Transcript

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Dominion Energy, Inc. (D)

Dominion Energy Inc Investor update call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Dominion Energy Investor Update Conference Call. At this time, each of your lines is in a listen-only mode. At the conclusion of today's presentation, we will open the floor for questions. Instructions will be given for the procedure to follow if you would like to ask a question.

I would now like to turn the call over to Mr. Steven Ridge, Vice President, Investor Relations.

Steven D. Ridge

Vice President, Investor Relations, Dominion Energy, Inc.

Good morning and welcome to our investor update conference call. We appreciate everyone accommodating this time given the short notice. I'll begin by reminding you that call materials, including today's prepared remarks, may contain forward-looking statements and estimates that are subject to various risks and uncertainties. Please refer to our SEC filings, including our most recent annual reports on Form 10-K and our quarterly reports on Form 10-Q for a discussion of factors that may cause results to differ from management's estimates and expectations.

This morning, 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, which we can calculate are contained in the Earnings Release Kit available on the Investor Relations website.

Joining today's call are Tom Farrell, Chairman, President and Chief Executive Officer; Jim Chapman, Executive Vice President, Chief Financial Officer and Treasurer; as well as other members of the executive management team.

I'll now turn the call over to Tom.

Thomas F. Farrell

Chairman, President & Chief Executive Officer, Dominion Energy, Inc.

Thank you, Steve, and good morning, everyone.

Yesterday afternoon, we announced an agreement to sell substantially all of the assets in our Gas Transmission & Storage segment to Berkshire-Hathaway Energy in a transaction valued at nearly $10 billion. Transaction includes the assumption by Berkshire of nearly $6 billion of existing debt, which reduces Dominion's overall leverage. Transaction also includes a $4 billion cash payment to Dominion, which we intend to utilize, after accounting for taxes and other adjustments, to repurchase around $3 billion worth of shares of our common stock. Closing of the sale, which is expected to occur during the fourth quarter, is subject to Department of Energy approval and HSR clearance, but is not expected to require FERC or any other state utility commission approvals.

Over the last two decades, as we expanded our Gas Transmission & Storage operations, our talented employees have consistently set the industry standard for operating, environmental and safety performance and provided round-the-clock service for our customers. We've also managed and delivered immense capital projects on time and on budget, including the Cove Point liquefaction project, the largest investment in our company's history.

I'm pleased that these world-class employees are now joining another world-class organization in the form of Berkshire-Hathaway Energy who has agreed to provide significant protections for existing employees and honor existing union commitments. Berkshire's operating expertise and financial resources will also ensure that our customers will continue to receive the high level of service to which they have grown accustomed.

The transaction includes the assets shown on slide 4. We have decided to retain a 50% non-controlling and unlevered interest in Cove Point and its attractive long-term contracted profile and strong cash flows. We are also retaining our investments in renewable natural gas, which plays important role in our efforts to reduce greenhouse gas emissions. Given the scale of this announcement, it warrants addressing the strategic rationale for the decision, which we strongly believe will create significant long-term value for our shareholders.

In the second half of last year, we began considering the long-term role of our best-in-class storage and transmission assets within the Dominion family. As a part of that review, early this year, Berkshire-Hathaway Energy, an obviously credible and respected operator, indicated their interest in acquiring these high-quality assets and we decided to engage. As we learned more about their interest, it became clear Berkshire was willing to satisfy several essential aspects for any potential transaction we evaluate – first, a very attractive valuation; second, very strong commitments to our employees; and third, the ability to continue to serve our customers well.

To state the obvious, permitting for investment in gas transmission and storage has become increasingly litigious, uncertain and costly. This trend though deeply concerning for our country's economic growth and energy security is a new reality, which threatens the pace at which we intended to grow these assets. Over the last couple of years, we've observed a widening divergence in valuation for utilities and energy transmission asset classes. As we've engaged with shareholders, it has become apparent that the steady cash-yielding assets may garner more value for a temperate type of owner.

In reviewing this transaction, in the context of our long-term strategic direction, we weighed several key considerations, including the value to our industry-leading ESG focused strategy, providing a pure-play profile by narrowing our focus to state-regulated utility operations, increasing our long-term earnings growth rate by nearly 1.5 percentage points, representing a 30% increase, driven by a robust state-regulated investment opportunities, rebasing our dividend to reflect our revised operating and financial model and adopting a payout ratio aligned with peers and which provides for increased growth rate, and improving our credit and balance sheet as we embark on what will be the company's largest-ever programmatic capital investment plan totaling tens and tens and tens of billions of dollars.

As we carefully weighed the implications of these factors and evaluate our path forward, we determined that this is the right step at the right time. With the sale of these assets, Dominion Energy is positioned to offer an updated investment proposition captured in five major themes on slide 6, which represents a compelling and differentiated opportunity for our investors.

First, this transaction reflects the increased focus on our premier state-regulated utility operations where our commitment to customers and communities combined with supportive regulatory and legislative policy allows us to deliver reliable, affordable and increasingly sustainable energy to our nearly 7 million regulated utility customers.

Second, Dominion offers an industry-leading clean energy profile, which includes a comprehensive net zero target by 2050, one of the nation's largest zero carbon electric generation and storage investment plans as well as significant investments in renewable natural gas and other methane reduction activities.

Third, we are increasing our long-term earnings and dividend per share growth guidance, which, as Jim will cover in a moment, aligns with some of the industry's highest valued companies.

Fourth, this transaction complements the substantial efforts we have made in recent years to strengthen our balance sheet and improve our business risk profile. It will enhance our credit profile and position our balance sheet to support the expansive capital investment plans we have.

Finally, our updated and narrowed operational profile will allow us to extend our track record of delivering on earnings guidance and overall transparency – attributes that we know are highly valued by investors.

In recent years, the company has taken a series of strategic steps as shown on slide 7, including mergers with Questar Corporation and SCANA Corporation, and the divestiture of Blue Racer Midstream and merchant generation assets, to increase materially the regulated nature of our profile. The sale of these Gas Transmission & Storage assets will further position the company as a pure-play, state-regulated utility operating in some of the most attractive regions in the United States. As we look forward, we expect that state-regulated utilities will contribute between 85% and 90% of our operating earnings, a major increase over historic levels.

On slide 8, we update our segments to reflect the elimination of the Gas Transmission & Storage segment later this year. This should be familiar to you as it is largely consistent with prior disclosures. We retained 50% unlevered interest in Cove Point. We'll now report through the Contracted Assets segment, formally known as Contracted Generation. Our growing investments in renewable natural gas will report through the Gas Distribution segment. Taken as a whole, we are now approaching 100% state-regulated earnings profile.

Residual, high quality, regulated-like earnings comprised of Cove Point, the contracted Millstone Nuclear Power Station as well as a portfolio of contracted solar projects, generate earnings primarily under 10 to 20-year, fixed price take-or-pay contracts with high-quality demand-pull counterparties.

Turning to slide 9. Dominion Energy offers an industry clean energy profile. Our enterprise-wide commitment to net zero carbon and methane emissions by 2050 captures the environmental footprint of both our electric and gas operations. We're moving aggressively under the direction of state policy toward renewable and zero carbon forms of electric generation.

As described in our most recent integrated resource plans, we aim to transition one of the nation's largest electric generation systems to around 70% zero carbon by 2035. An additional 25% will come from ultra-efficient, low-emitting natural gas. The transaction also immediately reduces the emissions produced by our gas infrastructure assets by around 50%, bringing us much closer to achieving our comprehensive net zero targets.

Finally, we are allocating capital in a way that supports our public environmental commitments. We project up to $55 billion of growth capital investment in programs that will reduce our emissions footprint, including zero carbon generation and storage, replacement and modernization of the gas distribution lines and expanding our investments in renewable natural gas. We provide additional information about the Virginia Clean Economy Act in line with previous disclosures in the appendix for your review.

Our company continues to evolve, allowing us to focus even more on serving our customers and positioning us for a bright and increasingly sustainable future. We believe that Dominion Energy offers one of the industry's most compelling profiles for ESG-focused investors and stakeholders.

With that, I turn the call over to Jim to discuss the financial implications of the transaction.

James R. Chapman

Executive Vice President, Chief Financial Officer & Treasurer, Dominion Energy, Inc.

Thank you, Tom, and good morning, everyone. Before I jump into our updated earnings guidance, let me spend just a minute on the transaction valuation.

We are divesting around $1 billion of EBITDA, which implies an approximately 10 times EBITDA multiple. By way of reminder, for those reconciling to our Gas Transmission & Storage segment adjusted EBIT guidance, that EBIT guidance includes 100% of Cove Point as the Brookfield-owned minority interest is removed below the line. It also includes the full amount of ACP equity earnings as well as our RNG and other small gas investments. The remainder is attributable to some accounting nuances like intercompany interest and pension allocations.

While we don't provide asset-by-asset EBITDA guidance, the public FERC form may provide a useful starting point for your analysis. We evaluated this transaction, of course, on a variety of metrics, but let me speak specifically to the implied EBITDA multiple.

One way we thought about it was to look at where public companies of similar size and business profiles trade. For that, we look to companies focused generally on contracted natural gas transmission such as Kinder, Williams, Equitrans, and Energy Transfer, for example. Those peers trade at around 9 times. Now, people may view our assets as lower risk than those peers, but also potentially slower growth. So, in summary, we feel quite good about that 10 times EBITDA multiple in that context. Even more importantly, perhaps, as we look forward to delivering the best value for shareholders, we are focused on executing our revised earnings trajectory.

So, turning to slide 10, let me walk through our updated 2020 operating earnings step by step. First, our original 2020 guidance for operating earnings for Dominion Energy Virginia, Dominion Energy South Carolina, Gas Distribution and Corporate & Other is affirmed and unchanged at $2.89 to $3.11 per share, reflecting full-year normal weather.

Second, as Tom mentioned, we are retaining a 50% unlevered interest in Cove Point, which will be reported within the Contracted Assets segment. As a result, we are increasing that segment's annual guidance by around $0.25 per share for the full year.

Third, we will eliminate the Gas Transmission & Storage segment. Income associated with the assets being sold will be accounted for as discontinued operations under GAAP and will be excluded for the full year from our operating earnings. Thus, our new 2020 operating earnings guidance per share is $3.37 to $3.63, with a midpoint of $3.50. Keep in mind, this number reflects at most a de minimis impact from our anticipated share repurchases given the expected late year timing of those purchases.

Moving to slide 11. We expect 2021 operating earnings per share to grow by around 10% to 11%, attributable partially to organic growth and partially to the full year impact of the planned share repurchases. Thereafter, we expect our operating earnings to grow annually at around 6.5% off the 2021 base, which compares well with the industry's highest growth rates and which represents a significant increase from our previous guidance of 5-percent-plus. ESG, reliability and customer growth-driven programmatic investment will drive earnings and rate base growth combined with continued O&M discipline.

Turning now to slide 12. The sale of a material portion of our assets, of course, has implications for our dividend policy as well. Decisions around changes to our dividend are not taken lightly, but we believe these steps will position shareholders for the best long-term outcome. We now expect our 2020 dividend payment to total around $3.45 per share, which includes three payments of $0.94 per share and a fourth payment in December of $0.63 per share, reflecting our updated target dividend payout ratio of 65%, which we expect to be effective upon closing of the transaction in the fourth quarter.

In recent years, our payout ratio has consistently exceeded 80%, much higher than the industry norm of around 65%. A couple of thoughts here. This elevated payout ratio has seemingly not garnered an enhanced valuation for our investors. In fact, have been in opposite with what, in my view, has been investor distraction regarding this outlier payout ratio with a low dividend per share growth rate.

This new payout ratio better reflects our revised operating and financial strength, aligns with our best-in-class industry peers and allows us to grow our dividend much more rapidly than before at a rate of 6% annually off a base year of 2021 instead of our prior guidance of just 2.5%. Of course, I should note that as is customary, all dividend declarations are subject to board approval.

So, turning now to slide 13. The pro forma operational and financial results of this transaction solidly align Dominion Energy with the profiles of some of the industry's most highly-valued utility companies. We are positioning the company as an increasingly pure-play, state-regulated utility with a differentiated clean energy profile. Further, our financial outlook, specifically our long-term earnings and payout ratio guidance, now compares much more favorably with this peer set. Our efforts to improve our credit profile in recent years, complemented by this transaction, have significantly derisked our financial and business risk profiles. Going forward, our focus will be to extend our track record of consistent and credible financial results, a characteristic we know to be highly valued by utility investors.

So, before turning back to Tom, let me spend a minute on credit on slide 14. Of course, we don't speak for the agencies, but we view this transaction as credit-positive and as complementing the material improvement in our credit profile in recent years. First, our allocation of transaction enterprise value skews towards deleveraging with almost 60% or nearly $6 billion applied to debt reduction.

Second, we are materially increasing the percentage of our cash flows that come from state-regulated utilities. This continued shift towards a regulated utility profile has resulted, historically, in the reduction of our credit metric downgrade threshold as depicted here. The merger with SCANA, combined with non-regulated asset sales or otherwise derisking step, resulted in S&P reducing their downgrade threshold 200 basis points to 13%. Moody's reduced their threshold significantly as well. We believe the agencies will continue to consider the derisking of our business profile as they assess our credit going forward.

Third, we are retaining 50% of Cove Point cash flows, but transferring 100% of the related debt at Dominion Energy Gas Holdings, or DEGH, to the buyer as part of the sale. I'll address what that means for DEGH bondholders in a minute.

Finally, we estimate that the change to our dividend payout ratio, combined with the expected reduction of shares outstanding based on planned share repurchases, will allow us to conserve about $1.3 billion of cash in 2021 and beyond, which can be used to fund operations and capital investment growth.

Going forward, our general credit guidance is unchanged. We target credit ratings of high BBB in our Parent and Single-A at our OpCos. Our CFO pre-working capital to debt as reported by Moody's has increased from 11% in 2016 to 15.5% in 2019 and we expect FFO or CFO pre-working capital to debt figures to continue to be in the mid-teens percent range.

Also, let me note that we do not expect the cancellation of the Atlantic Coast Pipeline, which Tom will address shortly, to significantly impact our existing credit metrics. In computing our metrics, we have consistently and conservatively imputed our share of off-balance sheet project-level debt and excluded the non-cash AFUDC equity earnings from FFO or from CFO pre-working capital.

Now with regard to DEGH bondholders, as shown on slide 15, Berkshire-Hathaway Energy, which carries an A rating, is committed to deleveraging DEGH post-closing. They have agreed to forego the refinancing of some $1.2 billion of DEGH maturities over the coming 12 months. Berkshire will also consider additional credit-supported measures, including additional deleveraging post-2021, if needed.

With that, I'll turn it back to Tom.

Thomas F. Farrell

Chairman, President & Chief Executive Officer, Dominion Energy, Inc.

Thank you, Jim. Separately and unrelated to our decision to divest our Gas Transmission & Storage assets, Dominion Energy and Duke Energy have announced the cancellation of the Atlantic Coast Pipeline due to ongoing delays and increasing cost uncertainty which threaten the economic viability of the project.

For almost six years, we have worked diligently and invested literally billions of dollars to complete the project and deliver the much-needed infrastructure to our customers and communities. We've engaged extensively with and incorporated feedback from local communities, labor and industrial leaders, government and permitting agencies, environmental interests and social justice organizations. We deeply appreciate the tireless efforts and important contributions made by all who were involved in this essential project. This announcement reflects the increasing legal uncertainty that overhangs large-scale energy and industrial infrastructure development in the United States. Until these issues are resolved, the ability to satisfy the country's energy needs will be significantly challenged.

Despite last month's overwhelming 7-2 victory at the United States Supreme Court, which vindicated the project and decisions made by permitting agencies, recent developments have created an unacceptable layer of uncertainty and anticipated delays for ACP.

Specifically, the decision of the United States District Court for the District of Montana overturning the Nationwide 12 program, a longstanding federal permit authority for waterbody and wetland crossings, followed by a Ninth Circuit ruling on May 28 indicating an appeal is not likely to be successful, are new and serious challenges. The potential for a Supreme Court stay of the district court's injunction would not ultimately change the judicial venue for appeal nor decrease the uncertainty associated with an eventual ruling. The Montana district court decision is also likely to prompt similar challenges in other Circuits related to permits issued under the nationwide program, including for ACP.

This new information and litigation risk, among other continuing execution risks, make the project too uncertain to justify investing more shareholder capital. The Atlantic Coast Pipeline was initially announced in 2014 in response to a lack of energy supply and delivery diversification for millions of families, businesses, schools and national defense installations across North Carolina and Virginia. Robust demand for the project is driven by the regional retirement of coal-fired electric generation in favor of environmentally superior, lower cost natural gas-fired generation combined with widespread growing demand for residential, commercial, defense and industrial applications of low-cost and low-emitting natural gas. Those needs are as real today, it will be tomorrow, as they were at project inception as evidenced by the recently renewed customer subscription of approximately 90% of the project's capacity. The project was also expected to create thousands of construction jobs and millions and millions of dollars in tax revenue for local communities across West Virginia, Virginia and North Carolina.

We remain steadfast in the belief that fuel diversity, including renewables, nuclear and natural gas, is critical for reliably and sustainably serving our customers and communities. We will continue aggressively to pursue the development of renewables, storage, nuclear license renewals, electric vehicle infrastructure, energy delivery infrastructure as well as energy efficiency and demand side management programs to meet our customers' needs while creating jobs and spurring new business growth.

We've covered a lot of ground today. These are undoubtedly significant steps that we believe will optimally position our company for many years to come. We are narrowing our focus to our premier utility franchises. We are leading the way and aggressively transforming our system by environmental footprint. We are offering a refreshed earnings and dividend growth outlook that aligns our long-term growth with the highest valued utility peers. We are repositioning our credit and balance sheet as we embark on the company's largest ever programmatic capital investment plan. And by narrowing our strategic and operational focus, we are improving our ability consistently to deliver on our commitments to all stakeholders – financial, community, customers, employees and the environment.

With that, we'll be happy to answer your questions.