract revenues. Our 2018 earnings estimate is $4.05 per share.

SCANA Acquisition

On January 3, Dominion and SCANA Corp., a South Carolina utility, announced an agreement in which Dominion would acquire SCANA in a stock transaction valued at approximately $14.6 billion. Under the proposed terms, SCANA shareholders would receive 0.669 shares of Dominion for each SCANA share held. SCANA saw its fortunes decline last year after the company cancelled its plans to build a new nuclear unit. The companies hope to complete the acquisition later this year. However, the transaction must receive both regulatory and shareholder approval. In addition, some legislators in South Carolina are attempting to repeal a law that would allow recovery of costs. Should this occur, Dominion may walk away from the deal. Thus, there remains considerable uncertainty as to whether the deal eventually takes place. We view the proposed acquisition as an opportunistic move on Dominion's part. D indicated the deal would be immediately accretive and boost its earnings growth rate. While a potential positive for Dominion, we are not assuming that the transaction is completed in our upgrade.

Other Developments

Management indicated during its conference call that the construction of its Cove Point Liquified Natural Gas facility is complete. It is now in the final stages of commissioning and the company expects it to become operational in early March. Cove Point is expected to contribute to this year's earnings and become a consistent earnings contributor going forward. Also, the company is moving forward with its Atlantic Coast Pipeline and Supply Header plans. This is an infrastructure project in which Dominion is partnering with Duke Energy and Southern Company that will create an underground pipeline to better serve consumers in Virginia and North Carolina. The project is expected to be completed in the second half of 2019.

Outlook

We believe Dominion has an attractive fundamental outlook between its core regulated utility operations in Virginia and other energy related businesses. Earnings are expected to grow by at least 10% this year and by a 6% to 8% rate between 2017 and 2020. Management indicated earnings could grow by 8%+ if the company is able to complete its acquisition of SCANA. Earnings are expected to grow by at least 5% annually beyond 2020. Also, with regard to tax reform, Dominion indicated it would provide a $0.10 to $0.15 per share positive impact as a result of lower taxes on its non-regulated operations. In addition, the company recently indicated it intends to raise its annual dividend by 10% for three consecutive years. *This is an unusually strong dividend growth rate for a utility.* The first dividend increase has been declared, and we expect similar 10% increases at the start of both 2019 and 2020.

Rating

We rate Dominion a Buy and regard it as a suitable holding for investors seeking both capital appreciation and rising dividends. We are attracted to both its earnings and dividend growth prospects along with its attractive 4.4% dividend yield. In our view, Dominion is a well-managed, high quality company that has performed well for its shareholders over the years. Accordingly, we believe D is also suitable for long-term total return accounts as a core utility holding.

Valuation

Our one year price target is $86. Dominion currently trades at 18.5x estimated 2018 earnings of $4.05 per share. If the company delivers on both its projected earnings and dividend growth we believe this multiple could expand modestly. At a price of $86, the stock would trade at 19.5x estimated 2019 earnings of $4.40 per share. Our one year price target implies a potential total one year return of approximately 18%.

Suitability

We assign a 2 suitability rating to Dominion Resources. The company generates the majority of its earnings from its regulated utility assets, which has allowed for consistent earnings and dividend growth. In addition, the company does have some merchant generation exposure and is pursuing additional energy projects. As a result, it carries somewhat more risk than a completely regulated utility. We view Dominion as an appropriate holding for utility investors seeking total return.

Investment Risks

There exist a variety of risks that could prevent the stock from attaining our price objective. These would include economic weakness in Dominion’s service territory, resulting in lower customer growth, demand and usage. There could be potential delays in the opening of the company’s Cove Point Liquified Natural Gas facility, which could lessen the expected earnings contribution from this project. Other factors include unfavorable weather or unfavorable natural gas prices, which could potentially impact D’s Millstone merchant generation plant. There could be potential problems associated with the proposed acquisition of SCANA. There is also the possibility of delays with its Greensville gas fired combined cycle plant or its Atlantic Coast Pipeline project. In addition, the share price could negatively be impacted by changing regulatory conditions at the federal or state level along with higher interest rates, which could raise the cost of capital.

Additional information is available upon request.

Prices of other stocks mentioned: SCANA Corporation (SCG-$43.31), Duke Energy (DUK-$77.29), and Southern Company (SO-$43.99).

Analyst Certification

I, David B. Burks, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

Important Disclosures

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons’ profitability. They do not receive direct payments from investment banking activity.

Investment Ratings
Buy - We believe the stock has significant total return potential in the coming 12 months.
Long-term Buy - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.
Neutral - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.
Underperform - We believe the stock is vulnerable to a price set back in the next 12 months.

Suitability Ratings
1 - A large cap, core holding with a solid history
2 - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks
3 - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage
4 - Speculative, due to small size, inconsistent profitability, erratic revenue, volatility, low trading volume or a narrow customer or product base

	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
Rating	**# of Stocks Covered**	**% of Stocks Covered**	**Banking**	**No Banking**
Buy	31	28%	10%	90%
Hold/Neutral	75	67%	9%	91%
Sell	6	5%	0%	100%

As of 8 January 2018

Other Disclosures

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