

**December 5, 2011**

**CURRENT PRICE:** \$20.70  
**RATING:** OUTPERFORM  
**PRICE TARGET:** \$22.00  
**CURRENT YIELD:** 4.8%

**EPS Estimates**

	DEC 10A	DEC 11E
1Q	\$0.36	\$0.39A
2Q	\$0.34	\$0.33A
3Q	\$0.51	\$0.50A
4Q	\$0.21	\$0.21
	<b>\$1.43</b>	<b>\$1.43</b>

**Trading Data**

52-WEEK PRICE RANGE: **\$21.02-\$16.87**  
 SHARES OUTSTANDING: **1,332(M)**  
 MARKET CAP: **\$27,572(M)**  
 AVG. DAILY TRADING VOLUME: **14.8(M)**  
 S&P 500: **1,257**

**Valuation Data**

BOOK VALUE: **\$17.19**  
 PRICE TO BOOK: **1.2x**  
 DIVIDEND: **\$0.98**

**DUKE ENERGY(NYSE:DUK)**

*Quarterly Earnings Report: Raising Target Price*

**Highlights**

- 3Q11 earnings of \$0.50/share vs \$0.51/share
- Raises 2011 earnings guidance to \$1.40-\$1.45/share
- Potential \$700 million in savings from DUK/PGN merger
- Attractive 4.8% dividend yield
- Raising price target to \$22.00/share from \$20.50/share

**Investment Thesis**

Currently Wall Street is debating the length of the US economic malaise with GDP estimated to grow about 2% over the next year or two. While we find this difficult to predict, 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 this malaise. One attractive sector is the utility group and one company in this area we like Duke Energy (DUK-\$20.70). This utility pays an attractive 4.8% dividend yield, potential dividend growth, trades at 1.2x book value/share, and offers earnings growth prospects with a recovery in the US economy. DUK is rated OUTPERFORM and our new price target is \$22.00/share.

**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 approximately 27,000 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. Commercial Power owns/operates 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.*



# EQUITY RESEARCH

Duke Energy Generation Services, part of Commercial Power, operates/owns various generating assets including wind assets serving large use industrial, municipal, and utility customers. DEI manages/operates power generation facilities in Latin America and has equity investments in Greece and Saudi Arabia. Overall, DUK's domestic regulated electrical generation is fueled by coal (59%), nuclear (39%), hydro/wind (2%), and natural gas/oil (>1%). 2010 revenues for DUK totaled \$14.3 billion with the majority coming from USFE&G (74.3%), followed by Commercial Power (17.2%), DEI (8.4%), 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 500,000 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. Currently CP has 735 MW of wind production in service and a potential developmental pipeline of an additional 5,000 MW. DEI has approximately 4000 MW of generating capacity located primarily in Latin America. Roughly 75% of DEI's electrical generation comes from hydroelectric with 90% of output for 2010 under contract.

## Recent Earnings

DUK reported 3Q11 adjusted earnings of \$0.50/share vs. \$0.51/share during 3Q10. 3Q11's earnings benefitted from higher-than-normal service territory temperatures in USFE&G's regulated electric service and gas territories. On a quarter-to-quarter basis, USFE&G reported continuing operations segment EBIT of \$721 million compared to \$946 million. CP produced continuing operations segment EBIT of \$67 million vs. \$188 million. 3Q11 CP results were negatively impacted by a \$79 million pre-tax charge and lower mark-to-market charges. Also, affecting this unit was annualized effect of 2010 customer switching in Ohio. DEI's continuing operations segment EBIT improved to \$168 million, from \$110 million, due to favorable overseas results and positive pricing/foreign exchange rates in Brazil. Overall operating revenues rose to \$3.96 billion, from \$3.95 billion, and operating expenses grew to \$3.19 billion from \$2.92 billion. Interest expense increased to \$213 million from \$202 million due to higher debt balances from financing of ongoing construction program.

### SEGMENT RESULTS:

USFE&G's 3Q11 segment EBIT from continuing operations declined to \$721 million from \$946 million due to a \$220 million pre-tax impairment charge from estimated cost increases related to the Edwardsport IGCC project in Indiana. The just completed quarter was also impacted by less favorable weather and anticipated increases in



operating/maintenance cost, partially offset by higher profits from DUK's ongoing modernization program. Segment operating revenues declined to \$2.93 billion from \$2.94 billion while operating expenses rose to \$2.28 billion from \$2.07 billion. GWh sales in the Carolina service territory fell 3.3% to 22,832 GWh and Midwest service territory sales were lower by 2.8% to 16,127 GWh.

CP reported 3Q11 EBIT of \$67 million vs. \$188 million. 3Q11's results were impacted by a \$79 million pre-tax impairment of emission allowances produced by recently finalized EPA Cross-State Air Pollution Rule and lower mark-to-market gains on economic hedges. Results were also negatively impacted by the annualized effect of 2010 customer switching in Ohio. Management stated the Ohio switching situation continued to remain stable and expects its Midwest gas fleet to set a production record in 2011. CP's operating revenues declined to \$687 million from \$737 million and operating expenses rose to \$621 million from \$553 million. GWh sales improved 8.7% to 11,207 GWh and plant production rose 15.9% to 8,813 GWh.

DEI's 3Q11 continuing operations segment EBIT from continuing operations rose to \$168 million from \$110 million. The improvement in EBIT came from higher average selling prices/volumes from the National Methanol Company unit, favorable hydrology and increased average prices in Central America, and positive pricing/foreign exchange rates in Brazil. DEI's operating revenue improved to \$360 million from \$273 million while operating expenses increased to \$236 million from \$180 million. GWh sales rose to 4,565 GWh from 4,426 GWh.

Duke's "Other" reported continuing operating revenues of \$14 million vs. \$17 million. Operating expenses declined to \$80 million from \$142 million due to the prior year's quarter severance costs associated with a voluntary separation plan/office consolidation and a litigation reserve. "Others" net expense improved to \$74 million from \$100 million.



# EQUITY RESEARCH

## Our Thoughts

DUK's reported 3Q11 adjusted earnings guidance of \$0.50/share, vs \$0.51/share, was well within the consensus of Wall Street expectations. Continuing operations segment EBIT declined at the USFE&G unit due to the \$220 million pre-tax impairment charge from estimated cost increases related to the Edwardsport IGCC project in Indiana, less favorable weather comparisons, and higher operating/maintenance costs. These were partially offset by higher profits from DUK's ongoing modernization program. CP's continuing operations segment EBIT fell to \$67 million from \$188 million due to a \$79 million pre-tax impairment related to emission allowances, lower mark-to-market gains on economic hedges, and annualized effect of 2010's customer switching in Ohio. DEI's continuing operations segment EBIT increased to \$168 million from \$110 million because of higher average selling

prices/volumes from the National Methanol Company unit, favorable hydrology and increased average prices in Central America, and positive pricing/foreign exchange rates in Brazil.

Overall operating revenues rose to \$3.96 billion, from \$3.95 billion, and operating expenses grew to \$3.19 billion from \$2.92 billion. Interest expense increased to \$213 million from \$202 million due to higher debt balances from financing of ongoing construction program.

During the earnings conference call management raised its 2011 earnings guidance range to \$1.40-\$1.45/share from \$1.35-\$1.40/share. Additionally, the company discussed its focus on the upcoming merger with Progress Energy (PGN-\$53.97). This merger awaits approval from the states of North Carolina and South Carolina in order to finalize the deal. Once done, DUK anticipates the combined entities could produce fuel/joint dispatch savings of \$700 million over the first five years. These savings would flow-through to customers via the fuel clause. DUK entered into an agreement with North Carolina guaranteeing a minimum of \$650 million over the first five years following the proposed merger.

While there is likely to be some growth from the combined regulated service territories, Wall Street appears to be keying on savings from the merger. Potentially, these savings will improve overall cash flow and generate future increases of the dividend. Shareholders should note, when the deal is finalized DUK's stock will do a 3:1 reverse split taking its price closer to the current price level of PGN.

We rate DUK **OUTPERFORM** and recommend these shares to income/growth investors. Our 2011 earnings estimate of is \$1.43/share. The high dividend yield of 4.8% should reward patient investors awaiting earnings growth, and positive effects from cost synergies, from the combination of PGN and DUK. We are raising our price target to \$22.00/share, from \$20.50/share, equating to 1.28x DUK's book value of \$17.16/share.



## 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 results from foreign operating units, 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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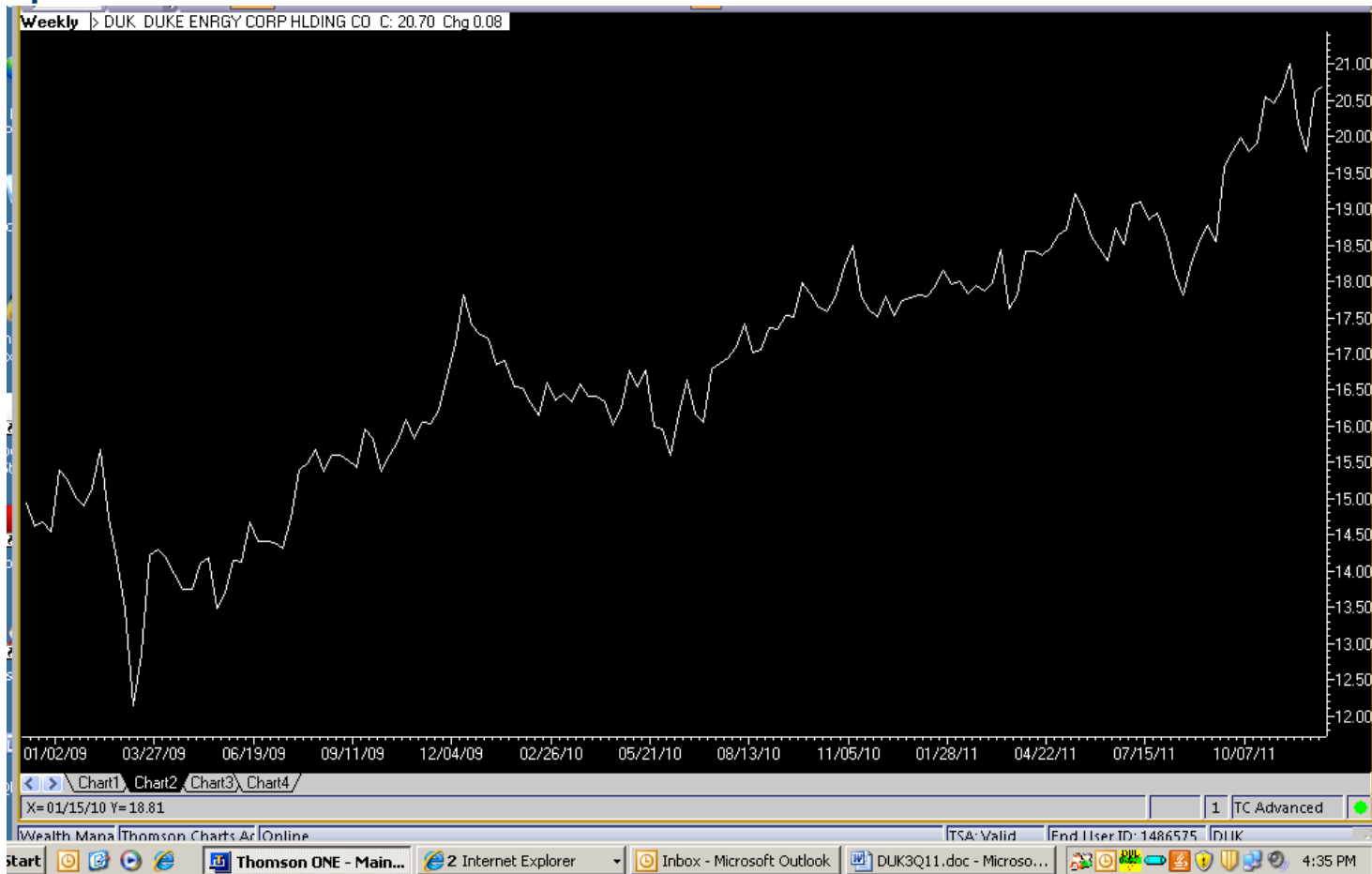
**CAPITOL  
SECURITIES**  
MANAGEMENT, INC.

# EQUITY RESEARCH

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

	1Q10	2Q10	3Q10	4Q10	2010	1Q11	2Q11	3Q11	4Q11e	2011e
Segment Earnings Before Interest/taxes From Continuing Operations										
US Franchised Electric & Gas	\$744	\$671	\$946	\$605	\$2,966	\$712	\$619	\$943	\$572	\$2,846
Commercial Power	100	89	155	54	398	95	59	145	91	390
International Energy	140	126	110	110	486	180	179	168	102	629
Total reportable segment EBIT	984	886	1,211	769	3,850	987	857	1,256	765	3,865
Other	-71	-39	-47	-121	-278	-34	-54	-61	-84	-233
Total reportable segment EBIT & other EBIT	\$913	\$847	\$1,164	\$648	\$3,672	\$953	\$805	\$1,195	\$681	\$3,634
Interest Expense	-210	-212	-202	-216	-840	-219	-203	-213	-218	-853
Interest Income & Other	14	39	25	4	82	27	36	8	12	83
Income Taxes from Continuing Operations	-246	-216	311	-156	-929	-238	-193	-326	-191	-948
Discontinued Operations, net of taxes										
Less: Net Income Attributable to Non-Controlling Interests		5	-4	2	3	2	6	-2	-4	2
Net Income (Loss)	\$471	\$453	\$680	\$278	\$1,882	\$525	\$439	\$666	\$280	\$1,910
Earnings Per Share (fully diluted)	\$0.36	\$0.34	\$0.51	\$0.21	\$1.43	\$0.39	\$0.33	\$0.50	\$0.21	\$1.43

## Important Disclosures



12/5/11 Raised Price Target to \$22.00

9/19/11 Raised Price Target to \$20.50

9/23/09 \$15.72 Initiate OUTPERFORM

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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) 40%, (2) 60%, (3) 0%

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