

September 23, 2009

CURRENT PRICE: \$15.72
RATING: OUTPERFORM
PRICE TARGET: \$20.00
CURRENT YIELD: 6.1%

EPS Estimates - Non-GAAP

	DEC 08A	DEC 09E
1Q	\$00.35A	\$00.28A
2Q	\$00.27A	\$00.26A
3Q	\$00.33A	\$00.40e
4Q	\$00.27A	\$00.25e
	\$1.21	\$1.19

Trading Data

52-WEEK PRICE RANGE: **\$18.05-\$11.72**
 SHARES OUTSTANDING: **1,297(M)**
 MARKET CAP: **\$20,389(M)**
 AVG. DAILY TRADING VOLUME: **8.41(M)**
 S&P 500: **1,061**

Valuation Data

BOOK VALUE: **\$16.51**
 PRICE TO BOOK: **0.9x**
 DIVIDEND: **\$0.96**

DUKE ENERGY(NYSE:DUK)

Initiating Coverage with an Outperform Rating

Highlights

- Provides energy & services to 4 million US customers
- Cost cutting efforts/potential revenue growth may produce 2010 margin/earnings improvement
- Attractive dividend yield of 6.1%
- Trading below book/value per share
- \$20/share price target

Investment Thesis

Wall Street is debating when the US economy will emerge from the current recession. While we find difficulty in predicting its end, we believe investors should consider investing in sectors where revenue streams are fairly predictable, with attractive dividend yields, low valuations, and earnings growth potential when the US economy emerges from the recession. One attractive sector is the utility group and one company in this area we like is Duke Energy (DUK-\$15.72). This utility pays an attractive 6.1% dividend yield, potential dividend growth, trades below book value/share, and offers earnings growth prospects with a recovery in the US economy. Given these factors we are initiating coverage of DUK with an OUTPERFORM rating and a \$20/share price target.

Company Summary

Duke Energy, headquartered in Charlotte NC, is one of the largest energy providers in the US. The company is comprised of three business units; US Franchised Electric and Gas (USFE&G), Commercial Power, and Duke Energy International (DEI). USFE&G contains the company's regulated generation and the electric/gas distribution and transmission systems. Serving approximately 4 million electric customers in NC, SC, IN, OH, and KY USFE&G operates 150,900 miles of electric distribution lines and a 20,900-mile transmission system. USFE&G owns 28,000 megawatts (MW) of electrical generating capacity with its plants fueled by coal, oil, natural gas, hydroelectric, and nuclear. The regulated gas business provides natural gas to 500,000 customers in OH and KY. The Commercial Power unit owns/operates/manages non-regulated power plants, with 8,000 MW capacity, located mainly in the Midwest.

For Important Disclosure information regarding the Firm's rating system, valuation methods and potential conflicts of interest, please refer to the last page of this report.



Duke Energy Generation Services, part of Commercial Power, develops/operates/owns various generating assets including wind assets serving large use industrial, municipal, and utility customers. DEI manages/operates power generation facilities in South America and has equity investments in Greece and Saudi Arabia. Overall, DUK's domestic electrical generation is fueled by coal (70%), nuclear (27%), natural gas/oil (2%), and hydro/wind (>1%). 2008 revenues for DUK totaled \$13.2 billion with the majority coming from USFE&G (76.9%), followed by Commercial Power (13.8%), DEI (8.9%), and Other (>1%).

Business Overview

DUK provides and supplies energy to over 4 million customers in the US. The company's regulated businesses, USFE&G, provides power/natural gas to customers in NC, SC, KY, IN, and OH with a service territory exceeding 47,000 square miles. USFE&G serves 4 million customers with electricity and natural gas to 515,000 customers in OH and KY. The Commercial Power (CP) unit is one of DUK's unregulated businesses with approximately 7,550 net MW power generation capability, when excluding wind generation assets. Electricity from these generating facilities are sold into the wholesale electric markets, with the majority of this segment's results coming from sales to retail customers in OH. DUK recently filed plans to separate the merchant generation plants from its Duke Energy of Ohio subsidiary for the purpose of increasing financial flexibility surrounding these assets. Currently CP has 522 MW of wind production in service and a potential developmental pipeline of an additional 5,000 MW. DEI has approximately 4,000 MW of generating capacity located primarily in Latin America. Roughly 75% of DEI's electrical generation comes from hydroelectric with about 90% of output under contract. In DUK's "Other" category is Crescent Real Estate, a joint venture with the Morgan Stanley Real Estate Fund which manages land holdings and develops commercial, residential, and multi-family real estate projects in 10 states, located in the Southeast/Southwest US.

Recent Earnings

DUK reported 2Q09 adjusted diluted earnings of \$0.26/share vs \$0.27/share during 2Q08. The lower results, due to lower kilowatt sales from the economic recession, were partially offset by aggressive cost controls by management. On a quarter-to-quarter basis, USFE&G reported adjusted segment EBIT of \$500 million versus \$503 million due to a decline in weather-adjusted sales volumes to industrial customers. CP produced adjusted EBIT of \$115 million from continuing operations, compared to \$128 million, as results were adversely impacted by lower wholesale customer power prices and a decline in sales to Ohio retail customers. These results were partially offset by increased native margins related to the recent implementation of the Electric Security Plan in Ohio and the timing of fuel expenses and a purchased power rider. DEI reported adjusted EBIT of \$94 million versus \$116 million due to lower results from the National Methanol subsidiary because of lower commodity prices, and unfavorable exchange rates mainly in Brazil. However, favorable contract prices in Brazil helped to offset declines in DEI's EBIT. DUK saw improvements in costs as net adjusted expenses from continuing operations declined to \$37 million from \$77 million. This improvement came from the absence of 2008 Crescent Real Estate losses, favorable governance expenses, and favorable results from captive insurance during 2009. Interest expense, when comparing the two quarters, declined to \$186 million from \$194 million, due to lower rates paid on floating rate debt/commercial paper, which was partially offset by an increase in debt.



EQUITY RESEARCH

Our Thoughts

We are initiating coverage of DUK with an OUTPERFORM rating for several reasons. First, while an improving US economy will potentially be needed to provide earnings growth to Corporate America, DUK's 6.1% dividend yield offers investors an attractive current return. The Board of Directors recently raised the annual dividend 4.3% to \$0.96/share. Additionally, improved cash flow in the future could allow management to increase the annual dividend.

Second, cost cutting initiatives implemented by DUK, such as reducing 2009's capital expenditures by \$200 million-\$300 million and lowering internal costs have helped to reduce the company's ongoing expenses. In fact management recently raised expected savings from internal efforts to \$150 million in 2009 from earlier guidance of \$100 million. The company's cost cutting efforts could produce healthy margin/profit growth with an increase in overall revenues.

Third, in a best case scenario, favorable rate relief and a potential US economic recovery could generate significant revenue growth for DUK. Revenues may increase from a pick-up in industrial sales due to increased US economic activity and potential rate increases in NC and SC. DUK has asked NC for approximately \$500 million and SC for about \$100 million in rate increases. The two states may rule on these requests by year-end 2009 and a favorable ruling could potentially have a positive impact on DUK's revenue stream in 2010. This scenario, coupled with the company's recent cost cutting efforts, may produce higher return on equity/profit margins and earnings growth in 2010.

Fourth, DUK appears attractively priced paying a 6.1% dividend yield and trading below its book value of \$16.51/share, or 0.9x book value, while many of its utility peers trade on average at 1.5x-1.6x book value. Potentially, improved 2010 earnings, and its high dividend yield, could increase investor demand and award a higher multiple to DUK's stock. Additionally, given this low valuation, and mix of generating assets, we believe DUK is a merger/consolidation candidate as credit markets continue to improve in the US. These shares are rated OUTPERFORM and are recommended for income/growth investors. Our price target is \$20/share, or 1.2x current book value, and assumes earnings growth in 2010.

Risks

There is no guarantee DUK will improve earnings/cash flow. Declining electric sales volumes may hurt the company's revenues and profits. Rising interest rates, higher fuel prices, negative rate cases, tax issues, or rising operating costs could negatively impact DUK's earnings. DUK'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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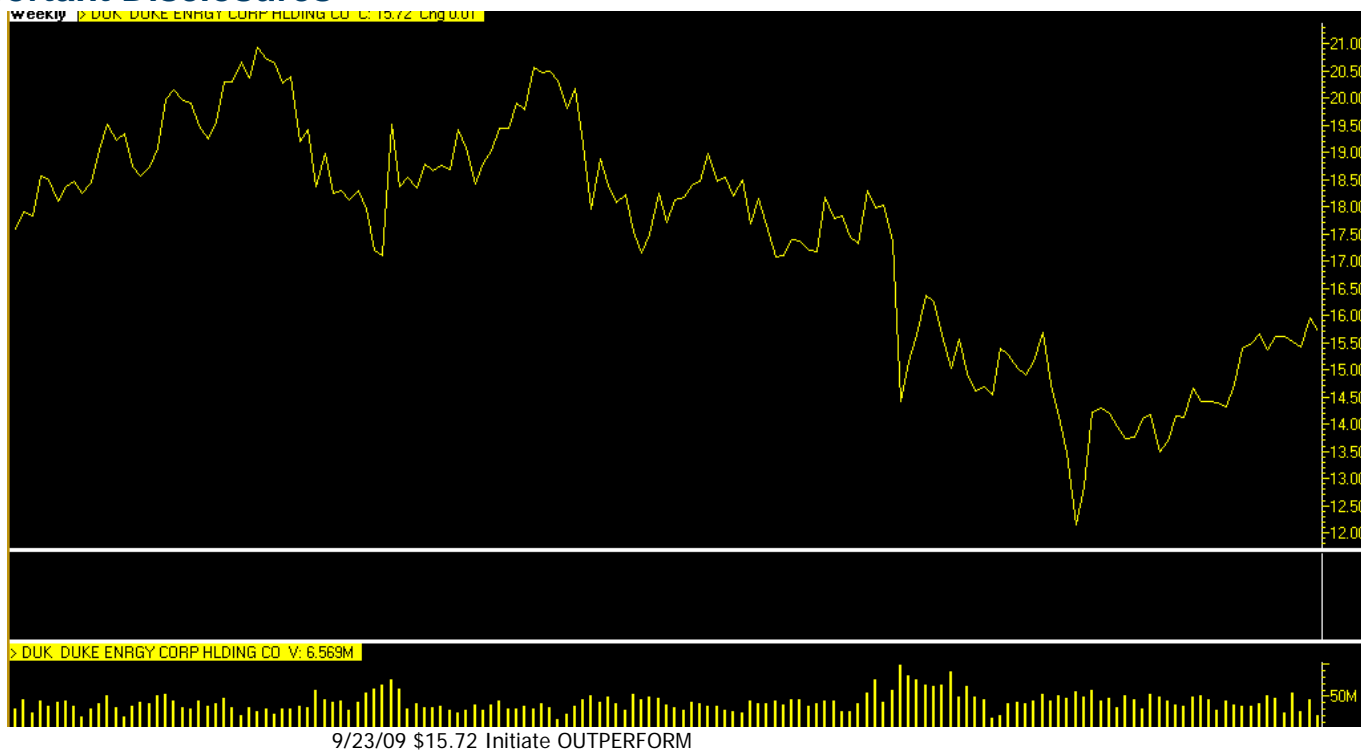


EQUITY RESEARCH

Duke Energy Corp.
Adjusted Diluted Earnings
(Dollars in millions, except per share amounts)

	1Q08	2Q08	3Q08	4Q08	2008	1Q09	2Q09	3Q09e	4Q09e	2009e
Segment Earnings Before Interest/taxes From Continuing Operations										
US Franchised Electric & Gas	\$637	\$503	\$726	\$532	\$2,398	\$557	\$500	\$714	\$526	\$2,297
Commercial Power	99	128	93	101	421	103	115	117	109	444
International Energy	114	116	77	104	411	93	94	97	99	383
Total reportable segment EBIT	850	747	896	737	\$3,230	753	709	928	734	3,124
Other	-65	-77	-70	-98	-310	-50	-37	-40	-46	-173
Total reportable segment EBIT & other EBIT	\$785	\$670	\$826	\$639	\$2,920	\$703	\$672	\$888	\$688	\$2,951
Interest Expense	-182	-194	-176	-189	-741	-184	-180	-177	-194	-735
Interest Income & Other	47	32	24	27	130	35	28	25	22	110
Income Taxes from Continuing Operations	-209	-173	-252	-139	-773	-191	-190	-220	-190	-791
Discontinued Operations, net of taxes										
Less: Net Income Attributable to Non-Controlling Interests	1	-2		-5	-6	-5	6		-4	-3
Net Income (Loss)	\$440	\$337	\$422	\$338	\$1,537	\$358	\$334	\$516	\$322	\$1,530
Earnings Per Share (fully diluted)	\$0.35	\$0.27	\$0.33	\$0.27	\$1.21	\$0.28	\$0.26	\$0.40	\$0.25	\$1.19

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Stock ratings used in this report are defined as follows:

- (1) Outperform – The stock's total return including dividends is expected to exceed the industry or market average by at least 10% over the next twelve months.
- (2) Neutral – The stock's total return including dividends is expected to be in line with the industry or market average of +/- 10% over the next twelve months.
- (3) Underperform – The Stock's total return including dividends is expected to be below the industry or market average by 10% or more over the next twelve months.

The distribution of investment ratings for all companies in our coverage universe are as follows: (1) 100%, (2) 0%, (3) 0%

Capitol Securities does not have investment banking operations.

For regulatory purposes, our ratings of Outperform, Neutral and Underperform most closely correspond to Buy, Hold and Sell, respectively.

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