



December 26, 2014

**CURRENT PRICE:** \$85.81  
**RATING:** BUY  
**PRICE TARGET:** \$85  
**CURRENT YIELD:** 3.8%

**EPS Estimates - Non-GAAP**

	DEC 13A	DEC 14E
1Q	\$1.02	\$1.17A
2Q	\$0.87	\$1.11A
3Q	\$1.46	\$1.40A
4Q	\$1.00	\$0.88
	<b>\$4.35</b>	<b>\$4.56</b>

**Trading Data**

52-WEEK PRICE RANGE: **\$86.43 - \$67.05**  
 SHARES OUTSTANDING: **707(M)**  
 MARKET CAP: **\$60,668(M)**  
 AVG. DAILY TRADING VOLUME: **2.8(M)**  
 S&P 500: **2,007**

**Valuation Data**

BOOK VALUE: **\$58.61**  
 PRICE TO BOOK: **1.46x**  
 DIVIDEND: **\$3.18**

**Duke Energy (NYSE: DUK)**

*3Q14 earnings results- maintain BUY rating*

**Highlights**

- Adjusted diluted earnings of \$1.40/share vs. \$1.46 /share
- Mild weather hurts earnings comparisons
- Recognized \$3.4 billion liability for asset retirement obligations
- Maintains 2014 earnings guidance range of \$4.50-\$4.65/share
- Maintain BUY rating & raising price target to \$88

**Investment Thesis**

Wall Street believes the US economy is emerging from its recent economic malaise with GDP estimated to grow about 2%-3% 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. This utility pays an attractive 3.8% dividend yield, has potential dividend growth, and offers earnings growth potential going forward. DUK is rated BUY and our price target is \$88/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; Regulated Utilities (RU), Commercial Power (CP), and Duke Energy International (IE). USFE&G contains the company's regulated generation and the electric/gas distribution and transmission systems. Serving approximately 7.2 million electric customers in NC, SC, FL, 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 49,000 megawatts (MW) of regulated electrical generating capacity with its plants fueled by coal, oil, natural gas, hydroelectric, and nuclear. This past July DUK recently merged with Progress Energy creating one of the largest electric utilities in the US.

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

100 Concourse Boulevard, Suite 101  
 Glen Allen, Virginia 23059

804.612.9700 ■ 800.612.1484  
 804.527.1104

[www.CapitolSecurities.com](http://www.CapitolSecurities.com)

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# EQUITY RESEARCH

## Recent Earnings

DUK reported 3Q14 adjusted diluted earnings of \$1.40/share vs. \$1.46/share during 3Q13. Results were impacted by mild weather in its service territories, lower profits from the Regulated and International units, and lower retail customer load growth. Reported diluted earnings, when comparing the two quarters, was \$1.80/share vs. \$1.42/share, and results were impacted by a pre-tax reversal of an impairment charge (+\$0.43/share) during 3Q14. Regulated Utilities segment's adjusted segment income declined slightly \$920 million from \$923 million, International Energy's fell to \$80 million from \$116 million, while Commercial Power's rose to \$51 million from \$15 million. Total operating revenues rose to \$6.40 billion from \$6.22 billion and total operating expenses increased to \$4.79 billion from \$4.56 billion. Book value improved to \$58.61/share from \$58.41/share.

## SEGMENT RESULTS

The Regulated Utility segment's reported adjusted segment income fell slightly to \$920 million from \$923 million and operating income decreased to \$1.63 billion from \$1.66 billion. The unit benefited from higher pricing coming from a 2013 Duke Carolina rate case (+\$0.07/share), a favorable tax rate (+\$0.04), and positive weather comparisons (+\$0.04/share). Offsetting these positives were higher depreciation/amortization expense (-\$0.06/share), and interest mainly associated with new assets in the rate base (-\$0.04/share), lower retail customer volumes (-\$0.03/share), and higher property/other non-income taxes (-\$0.03/share).

Total GWh sales declined to 65,600 GWh from 66,539 GWh. The decrease was due to lower sales from Duke Indiana (-6.0%), Duke Energy Progress (-2.7%), Duke Energy Ohio (-1.9%), and Duke Energy Carolina (-0.5%) while being partly offset by a rise from Duke Energy Florida (+2.6%).

CP reported adjusted segment income of \$51 million vs. \$15 million. The improved results was attributable to higher profits from the Midwest coal/gas generation fleets (+\$0.05/share) created by higher PJM capacity prices. Operating income from this unit was -\$37 million vs. -\$46 million. Actual plant GWh production decreased 14.5% to 1,246 GWh as coal fired plant production fell 63% to 192 GWh. This was partly offset by a 12% increase to 1,054 GWh from renewable plant production.

IE reported adjusted segment income of \$80 million from \$116 million. The decline was due to decreased quarterly adjusted earnings from unfavorable results at IE's Latin American operations (-\$0.05/share) caused by lower volumes and higher purchased power costs caused by poor hydrology in Brazil. Also contributing was an unexpected plant outage in Chile. Overall GWh sales decreased 15.2% to 4,292 GWh from 5,062 GWh.

"Other", which includes corporate interest expense not allocated to the other units/DUK's captive insurance company/other investments/income tax levelization adjustments rose to \$58 million from \$21 million. The increase resulted from a prior-year state deferred tax adjustments.



## RECENT DEVELOPMENTS

The Board of Directors recently increased the annual dividend 2% to \$3.18/share from \$3.12/share.

DUK, Dominion Resources (D-\$79.38), and AGL Resources (GAS-\$54.95), and Piedmont Natural Gas (PNY-\$39.58) announced the formation of a joint venture to build a natural gas pipeline, called the Atlantic Coast Pipeline. The project will cost approximately \$4.5-\$5.0 billion and will move gas from the Marcellus shale area in WVA to NC and VA. The objective is to move natural gas to end users in VA and NC and is expected to be in service by year end 2018. D will build/operate the pipeline on behalf of the joint venture and will be given a 45% ownership stake, with DUK owning 40%, and PNY and GAS owning 10% and 5%, respectively.

On 9/30/14 DUK recognized a liability of approximately \$3.4 billion in asset retirement obligations from the Coal Ash Management Act of 2014. This act required DUK to close ash basins in NC.

After announcing the sale of its Midwest generation assets to Dynegy during 3Q14, DUK reclassified this business as discontinued operations for accounting purposes.

This past August DUK filed a seven year \$1.9 billion grid modernization with the Indiana commission to invest in its transmission and infrastructure system in that state. Regulators are expected to rule on the plan during 2Q15. DUK finalized an agreement for a \$1.2 billion purchase of NC Eastern Municipal Power Agency's (NCEMPA) minority existing nuclear/coal generation. Additionally, the company filed for FERC approval for the asset purchase agreement and a 30-year full-requirement wholesale agreement with NCEMPA.

During 3Q14, hearings were held by the Florida Commission (FC) on the proposed 1,640 MW combined cycle-facility in Citrus County FL, and the 220 MW of uprates at the Hines FL facility. Last month the FC issued certificates for both the Hines and Citrus and Hines County facilities.



## Our Thoughts

DUK produced 3Q14 adjusted diluted earnings of \$1.40/share vs. \$1.46/share during 3Q13. The decline in results was due to mild weather in its service territories, with CP being the only operating unit to show improved profitability during 3Q14. During the quarterly conference call management affirmed its 2014 adjusted earnings guidance of \$4.50-\$4.65/share. Income investors were rewarded with a dividend increase during 3Q14 as the common stock's annual dividend was increased to \$3.18 share from \$3.12/share. Further earnings growth in 2015 could lead to another increase of DUK's annual dividend. We are raising our price target on DUK to \$88/share, equating to the shares trading at 1.5x current book value/share. This stock is rated a BUY.

## Risks

There is no guarantee DUK will improve earnings/cash flow. Declining US electric sales volumes may hurt the company's revenues and profits. Rising interest rates, higher fuel prices, negative rate case decisions, 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.

Steven F. Marascia  
Director of Research  
Capitol Securities Management  
804-612-9715

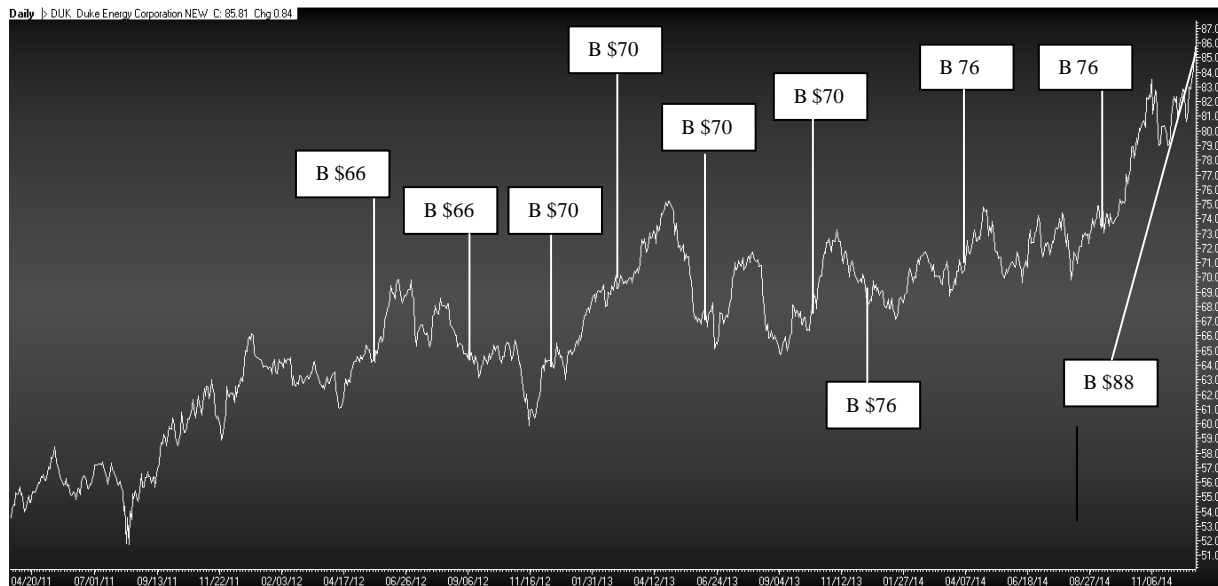


# EQUITY RESEARCH

**Dominion Resources**  
(in millions, except per share data)

	1Q13	2Q13	3Q13	4Q13	FY13	1Q14	2Q14	3Q14	4Q14e	FY14e
<b>Operating Revenue</b>	\$3,475	\$ 2,961	\$3,439	\$3,234	\$13,109	\$3,631	\$2,813	\$3,050	\$3,295	\$12,789
<b>Operating Expenses</b>										
Electric fuel/other energy-related purchases	950	851	1,107	952	3,860	898	633	743	955	3,229
Purchased electric capacity	88	88	91	91	358	88	87	86	92	347
Purchased gas	467	283	220	326	1,298	533	324	209	331	1,397
Other operations & maintenance	569	594	507	583	2,253	512	626	570	578	2,297
Depreciation, depletion, & amortization	297	303	309	298	1,207	307	308	317	294	1,226
Other taxes	183	139	134	120	556	160	134	123	117	534
<b>Total operating expenses</b>	<b>2,534</b>	<b>2,258</b>	<b>2,368</b>	<b>2,370</b>	<b>9,530</b>	<b>2,498</b>	<b>2,112</b>	<b>2,048</b>	<b>2,367</b>	<b>9,023</b>
<b>Income from operations</b>	<b>941</b>	<b>703</b>	<b>1,071</b>	<b>864</b>	<b>3,579</b>	<b>1,133</b>	<b>701</b>	<b>1,002</b>	<b>928</b>	<b>3,762</b>
<b>Other income</b>	<b>44</b>	<b>37</b>	<b>28</b>	<b>36</b>	<b>145</b>	<b>26</b>	<b>51</b>	<b>39</b>	<b>45</b>	<b>161</b>
<b>Income before interest &amp; income taxes</b>	<b>985</b>	<b>740</b>	<b>1,099</b>	<b>900</b>	<b>3,724</b>	<b>1,159</b>	<b>752</b>	<b>1,041</b>	<b>973</b>	<b>3,325</b>
<b>Interest &amp; related charges</b>	<b>226</b>	<b>201</b>	<b>217</b>	<b>226</b>	<b>870</b>	<b>236</b>	<b>226</b>	<b>228</b>	<b>239</b>	<b>1,185</b>
<b>Income before income taxes</b>	<b>759</b>	<b>539</b>	<b>882</b>	<b>674</b>	<b>2,854</b>	<b>923</b>	<b>526</b>	<b>813</b>	<b>734</b>	<b>2,398</b>
<b>Income taxes</b>	<b>276</b>	<b>178</b>	<b>293</b>	<b>203</b>	<b>950</b>	<b>310</b>	<b>163</b>	<b>266</b>	<b>250</b>	<b>989</b>
<b>noncontrolling interests</b>	<b>7</b>	<b>6</b>	<b>6</b>	<b>4</b>	<b>23</b>	<b>6</b>	<b>2</b>	<b>2</b>	<b>5</b>	<b>15</b>
<b>Operating Earnings</b>	<b>\$476</b>	<b>\$355</b>	<b>\$583</b>	<b>\$467</b>	<b>\$1,881</b>	<b>\$607</b>	<b>\$361</b>	<b>\$545</b>	<b>\$479</b>	<b>\$1,992</b>
<b>Operating Earnings per Share</b>	<b>\$0.83</b>	<b>\$0.62</b>	<b>\$1.00</b>	<b>\$0.80</b>	<b>\$3.25</b>	<b>\$1.04</b>	<b>\$0.62</b>	<b>\$0.93</b>	<b>\$0.82</b>	<b>\$3.41</b>
<b>Items excluded from operating earnings (net of taxes)</b>	<b>-19</b>	<b>-153</b>	<b>-14</b>	<b>-36</b>	<b>-184</b>	<b>-288</b>	<b>-203</b>	<b>-19</b>	<b>-27</b>	<b>-537</b>
<b>Reported Net Income</b>	<b>\$495</b>	<b>\$202</b>	<b>\$569</b>	<b>\$431</b>	<b>\$1,697</b>	<b>\$379</b>	<b>\$158</b>	<b>\$526</b>	<b>\$452</b>	<b>\$1,515</b>
<b>Reported Earnings Per Common Share-Diluted</b>	<b>\$0.86</b>	<b>\$0.35</b>	<b>\$0.98</b>	<b>\$0.74</b>	<b>\$2.93</b>	<b>\$0.65</b>	<b>\$0.27</b>	<b>\$0.90</b>	<b>\$0.78</b>	<b>\$2.60</b>
<b>Average shares outstanding, diluted</b>	<b>577.5</b>	<b>578.9</b>	<b>580.1</b>	<b>581.3</b>	<b>579.5</b>	<b>581.6</b>	<b>583.9</b>	<b>584.6</b>	<b>584.6</b>	<b>584.6</b>

## Important Disclosures



12/26/14 Raise Price Target to \$88  
 12/6/13 Raise Price Target to \$76  
 12/12/12 Raise Price Target to \$70  
 12/5/11 Raise Price Target to \$66  
 9/19/11 Raise Price Target to \$61.50  
 9/23/09 Initiate Buy Rating & \$60 Target Price  
 Ratings:  
 Buy: B  
 Hold: H  
 Sell: S

\$88 price target equates to 1.5x book value/share

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- (2) Hold – 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.
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