Company Name: Dominion Resources
Company Ticker: D US
Date: 2016-10-31
Event Description: Q3 2016 Earnings Call

Market Cap: 46,525.48
Current PX: 74.35
YTD Change($): +6.71
YTD Change(%): +9.920

Bloomberg Estimates - EPS
Current Quarter: 1.021
Current Year: 3.790
Bloomberg Estimates - Sales
Current Quarter: 3803.600
Current Year: 12476.917

Q3 2016 Earnings Call

Company Participants

- Thomas E. Hamlin
- Mark F. McGettrick
- Thomas F. Farrell

Other Participants

- Julien Dumoulin-Smith
- Jeremy B. Tonet
- Steve Fleishman
- Rose-Lynn Armstrong
- Angie Storozynski
- Praful Mehta
- Michael Lapides

MANAGEMENT DISCUSSION SECTION

Thomas E. Hamlin

GAAP and Non-GAAP Financial Measures

Also, on this call, we will discuss some measures of our company's performance that differ from those recognized by GAAP

Reconciliation of our non-GAAP measures to the most directly comparable GAAP financial measures we are able to calculate and report are contained in the Earnings Release Kit and Dominion Midstream's press release

Mark F. McGettrick

Financial Highlights

Earnings

- Dominion Resources' reported operating earnings of $1.14 per share for the current quarter of 2016, finishing well above the top of our guidance range
- Positive factors relative to guidance for the quarter were favorable weather, lower operating expenses, and earlier approval of our Questar acquisition and partnership income from one of our large solar projects
- Some of the partnership income is timing-related and will reverse in Q4
- Negative factors were an unplanned outage at Millstone and higher major storm restoration cost
- GAAP earnings were $1.10 per share for Q3

- The principal difference between GAAP and operating earnings were charges related to transaction cost for our merger with Questar
  - A reconciliation of operating earnings to reported earnings can be found on Schedule 2 of the Earnings Release Kit

Operating Segment

EBITDA, Costs and Operating Expenses

- Moving to results by operating segment, for Dominion Virginia Power, EBITDA for Q3 was $423mm, which was in the upper half of its guidance range
- Favorable weather conditions were partially offset by higher major storm restoration costs
- Dominion Generation produced EBITDA of $921mm in Q3, which exceeded the top of its guidance range
- Favorable weather was the principal factor in the strong performance, partially offset by an unplanned outage at Millstone
- Third quarter EBITDA for Dominion Energy was $310mm, which was above the top of its guidance range
- Lower operating expenses and an earlier-than-planned contribution from Questar were the principal drivers of the strong results
- Overall, we are very pleased with the performance of each of our operating segments

Midstream Partners

EBITDA, Cash Flow and Distribution

- For Q3 2016, Dominion Midstream Partners produced adjusted EBITDA of $27.9mm, 37% higher than the level produced in Q3 last year
- Distributable cash flow increased 22% to $24.1mm, which was consistent with management's expectations
- On October 21, Dominion Midstream's Board of Directors declared a distribution of $0.2475 per unit payable on November 15
  - This distribution represents a 5% increase over last quarter's payment and is consistent with our plan to achieve 22% annual distribution growth for LP units

Cash Flow, Liquidity and Credit Facilities

- Moving to cash flow and treasury activities at Dominion, funds from operations were $3.1B for the first nine months of the year
- We have $5.5B of credit facilities and, taking into account cash, short-term investments and commercial paper outstanding, we ended the quarter with available liquidity of $2.5B.
- For statements on cash flow and liquidity, please see pages 14 and 25 of the Earnings Release Kit

Financing Transactions

Public Debt Financing Planned and Operating Earnings

- During Q3, we completed a number of financing transactions to support our growth plan and cover the acquisition of Questar
- Slide 6 highlights our recent financing activities
- We have one public debt financing planned for the remainder of this year at VEPCO.
- Looking ahead to Q4, Dominion's operating earnings guidance is $0.90 to $1.05 per share
  - The midpoint of that range is $0.28 per share above operating earnings of $0.70 per share for Q4 2015

Capacity Expenses, Financing Costs and DD&A

- Positive earnings drivers for the quarter compared to last year are a return to normal weather, the absence of a refueling outage at Millstone, lower capacity expenses and the addition of Questar
- Negative drivers for the quarter compared to last year include higher financing costs and DD&A
- Dominion's operating earnings guidance for the year remains $3.60 to $4.00 per share

Hedging

- As to hedging, you can find our hedge positions on page 27 of the Earnings Release Kit
- As of mid-October, we have hedged 8% of our expected 2017 production at Millstone
  - We expect to add to our hedges over the next three months and plan to have about 80% of our 2017 production hedged by the end of January

Summary

Operating Earnings

- So, let me summarize my financial review
- Operating earnings were $1.14 per share for Q3 2016, which was well above our guidance range
- Operating results for Dominion Midstream Partners were in line with management's expectations
- And finally, Dominion's operating earnings guidance for Q4 is $0.90 to $1.05 per share and full-year earnings guidance remains $3.60 to $4.00 per share

Thomas F. Farrell

Q3 Highlights

Operational and Safety Performance

- Strong operational and safety performance continued in Q3
- All of our business units are on track to meet their safety goals for the year
- We expect to set another company-wide safety record this year

- Our nuclear fleet continues to operate well
- The net capacity factor of our six units was 93% for the first nine months of the year
- The contribution of the Brunswick County Power Station helped our regulated power generation group achieve record net generation

Growth Plans

Construction and Solar Projects

- Now, for an update on our growth plans
- Construction of the 1,588-megawatt Greensville County combined cycle power station continues on time and on budget
    - Approximately 480 workers are on site performing civil and structural work
- The $1.3B project is expected to achieve commercial operations in late 2018
- Our two large contracted solar projects, Four Brothers and Three Cedars in Utah, were completed in September on time and on budget
    - We own 50% of the two projects that have a combined capacity of 530 megawatts and are secured by 20-year power purchase agreements
- We have a number of solar projects under development in the state of Virginia, and continue to see demand for renewables from our customers, including datacenters, military installations and the state government
- The 80-megawatt solar facility on Virginia's Eastern Shore is complete and went into the service – went into service over this past weekend
    - Three other Virginia solar projects totaling 56 megawatts are also expected to be in service by year-end
- Earlier this month, we announced a 60-megawatt solar development in North Carolina, secured by 25-year power purchase agreements
    - This project should also be in service by the end of this year

State Corporation Commission

- We have filed with State Corporation Commission for approval of an additional 20-megawatt solar facility at the site of our Remington power station to be in service next year
- In July, we signed a lease with the Department of the Navy to develop an 18-megawatt solar facility at the Oceana Naval Air Station in Virginia
- If approved by the State Corporation Commission, this solar facility is expected to be in service by late next year
    - This will bring our operating solar fleet to 1,200 megawatts by the end of 2017
- We are in discussions with multiple parties for further solar development in the future, and we fully expect to exceed our goal of adding 500 megawatts of solar farms in Virginia and North Carolina

Electric Transmission Projects

- We have a number of electric transmission projects at various stages of regulatory approval and construction. $580mm worth of these facilities have been completed so far this year, including our new systems operation center
  - We expect to place over $730mm of new transmission assets into service by year-end

Growth Plan for Dominion Energy

Cove Point Liquefaction Project

- Progress on our growth plan for Dominion Energy continues as well
- Our Cove Point Liquefaction project is now 75% complete, with over 2,000 construction workers on site
- Our engineering, procurement and construction contractor, IHI/Kiewit, has installed well over half of the 21,500 tons of the structural steel required, and the piping installation is proceeding on plan
  - All major components have been delivered to the site, and all will be installed on their foundations by year-end

Operation Staffing Plan

- Our operation staffing plan is also on schedule
- The project continues to be on time and on budget for a late 2017 in-service date
- We continue to work towards the commencement of construction on the Atlantic Coast Pipeline and the related Supply Header Project
- FERC issued its Notice of Schedule on August 12
- We expect to receive the Draft EIS in a few weeks and the final EIS in June
  - We anticipate beginning construction upon receipt of the FERC certificate during H2 next year

Surveying and Pipeline Engineering

- Surveying and pipeline engineering is nearly complete and will be finished this year
- We're finalizing our detailed construction plans, and on September 16, executed the construction contract with Spring Ridge Constructors
  - We expect completion of the Atlantic Coast Pipeline and Supply Header in H2 2019

Pipeline Growth Projects

- In addition to the Atlantic Coast Pipeline and Supply Header, we have 10 pipeline growth projects underway with $1B of investment to move 1.5mm cubic feet per day for customers by the end of 2018
- On the [indiscernible] (13:02) project, with more than 200,000 dekatherms per day of capacity, it was put into service in October
  - And we have another three projects to come online this year
- Our new expansion projects are primarily demand driven, moving gas and to end-use power generators for local distribution companies

Regulatory Matters

- In regulatory matters, hearings were held earlier this month for Dominion's base rate case for our North Carolina service territories, seeking approval of $51.1mm increase in base rate revenues
- A settlement was reached with the staff and a group of investor customers calling for $34.7mm increase based on a 9.9% return on equity
    - We will implement the proposed rates subject to refund tomorrow with permanent rates becoming effective January 1 of next year
- A decision is expected in December

Merger with Questar Corporation

- Finally, I want to update you on our merger with Questar Corporation
- The Public Service Commission of Utah approved the merger on August 23 and the Wyoming Public Service Commission approved it on September 14
    - We completed the merger two days later
- Ron Jibson, Questar's retired Chairman and CEO, has joined Dominion's Board of Directors
- Harris Simmons, the former lead Director for Questar has joined the board of Dominion Midstream Partners
- We are excited about adding Questar to Dominion's operations and look forward to developing new growth opportunities in the Western states

Summary

So to summarize, our business has delivered strong operating and safety performance in Q3

Construction of the Greensville County project is on time and on budget

Construction of the Cove Point Liquefaction project is on time and on budget

We continue to work toward FERC approval for the Atlantic Coast Pipeline and the Supply Header Project

And we are excited about our future opportunities that will come as a result of our merger with Questar

Mark F. McGettrick

Q3 Results

Financing Transactions and Equity & Discount to Market

- We issued press releases this morning announcing the launch and subsequent pricing our Dominion Midstream financing to acquire Questar Pipeline
- I wanted to discuss it on this afternoon's call for a number of reasons
- First, it represents one of the largest financing transactions by a publicly traded MLP this year

- Second, based on the low initial yield for the preferred equity and the modest discount to market for the common units, this financing was the least expensive for an MLP issuer this year
  - It provides clear evidence of the high level of interest by investors in DM equity

Demand for Common Equity and Strategic Plan

- Third, despite being one of the largest offerings this year, demand for the common equity was significantly oversubscribed, leading us to upsize the offering
- Fourth, the successful financing validates our strategic plan for Dominion Midstream Partners which involves accessing capital markets at advantageous terms to fund the acquisition of midstream assets from Dominion that will in turn support a 22% annual distribution growth rate
  - And finally, this successful financing in low-achieved yields confirm the value accretive proposition underlying the formation of Dominion Midstream two years ago for investors of both D and DM.

Questar Pipeline

- As noted in this morning's press releases, Dominion Midstream Partners will acquire 100% interest in Questar Pipeline on or about December 1 for an implied enterprise value of $1.725B or about 10.3 times 2016 EBITDA.
- About $435mm of existing long-term debt will remain in place at Questar Pipeline, leaving net consideration of just about $1.3B.
  - As announced this morning, we have priced common unit offering including both an underwritten offering in a private placement totaling some $500mm assuming underwriters exercise the greenshoe option

MLP Unit Offerings

- Again, I would note that this common unit offering registered is one of the largest MLP unit offerings of the year and at just 2.9% reflects, by far, the smallest discount to any trade of any offering this year

Stonepeak Infrastructure Partners

Convertible Preferred Securities

- We have also received commitments from a group of private investors led by Stonepeak Infrastructure Partners for up to $600mm in convertible preferred securities, which was priced together with this morning's offering and which closes in conjunction with the transaction close on December 1
- Among comparable securities offered by MLPs, this preferred security has the lowest ever initial yield of 4.75% and an attractive conversion premium of 15%
  - It is clear from the interest in DM preferred structure, investors see very high growth potential in DM shares
- We very much appreciate the overwhelming interest and participation in this offering from both public and private investors

Cash

- At closing, the cash consideration to Dominion provided by these offerings will be used to repay existing Dominion level debt
- We will also refinance the existing DM intercompany note with a three-year term note from a group of banks
- As shown on slide 19, including the $1.2B of proceeds from this transaction, we expect the MLP to generate about $7B to $8B in cash for Dominion through 2020
  - Which will be used to reduce holding company debt, increase dividends, invest in new growth projects and repurchase common stock

D/DM Structure

- We realize the D/DM structure is somewhat unique in the utility space, and investors have been waiting for us to begin to execute our dropdown strategy
- We expect that with the success of today's transactions, both D and DM investors will see the clearer long-term growth in value for both shareholders and unit holders

QUESTION AND ANSWER SECTION

<Q - Julien Dumoulin-Smith>: First quick question, can you elaborate just a little bit on the Millstone hedging plan from here on out? I just want to make sure if I heard you right; 80% from 8% largely today by early 2017. Is that sort of irrespective of the commodity environment? And perhaps, more importantly, how are you thinking about hedging future years, 2018, 2019 at this point?

<A - Mark F. McGettrick>: The answer to the first part of your question is it's regardless of what the market power price will be between now and the end of January. We committed over many years to investors and the credit agencies that there'll be a clear firm cash flow stream from Millstone as we put guidance out in the current period. So we've always hedged Millstone in the 80%-plus range by the end of the year call, and we plan on doing the same for 2017.

In terms of future periods, we will be very cautious on hedging Millstone for a number of reasons. One is we believe that the current forward strip is dramatically understating the value of the market. And second, as you know, there is a lot of discussion in Connecticut about potential legislation and the ability to Millstone bid into future auctions. We hope that would be cleared up in H1 next year, and we would want to see what the outcome of that would be before we hedge 2018 and beyond.

<Q - Julien Dumoulin-Smith>: Just to follow up real quickly – obviously, well done on closing Questar. Just what's the status in terms of future growth opportunities? Can you elaborate just real quickly in terms of where you stand on some of the initial thoughts you'd originally delineated with that transaction?

<A - Thomas F. Farrell>: The more we look, the more opportunities we see. The West – that part of the West is largely powered by coal-fired power plants. Many of them are going to have to close or be converted to natural gas. There's an increasing amount of RPS requirements in states on – particularly on the Western Sea Coast where, as you know, and I think investors know, the more renewables that are built, the more gas-fired peakers are going to be required to deal with the fact that it's intermittent.

So, that's just one potential opportunity that we see in the West. There's a lot of natural gas infrastructure that's going to be required in the future there. Now, it's not on the same scale obviously as the Mid-Atlantic as far as population goes. But starting from the base that we have in the West, we think there's a tremendous amount of opportunity.

<Q - Julien Dumoulin-Smith>: But nothing more specific at this point in time?

<A - Thomas F. Farrell>: Nothing more after six weeks of ownership, no.

<Q - Jeremy B. Tonet>: Especially on the preferred, which effectively look like the same cost of equity as the common when factoring in the IDRs. Given your ability to access far more equity than the majority of your MLP peers out there, I'm just wondering if you can provide us any updated thoughts as far as what you think about opportunistic M&A out there given your ability to access so much equity on attractive terms today.

<A - Mark F. McGettrick>: We were very pleased – although we were always confident, as we've stated to investors over the past nine months, based on what we've heard from investors [ph] that lack (24:39) liquidity in the DM stock. We knew there'd be a lot of interest. We've been particularly pleased with the convert and interest shown in that by multiple parties, and the very aggressive financing around that. So, I think that just reinforces our view that if we see an asset out there that fits the DM profile that we can fund it within the DM umbrella if we need to, or with D parent support if required. But I think today's results just validate for us that the DM shares are highly valued and will be a great source of future equity financing if we decide to enter the M&A [ph] stage (25:20) at all.

<Q - Jeremy B. Tonet>: And then, just one follow-up if I could. There's been some concern in the market with regards to recent developments from the IRS, and just wondering if you might be able to comment there, maybe this alters one mechanism that you guys were looking at for dropdowns, but it seems like your targets over time would be largely unchanged. Is that a fair way to think about things?

<A - Mark F. McGettrick>: Our targets will be unchanged, and I think your reference is that the IRS after this CY do not allow certain tax shields that existed prior to that – that MLPs can make themselves available to. But we have a long-term tax planning for each of the years through 2020. We were aware of that potential down the road, and it will not impact either our growth rate or distribution focus going forward. That has been incorporated into our tax planning for quite some time.

<Q - Steve Fleishman>: You mentioned this solar that you booked in the quarter, but then some of it will come out in Q4. Could you just explain that a little better?

<A - Mark F. McGettrick>: This solar involves partnership income from one project, Four Brothers in Utah, and it's complicated partnership accounting. When we put the guidance out – actually, when we put the budget together this year, we thought the contribution will be evenly distributed over a number of quarters, but the final accounting determination required us to book $0.04 in Q3 and that will roll off $0.02 in Q4 and $0.02 in H1 next year. So that's a timing issue for the quarter, but for year-end, there's no impact on our guidance at all.

<Q - Steve Fleishman>: And then, can I just have handy the number for the full year of what you're expecting for earnings to be for 2016?

<A - Mark F. McGettrick>: And I believe – in terms of ITCs, I think we're looking about $290mm.

<Q - Steve Fleishman>: And then, on the transaction, which is great, you got that done. The – just in terms of thinking about kind of the – so you're selling the asset down, you're getting the IDRs back. I think you're keeping – what percent of DM are you going to own now after this transaction?

<A - Mark F. McGettrick>: North of 50% still.

<Q - Rose-Lynn Armstrong>: Can you provide an update on the outlook for the ITC realization in 2017? I think on the last quarter call, you indicated potential for up to $0.30 of ITCs next year.

<A - Mark F. McGettrick>: I would continue to model $0.30 for next year.

<Q - Rose-Lynn Armstrong>: And are those from identified projects at this point or still to be announced, still to be determined?

<A - Mark F. McGettrick>: Almost all of them are identified. We have a few others that we're still working on. But I would say we're very far down the road in terms of identifying what supports the ITC estimate for 2017.

<Q - Angie Storozynski>: I just want to go back to the 2017 guidance. So, what do we need as far as developments to happen for you to be able to provide 2017 guidance? Are we waiting for some legislative actions in Connecticut? Are we waiting for the start of commercial testing at Cove Point, or are we simply waiting for the annual Analyst Day around, say, February, March timeframe?

<A - Mark F. McGettrick>: Angie, for 2017, we almost always give guidance on the year-end call, which is typically at the very end of January, beginning of February. The only thing we're really waiting on for 2017 is what will the actual hedge price be at Millstone. And since we're pretty open at Millstone right now, we hesitate giving any guidance range for 2017 until we're much further down the road on hedging.

<Q - Angie Storozynski>: And now, the dropdown today to DM, clearly very successful, but is it coming a bit early in a sense – I understand that the funds that you're raising from DM are aimed to de-lever the balance sheet, but are you, in a sense, trying to manage your interest expense for 2017 by accelerating this DM dropdown, or is it simply an opportunistic timing?

<A - Mark F. McGettrick>: It's more of the latter. We really believe we have overhang on both these stocks based on an anticipated offering at DM. We also, I think – as I mentioned earlier, people have been waiting for us to validate the structure of D and DM and those advantages and really answer the question, can you access the equity market at DM at a very high level that benefits both DM and D. So, based on that, we elected to go early. We didn't have to do it until Q3 next year, but we wanted to get it behind us. It does help us on financing a little bit at D next year, but the principal reason was to validate the model and to show the investor base that DM is a security that is sought after and has huge benefits to DM and D shareholders.

<Q - Angie Storozynski>: And then, the last question on Atlantic Coast Pipeline. So, with the start of construction in, I think you said, H2 2017, are we basically assuming that you're booking AFUDC from the moment you start construction, and so the impact on earnings of the delay of the start of operations [indiscernible] (32:53) simply because you're booking AFUDC earning during construction?

<A - Thomas F. Farrell>: That's why you ought to have it in your – in mind.

<Q - Praful Mehta>: The first question – hi. Good afternoon. First question was on – you've kind of indicated the $7B to $8B of cash that you expect Dominion to generate from the MLP through 2020. Just wanted to understand what kind of financing mix you're thinking about at the MLP to kind of fund the growth and kind of pay back Dominion. And secondly, in terms of future ownership, how do you see that ownership level of Dominion stay over this timeframe through 2020?

<A - Mark F. McGettrick>: You're going to see it, and today's examples are a good one. You're going to see the financing will be a combination of preferred common units and debt by adding leverage at DM; although, we said many times that we're going to make sure it's investment-grade rated when we decide to rate it, but it'll be a mix of the three. We'll also potentially take back some units as part of that for tax planning purposes.

But again, with the ability today and the market we have today to raise over $1B for the first transaction out there, and as the size of DM grows over the next couple of years, we're very optimistic about being able to place the financing.

In terms of ownership, I think you could – should assume that for the next several years our ownership is going to stay in the 50% range, and then over time, toward the end of the decade, start to move down more into the 40% range.

<Q - Praful Mehta>: And then originally, you were talking about Millstone, and just nuclear in general, you were talking about – thinking about hedging depending on the support you get. Just wanted to get a little bit more color on what you expect in terms of the kind of support, is it similar to a New York ZEC kind of program or what you expect and where in the regulatory approval process it stands right now?

<A - Thomas F. Farrell>: Let's go back to – the hedging will happen, as Mark said, regardless of what the price is. We've done that for a long time and we will continue to do it into the future. So everybody knows what expectations we should have for earnings and cash flows.

As far as the Connecticut, the New York example, as I understand New York, is a – basically a tax payer subsidization of two facilities in the northern part of New York without any support going to the Indian Point reactors outside New

York City. That's how I understand it. Just from recent trade press, I see similar moves are being followed into Illinois, for example.

Connecticut has gone about it in a different way. They have a RPS standard there and an auction has been established for some years where the LSEs bid – take their – meet their RPS requirements by auctions from renewable suppliers into that RPS auction on an annual basis. The contemplation by the legislature, not the regulators, in Connecticut is to expand that to a clean power standard that would include nuclear which would allow up to approximately 50% of Millstone to be included in that auction. That at this point obviously is still in contemplation by the legislature. There is some momentum behind it. We're following it very closely, but it won't affect 2017. It would affect 2018 and beyond.

<Q - Michael Lapides>: What kind of an assumption are you making on the $7B to $8B cash projection going forward? Considering the price that was received, I guess, for $23.20 for the LP units, and can we assume that it's going to still be [ph] a 10 to 11 (37:43) dropdown based on $7B to $8B?

<A - Thomas F. Farrell>: We can't answer that question today. We'll have to see what the market bears and what the conflicts committee is comfortable with. It's a long period of time, but I will say that the remaining dropdowns this decade are principally around the Cove Point export facility which we place a very high value on. So we'll see. We said two years ago if we were to model it, we'd model 11 times. So, this transaction went at 10.3. I think anything between 10 and 11 would be a very realistic data point, but we'll have to see what asset drops and what the market will bear at that time.

<Q - Michael Lapides>: When do the converts – when do the preferred converts convert over?

<A - Thomas F. Farrell>: We have certain conversion rights here at Dominion and then there's other conversion rights by the owners. I'll be glad to answer that after the call for you, but it's probably too complex to go into on the call.