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Research Update:

Dominion Energy Inc. Outlook Revised To Stable On Expected SCANA Aquisition; Ratings Affirmed

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Research Update:

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Rating Action Overview

- The Public Service Commission of South Carolina approved Dominion Energy Inc.'s acquisition of South Carolina Electric & Gas Co., and we expect that Dominion will close on its all-stock acquisition of SCANA Corp. in the very near term. In addition, Dominion previously entered into a definitive agreement to acquire Dominion Energy Midstream, which we also expect will soon be completed.
- On Dec. 27, 2018, S&P Global Ratings affirmed its ratings on Dominion and subsidiaries Virginia Electric & Power Co. (VEPCO), Dominion Energy Gas Holdings LLC, and Questar Gas Co., including the 'BBB+' issuer credit ratings, and revised the outlooks to stable from negative.
- At the same time, we raised the issuer credit and unsecured debt issue rating on subsidiary Dominion Energy Questar Pipeline LLC (DEQP) to 'BBB+' from 'BBB'. The outlook is stable.
- The stable outlook reflects our expectations that Dominion's lower-risk utility businesses will increase to about 75% of consolidated EBITDA following the SCANA acquisition from prior expectations of about 70% of consolidated EBITDA. We expect that financial measures will reflect the lower half of the range for its financial risk profile category. Specifically, we expect funds from operations (FFO) to debt of 15%-16%.

Rating Action Rationale

The outlook revision reflects the company's increasing focus on low-risk utility businesses and expectations for modestly improved financial measures following the acquisition of SCANA. We expect that Dominion's utility businesses will reflect about 75% of consolidated EBITDA, up from about 70% of consolidated EBITDA. Furthermore, we expect that FFO to debt will reflect about 15%-16% or a modest improvement from 14.8% at year-end 2017 and 14.4% for the rolling 12 months ended September 2018.

The upgrade on DEQP reflects our revised assessment of the relationship between Dominion and DEQP. Because Dominion will very shortly complete its acquisition of Dominion Energy Midstream Partners L.P. (DM), which was the parent company of DEQP, we expect that Dominion's relationship to DEQP will be consistent with that of Dominion's other subsidiaries. Previously, we assessed DEQP as a moderately strategic subsidiary of Dominion, partially reflecting the increased probability that some of DEQP would be sold as Dominion strategically reduced its interest in DM. However, with Dominion's acquisition of DM, we now consider DEQP to be a core subsidiary. This reflects our view that DEQP is highly unlikely to be sold, is integral to the overall group strategy, and has a strong long-term commitment from senior management. As a result, we assess the issuer credit rating on DEQP as in line with Dominion's 'bbb+' group credit profile.

We assess Dominion's stand-alone credit profile based on its excellent business risk profile and significant financial risk profile.

We assess Dominion's business risk profile based on its very large size and high proportion of lower-risk, rate-regulated utility assets reflecting about 75% of EBITDA and operating across nine states. However, we expect it may take SCANA's South Carolina utility several years to restore regulatory confidence and to effectively manage regulatory risk at the consistently high level that it did prior to the abandonment of its nuclear generating facility. Further supporting the company's business risk profile is its recent sale of its ownership in higher-risk Blue Racer Midstream LLC and non-nuclear merchant generating assets.

The balance of Dominion's non-utility businesses consist of gas transmission pipelines (about 10% of EBITDA), liquefied natural gas (LNG) (about 10% of EBITDA), and merchant nuclear generation (about 5% of EBITDA). While we generally view the Federal Energy Regulatory Commission (FERC)-regulated gas transmission pipeline business and the long-term contracted LNG businesses as more credit supportive than a typical industrial company, we still view these businesses as higher risk than the low risk regulated utility business. This reflects our assessment of the weaker FERC regulation for the gas transmission pipelines compared with regulated utilities and our view that over the long-term contracted assets are generally modestly higher risk than regulated utility assets because of counterparty credit risk and the possibility of an unforeseen event that could erode margins. Furthermore, we view the higher-risk merchant business as exposing the company to volumetric, commodity, and operational risks. Because of these higher risks, we continue to assess Dominion at the lower half of the range for its business risk profile category.

We assess Dominion's financial measures using our medial volatility table reflecting the company's operating focus on mostly lower-risk regulated utilities and its generally effective management of regulatory risk in Virginia, Ohio, and Utah.

Our base-case scenario includes the credit supportive funding of the SCANA transaction as an all-stock acquisition, robust capital spending of more than $5 billion annually, annual EBITDA greater than $8 billion, a fully operational Atlantic Coast Pipeline by mid 2020, and rising annual dividends of more than $2 billion. Under our base case, we expect financial measures to consistently reflect the lower half of the range for its financial risk profile category, with FFO to debt of 15%-16%.

To account for our assessment of Dominion's business and financial risk profiles at the lower half of their respective categories, we are revising the comparable rating analysis modifier to negative from neutral. However, Dominion's stand-alone financial profile is unchanged, as we are also revising the financial policy modifier to neutral from negative. This reflects Dominion's decision to fully acquire DM and our improved opinion of the company's financial policy. Our previous assessment reflected our expectations that the company would grow through acquisitions at a faster pace than peers because of DM, a master limited partnership, which added a degree of complexity to the company's organizational structure, and provided incremental opportunities and incentive for the company to complete acquisitions.

Outlook

The stable outlook reflects our expectations that Dominion's lower-risk utility businesses will show modest improvement to about 75% of consolidated EBITDA following the SCANA acquisition. We expect that financial measures will reflect the lower half of the range for its financial risk profile category, with FFO to debt of 15%-16%.

Downside scenario

We could lower the ratings on Dominion over the next two years if the company's financial measures materially weaken reflecting FFO to debt below 13%. This could occur if the company's ability to effectively manage regulatory risk weakens or it suffers material delays and cost increases at its large projects including the Atlantic Coast Pipeline.

Upside scenario

We could upgrade Dominion over the next two years if its financial measures significantly improve, reflecting FFO to debt that is consistently greater than 18%, without a material increase to business risk. This would most likely occur if the company finances a higher percentage of its future projects with a higher degree of equity, and continues to largely grow through its regulated utility operations.

Company Description

Dominion Energy is a very large company that has a significant utility, pipeline, LNG, and merchant generation businesses. The company's utilities serve more than 6 million customers across nine states. The lower-risk utility business accounts for about 75% of its consolidated EBITDA. The company also has a large gas pipeline business that accounts for about 10% of consolidated EBITDA and is regulated by FERC. The company's Cove Point LNG also accounts for about 10% of EBITDA and has long-term contracts with high credit counterparties. The company's highest risk business is its nuclear merchant generation business that accounts for about 5% of EBITDA.

Liquidity

We assess Dominion's liquidity as adequate because we believe its liquidity sources are likely to cover its uses by more than 1.1x over the next 12 months and to meet cash outflows even with a 10% decline in EBITDA. Under our stress scenario, we do not expect that Dominion would require access to capital markets during that period to meet its liquidity needs. In addition, Dominion has sound relationships with its banks, satisfactory standing in the credit markets, generally prudent risk management, and could absorb a high-impact, low-probability events with limited need for refinancing.

Principal liquidity sources:

- Credit facility availability of about $6 billion;
- FFO of more than $6 billion; and
- Minimal cash of about $300 million.

Principal liquidity uses:

- Robust capital spending of more than $5 billion;
- Rising dividends at more than $2 billion; and
- Long-term debt maturities of more than $4 billion in 2019.

Issue Ratings - Subordination Risk Analysis

Capital structure

Dominion Energy Inc.'s capital structure consists of approximately $40 billion of debt, of which about $22 billion is outstanding at its subsidiaries following the SCANA acquisition.

Analytical conclusions

- The short-term rating on Dominion is 'A-2' based on our long-term issuer credit rating (ICR) on the company.
- The unsecured debt issued at Dominion is rated 'BBB', one notch lower than the ICR. This is due to the significant proportion of priority debt at the company's subsidiaries.
- Dominion's junior subordinated notes are subordinated and not deferrable and we therefore rate them in line with the senior unsecured debt at 'BBB', one notch below our ICR.
- DEI's enhanced junior subordinated notes are rated 'BBB-', two notches below the ICR. We classify the enhanced junior subordinated notes as hybrid securities premised on their permanence, deferability, and subordination features.
- DEI's equity units are hybrid securities that incorporate equity risk and are therefore also rated 'BBB-', two notches below the ICR.

- The unsecured debt issues at Dominion Energy Gas Holdings LLC and Dominion Energy Questar Pipeline LLC are rated 'BBB+', the same as the ICR, because there is no secured or priority debt that ranks ahead of these issues in its capital structure.
- The unsecured debt issues at VEPCO and Questar Gas Co. are rated 'BBB+', the same as the ICR, as these are unsecured debt issues of a qualifying investment-grade regulated utility.

Ratings Score Snapshot

Issuer Credit Rating: BBB+/Stable/A-2

Business risk: Excellent
- Country risk: Very low
- Industry risk: Very low
- Competitive position: Strong

Financial risk: Significant
- Cash flow/Leverage: Significant

Anchor: a-

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Negative (-1 notch)

Stand-alone credit profile: bbb+
- Group credit profile: bbb+

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Midstream

Energy Industry, Dec. 19, 2013

- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Insurance - General: Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

Ratings List

Ratings Affirmed; Outlook Action		
	To	From
Dominion Energy, Inc.		
Virginia Electric & Power Co.		
Questar Gas Co.		
Dominion Energy Gas Holdings, LLC		
Issuer Credit Rating	BBB+/Stable/A-2	BBB+/Negative/A-2
Upgraded; Outlook Action		
Dominion Energy Questar Pipeline, LLC		
Issuer Credit Rating	BBB+/Stable/--	BBB/Negative/--
Issue-level Ratings Raised		
Dominion Energy Questar Pipeline, LLC		
Senior Unsecured	BBB+	BBB
Ratings Affirmed		
Dominion Energy, Inc.		
Senior Unsecured	BBB	
Junior Subordinated	BBB	
Junior Subordinated	BBB-	
Commercial Paper	A-2	

Dominion Energy Gas Holdings, LLC	
Senior Unsecured	BBB+
Commercial Paper	A-2
Questar Gas Co.	
Senior Unsecured	BBB+
Commercial Paper	A-2
Virginia Electric & Power Co.	
Senior Unsecured	BBB+
Preferred Stock	BBB-
Commercial Paper	A-2

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.