



September 7, 2015

**CURRENT PRICE:** \$68.26  
**RATING:** BUY  
**PRICE TARGET:** \$88  
**CURRENT YIELD:** 4.8%

**EPS Estimates - GAAP**

|    | DEC 14A       | DEC 15E       |
|----|---------------|---------------|
| 1Q | \$1.17        | \$1.22A       |
| 2Q | \$1.11        | \$0.95A       |
| 3Q | \$1.41        | \$1.31        |
| 4Q | \$0.86        | \$1.13        |
|    | <b>\$4.55</b> | <b>\$4.61</b> |

**Trading Data**

52-WEEK PRICE RANGE: **\$89.97 - \$68.66**  
 SHARES OUTSTANDING: **692(M)**  
 MARKET CAP: **\$47,236(M)**  
 AVG. DAILY TRADING VOLUME: **3.7(M)**  
 S&P 500: **1,921**

**Valuation Data**

BOOK VALUE: **\$57.56**  
 PRICE TO BOOK: **1.19x**  
 DIVIDEND: **\$3.30**

**Duke Energy (NYSE: DUK)**

*2Q15 earnings results- maintain BUY rating*

**Highlights**

- Adjusted diluted earnings of \$0.95/share vs. \$1.11 /share
- International Energy unit struggles
- Midwest Generation business sold to Dynegy/share repurchase
- Dividend increased 4%
- Maintain BUY rating

**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 4.8% 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.*

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## Recent Earnings

DUK reported 2Q15 diluted earnings of \$0.78/share vs. \$0.86/share during 2Q14. Results were lower due to the absence of tax items incurred in 2Q14, timing of O&M expenses in the RU, and continued weakness in DUK's International operations. 2Q15's adjusted diluted earnings decreased to \$0.95/share from \$1.11/share during 2Q14. Segment income declined at all three of the company's operating units. Revenues from CP decreased, when comparing the two quarters, following DUK's sale of its Midwest Generation business from this unit on 4/2/15. In conjunction with the sale of the Midwest generation business to Dynegy (DYN-\$24.19) for \$2.8 billion, DUK completed an accelerated share repurchase program of approximately 19.8 million shares.

## SEGMENT RESULTS

The Regulated Utilities adjusted segment income decreased to \$632 million from \$689 million (excluding effects of the share repurchase program) as operating revenues fell to \$5.22 billion from \$5.28 billion and operating expenses declined to \$4.00 billion from \$4.02 billion. The lower results were due to higher O&M expenses (-\$0.11/share) from the timed planned outages in its generation fleet and the impact of nuclear outage cost levelization (-\$0.05/share). Also negatively impacting quarterly results were higher DD&A expense (-\$0.05/share), mainly from additional plant in-service, and a higher effective tax rate (-\$0.04/share) due to the absence of a favorable tax benefit incurred during 2Q14. These were partly offset by higher weather-normal retail volumes (+\$0.05/share), favorable weather mainly in the Carolinas (+\$0.03/share), higher revenues generated by increased pricing/riders related to energy efficiency programs and the lack of prior year's true-ups (+\$0.03/share), and increased wholesale net margins produced by growth in contracted amounts (+\$0.02/share).

Total GWh sales grew 2.3% to 60,998 GWh from 59,646 GWh when comparing the two quarters. The increase was due to higher GWh sales from Duke Energy Carolinas (+2.3%), Duke Energy Progress (+1.8%), Duke Energy Florida (+9.8%), and Duke Energy Ohio (+7.0%). These were partly offset by lower sales from Duke Energy Indiana (-8.9%).

CP reported an adjusted segment income of \$8 million during 2Q15 vs. \$16 million during 2Q14. After selling its Midwest Generation business this past April, CP's remaining operations are in the commercial renewables area and its commercial electric/gas transmission investments. The decrease in operating results was due to lower wind production. Operating revenues rose to \$75 million from \$64 million and operating expenses increased to \$84 million from \$80 million. Actual GWh plant production declined to 1,373 GWh from 1,673 GWh.

IE reported 2Q15 adjusted segment income of \$52 million compared to \$146 million during 2Q14. The decline was due to lower results in Latin America from the absence of a favorable Chilean tax benefit incurred during 2Q14 (-\$0.07/share), a weak economy and lower electrical demand in Brazil (-\$0.04/share), and foreign currency exchange rates (-\$0.01/share).



Other, includes corporate interest expense not allocated to the business units (e.g., DUK's captive insurance company, other investments, and income tax levelization adjustments), and generated 2Q15 adjusted net expense of \$34 million vs. \$65 million.

## RECENT DEVELOPMENTS

Duke Energy Florida reached a proposed settlement agreement related to the company's recent CR3 Regulatory Asset filing (Docket: 150148-EI). The agreement will allow Duke Energy Florida to waive its rights to challenge the reasonableness/prudence of any DEF action related to the CR3 asset filing. The agreement also creates an agreement to reduce the value of the CR3 Regulatory Asset to be scrutinized at approximately \$1.283 billion. This agreement will cause DUK to take a pre-tax charge to adjusted earnings of roughly \$15 million.

DUK initiated a request for proposals for approximately 53 MW of utility scale solar capacity to be in service in SC by year end 2016.

DUK will announce its recommended new 230-kilovolt transmission line route between Campobello SC and Asheville NC in early October.

The NC department of Environment and Natural Resources announced approval of one of DUK's final requirements needed to store millions of tons of coal ash at the Colon and Brickhaven Mine sites in Lee and Chatham Counties. In a related issue, DUK submitted a comprehensive groundwater assessments for each of the 14 coal plant sites in NC.

DUK closed its \$1.25 million purchase four power plants owned by the NC Eastern Municipal Power Agency. These plants have a combined generating capacity of 700 MW.

The company's subsidiary, Duke Energy Renewables, acquired a 20 MW AC solar power project in Shawboro NC from Exoplexus, Inc. Construction of the project is expected to be completed by year end and will provide power to 4,000 homes. The power generated by this facility will be sold to Dominion Resource's (D-\$67.23) unit, NC Power, under a 15 year agreement.

DUK named senior VP of enterprise legal support for Duke Energy, David Fountain, as its state president for NC.

DUK completed the announced \$1.5 billion accelerated stock repurchase program associated with the recent sale of its Midwest Generation assets to Dynegy Corp. (DYN-\$24.19). The program retired approximately 19.8 million shares of DUK's common stock.



The Board of Directors increased the common stock's annual dividend 4% to \$3.30/year.

## Our Thoughts

DUK reported 2Q15 adjusted earnings of \$0.95/share vs. \$1.11/share during 2Q14 and diluted earnings per share of \$0.78/share vs. \$0.86/share. The lower results were due to a favorable tax item during 2Q14 and lower segment adjusted income in the IE unit during 2Q15. RU results were lower due to lower revenues, increased expenses, and a higher tax rate. The decline in IE was produced by the ongoing Brazilian economic slowdown and continued decreased rainfall levels in the region. During the conference call, DUK was hopeful the decreasing water levels would reach a nadir during the next 2 quarters and potentially improve in 2016. Additionally, management reiterated 2015 adjusted diluted earnings guidance of \$4.55-\$4.75/share. It appears DUK is working its way through its coal ash problem, setting up estimated reserves needed to deal with the clean-up costs (over \$1 billion) and seems confident of a positive resolution. Should the company successfully overcome its coal ash problems and continue to grow operating earnings, there is a good chance DUK will continue to raise its annual dividend.

Given the current dividend yield of 4.8%, and the potential for future dividend increases, DUK offers patient investors both income and share appreciation potential. Our price target is \$88/share, equating to DUK trading at 1.53x book value per share.



## 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.

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# EQUITY RESEARCH

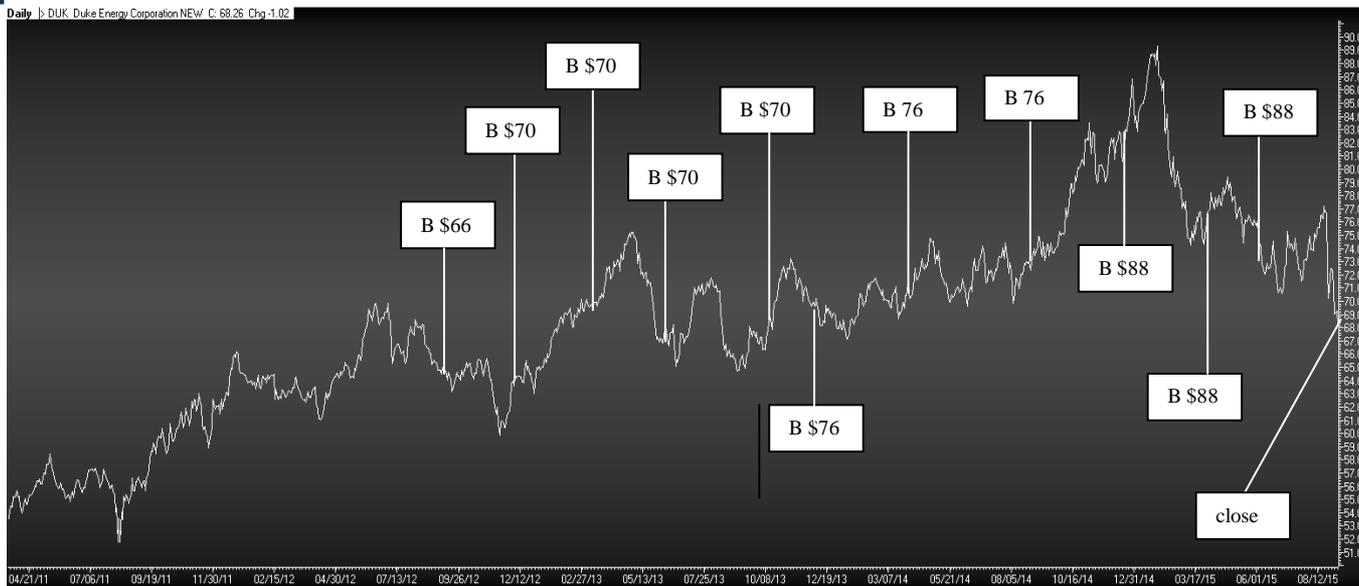
Duke Energy  
Condensed Consolidated Statements of Operations  
unaudited  
(in millions, except per share amounts)

|  | 1Q14     | 2Q14    | 3Q14     | 4Q14    | 2014     | 1Q15    | 2Q15    | 3Q15e    | 4Q15e    | 2015e    |
|--|----------|---------|----------|---------|----------|---------|---------|----------|----------|----------|
| <b>Operating Revenues:</b>                               |          |         |          |         |          |         |         |          |          |          |
| Regulated electric                                       | \$5,578  | \$5,167 | \$5,861  | \$4,944 | \$21,550 | \$5,457 | \$5,090 | 5,948    | \$5,286  | \$21,781 |
| Non-regulated electric/natgas/other                      | 824      | 675     | 449      | 144     | 1,802    | 377     | 403     | 852      | 940      | 2,572    |
| Regulated natural gas                                    | 222      | 107     | 85       | 159     | 573      | 231     | 96      | 88       | 163      | 578      |
| Total Operating revenues                                 | 6,624    | 5,949   | 6,395    | 4,957   | 23,925   | 6,065   | 5,589   | 6,888    | 6,389    | 24,931   |
| <b>Operating Expenses:</b>                               |          |         |          |         |          |         |         |          |          |          |
| Fuel electric gen. & purchased power-reg                 | 2,000    | 1,808   | 2,132    | 1,746   | 7,686    | 1,941   | 1,721   | 1,786    | 1,703    | 7,151    |
| Fuel electric gen. & purch power-non reg                 | 409      | 436     | 148      | 460     | 533      | 104     | 118     | 381      | 483      | 1,086    |
| Cost of natural gas & coal sold                          | 122      | 43      | 27       | 56      | 248      | 111     | 26      | 39       | 71       | 247      |
| Operation, maintenance, & other                          | 1,506    | 1,467   | 1,409    | 1,474   | 5,856    | 1,426   | 1,422   | 1,455    | 1,427    | 5,730    |
| Depreciation & Amortization                              | 790      | 761     | 788      | 728     | 3,066    | 777     | 790     | 785      | 752      | 3,104    |
| Property & other taxes                                   | 358      | 318     | 275      | 262     | 1,213    | 264     | 279     | 324      | 315      | 1,182    |
| Impairment charges                                       | 1,382    | 6       | 1        | 1,470   | 81       |         |         | 8        | 2        | 10       |
| Total Operating expenses                                 | 6,567    | 4,839   | 4,780    | 2,497   | 18,683   | 4,623   | 4,356   | 4,778    | 4,753    | 18,510   |
| Gains/losses sale of other assets (net)                  | 1        | 6       | 4        | 5       | 16       | 14      | 13      |          |          | 27       |
| Operating Income   | 58       | 1,116   | 1,619    | 2,465   | 5,258    | 1,456   | 1,246   | 2,109    | 1,636    | 18,537   |
| <b>Other Income/Expenses</b>                             |          |         |          |         |          |         |         |          |          |          |
| Equity in earnings of unconsolidated affiliates          | 36       | 33      | 28       | 33      | 130      | 13      | 23      | 32       | 26       | 94       |
| Impairments/Gains on unconsol affiliates sales           |          |         |          | 17      | 17       |         |         |          |          |          |
| Other Income/Expenses                                    | 95       | 89      | 109      | 58      | 351      | 74      | 72      | 43       | 35       | 224      |
| Total other income/expenses                              | 131      | 122     | 137      | 108     | 498      | 87      | 95      | 75       | 61       | 318      |
| <b>Interest expense</b>                                  |          |         |          |         |          |         |         |          |          |          |
| Income from Cont Ops before Income Taxes                 | 406      | 413     | 405      | 398     | 1,622    | 403     | 403     | 407      | 404      | 1,617    |
| Income tax expense                                       | -217     | 825     | 1,351    | 516     | 2,775    | 1,140   | 938     | 1,777    | 1,293    | 5,148    |
| Income from Cont Ops before Income Taxes                 | -127     | 209     | 460      | 1,127   | 1,669    | 364     | 334     | 568      | 414      | 1,680    |
| Income from Discontinued Ops, net of Taxes               | -80      | 616     | 891      | 1,948   | 2,465    | 776     | 604     | 1,209    | 879      | 3,468    |
| Income from Discontinued Ops, net of Taxes               | -3       | -3      | 378      | 948     | -576     | 91      | -57     | -4       | -4       | -26      |
| <b>Net Income</b>  |          |         |          |         |          |         |         |          |          |          |
| Net Income/loss attributable to non-controlling interest | -93      | 613     | 1,269    | 100     | 1,889    | 867     | 547     | 1,205    | 875      | 3,494    |
| Net Income attributable to Duke Energy Corp              | -4       |         | 10       | 6       |          | -3      | -4      |          | -7       |          |
| Net Income attributable to Duke Energy Corp              | (\$97)   | \$609   | \$1,274  | \$97    | \$1,883  | \$864   | \$543   | \$1,205  | \$875    | 3,487    |
| <b>Diluted EPS</b>                                       |          |         |          |         |          |         |         |          |          |          |
| Net Income from discon ops attributable shareholders     | (\$0.14) | \$0.86  | \$1.80   | \$0.14  | \$2.66   | \$1.09  | \$0.78  | \$1.55   | \$1.24   | \$4.66   |
| Diluted EPS  | (\$0.14) | \$0.86  | \$1.80   | \$0.14  | \$2.66   | \$1.09  | \$0.78  | \$1.55   | \$1.24   | \$4.66   |
| Adjustments  | \$1.31   | \$0.25  | (\$0.40) | \$0.72  | \$1.89   | \$0.13  | \$0.17  | (\$0.24) | (\$0.09) | (\$0.05) |
| Adjusted Diluted EPS                                     | \$1.17   | \$1.11  | \$1.40   | \$0.86  | \$4.55   | \$1.22  | \$0.95  | \$1.31   | \$1.13   | \$4.61   |



# EQUITY RESEARCH

## 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 1.53x book value/share

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