



**CAPITOL
SECURITIES**
MANAGEMENT, INC.

EQUITY RESEARCH

April 15, 2016

CURRENT PRICE: \$80.00
RATING: BUY
PRICE TARGET: \$88
CURRENT YIELD: 4.1%

EPS Estimates - GAAP

| | DEC 15A | DEC 16E |
|----|---------------|---------------|
| 1Q | \$1.22 | \$1.30 |
| 2Q | \$0.95 | \$0.91 |
| 3Q | \$1.47 | \$1.61 |
| 4Q | \$0.87 | \$0.82 |
| | \$4.54 | \$4.64 |

Trading Data

52-WEEK PRICE RANGE: **\$81.39 - \$65.50**
SHARES OUTSTANDING: **694(M)**
MARKET CAP: **\$58,520(M)**
AVG. DAILY TRADING VOLUME: **3.8(M)**
S&P 500: **2,080**

Valuation Data

BOOK VALUE: **\$57.78**
PRICE TO BOOK: **1.38x**
DIVIDEND: **\$3.30**

Duke Energy (NYSE: DUK)

Earnings results- maintain BUY rating

Highlights

- Adjusted diluted 4Q15 earnings of \$0.87/share vs. \$0.86 /share
- Announced plans to sell International Energy assets
- Management expects 4%-6% growth rate from 2016 levels
- DUK FY16 adjusted earnings guidance to \$4.50-\$4.70/share
- 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 4.1% 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 Portfolio (CP), and Duke Energy International (IE). RU 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. RU operates 150,900 miles of electric distribution lines and a 20,900-mile transmission system. RU owns approximately 49,000 megawatts (MW) of regulated electrical generating capacity with its plants fueled by coal, oil, natural gas, hydroelectric, and nuclear. DUK with Progress Energy in 2014 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 4Q15 diluted earnings of \$0.69/share vs. \$0.14/share during 4Q14 and 4Q15 adjusted diluted earnings of \$0.87/share vs. \$0.86/share during 4Q14. Results were affected by warmer than normal weather during 4Q15 in the company's service territory. DUK's three operating units delivered mixed results as RU's adjusted segment income rose to \$601 million from \$551 million, CP's increased to \$41 million from \$32 million, and IE's decreased to \$68 million from \$71 million. FY15 diluted earnings rose to \$4.05/share from \$2.66/share and FY15 adjusted diluted earnings decreased to \$4.54/share from \$4.55/share. Management provided FY16 adjusted diluted earnings guidance of \$4.50-\$4.70/share. During 2014 DUK incurred charges principally to repatriated \$2.7 billion of foreign earnings, a settlement resolving a grand jury investigation into coal ash spills, and merger costs-to-achieve.

SEGMENT RESULTS

Regulated Utilities 4Q15 adjusted segment income rose to \$601 million, from \$551 million during 4Q14. This added \$0.07/share to DUK's overall earnings. The improved results were driven by increased pricing/riders (+\$0.09/share) resulting from increased riders and including a favorable Ohio energy efficiency settlement. Additional improvement came from higher wholesale margins (+\$0.05/share) due to updated/new contracts (included earnings from wholesale contracts associated with the recent purchase of NCEMPA purchase) and higher weather-normal retail volumes (+\$0.04/share). Partly offsetting these improvements was mild winter weather in DUK's service territory (-\$0.12/share).

When comparing the two quarters, total GWh sales decreased 0.4% to 58,052 GWh from 58,271 GWh. These results were due to lower GWh sales from Duke Energy Carolinas (-2.1%), Duke Energy Progress (-3.9%), and Duke Energy Ohio (-3.8%). These declines were partly offset by an increases in sales from Duke Energy Florida (+7.1%) and Duke Energy Indiana (+5.3%).

International Energy's 4Q15 adjusted segment income declined to \$68 million from \$72 million. On a per share basis, earnings were penalized by \$0.01/share. The decrease in results were due to lower margins at National Methanol (-\$0.03/share) caused by lower MTBE and methanol prices. This was partly offset improved results in Brazil (+\$0.02/share) which was partially offset by negative currency exchange rates.

Commercial Power's produced 4Q15 adjusted segment income rose to \$41 million from \$32 million, adding \$0.01/share to earnings. The increases was due to additional in-service wind/solar facilities in the renewables portfolio (+\$0.03/share) and was partly offset by the absence of earnings from the Midwest generation business (-\$0.01)/share, which was sold in April 2015.

Other, includes corporate interest expense not allocated to the business units, results from Duke Energy's captive insurance company, other investments, and quarterly income tax levelization adjustments. This area produced adjusted segment net expense of \$108 million during 4Q15 vs. net expense of \$45 million during 4Q14. Higher



expenses came from increased income tax expense (-\$0.07/share) due to impacts from the extension of bonus depreciation and quarterly tax levelization adjustments, which included renewable tax credits allocated to the CP upon completion of projects.

RECENT DEVELOPMENTS

DUK acquired two 5-MW solar projects in eastern NC from ET Capital for an undisclosed amount. These two facilities will supply power to approximately 2,000 homes and power is being sold to Dominion NC Power under 15-year agreements.

Duke Energy received approval from NC regulators to transition its Asheville plant to clean energy. It is estimated this project will cost ~ \$1 billion and plans are to build two 280-MW combined cycle natural gas-fueled electric generating units to replace an existing 376-MW coal plant.

The company plans to do a 9.25 million share offering whose proceeds will be used to help finance its pending acquisition of Piedmont Natural Gas (PNY-\$59.80). Additionally, the FTC approved DUK's purchase of PNY.

This past February, a NC judge stated he plans to review the \$76 million coal ash settlement made with NC state regulators, to examine whether the presiding judge, which signed off on the agreement, overstepped legal limits to close lawsuits involving conservation groups.

DUK was fined \$6.6 million by NC regulators for environmental pollution connected to the 2014 coal ash spill into the Dan River. The company is reviewing its options to challenge this particular fine.

Management said it would like to sell all or part of its International Energy unit. This consists of power plants in Central and South America with approximately 4,400-MW of power producing capacity. Additionally, the unit's 25% interest in National Methanol Co. will not be included in the potential transaction.

Four consumer/environmental groups, and Duke Energy, agreed to settle the dispute over DUK's Edwardsport coal gasification plant in Indiana, and join the company's settlement reached with other parties last September.



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Our Thoughts

DUK reported 4Q15 diluted earnings of \$0.69/share vs. \$0.14/share during 4Q14. 4Q15 adjusted diluted earnings were \$0.87/share vs. \$0.86/share during 4Q14. Results were affected by warmer than normal weather during 4Q15 in the company's service territory. DUK estimates warm weather penalized earnings by \$0.12/share. The Regulated Utilities & Commercial Portfolio operating units reported increased adjusted segment income, while a decline occurred in International Energy. The company believes it is adding various assets and making capital expenditures which could generate earnings growth of 5%-6% through 2020 off a 2016 diluted earnings base of \$4.30/share.

During the 4Q15 earnings conference call management said the planned acquisition of Piedmont Gas (PNY-\$59.80), and its natural gas assets, is expected to be accretive to DUK's earnings by 2017. Furthermore, management announced plans to sell international assets and expects to deploy the resulting capital into its other businesses geared to increasing overall profits. Overall, the company plans to deploy \$22 billion-\$25 billion of growth capital in its regulated utilities and \$3 billion-\$5 billion in commercial renewables and gas pipeline investments. DUK's strategy is to reduce its operating risk and create a steady stream of earnings.

We continue to recommend DUK's stock to income/growth investors seeking potential future increases of the annual dividend. Management intends to pay out 70%-75% of earnings to shareholders in the form of dividends. If DUK grows its forward earnings, then dividend increases may occur on annual basis during the next 5 years. Our rating on this stock is a BUY with a price target of \$88/share, equating to 1.52x DUK's 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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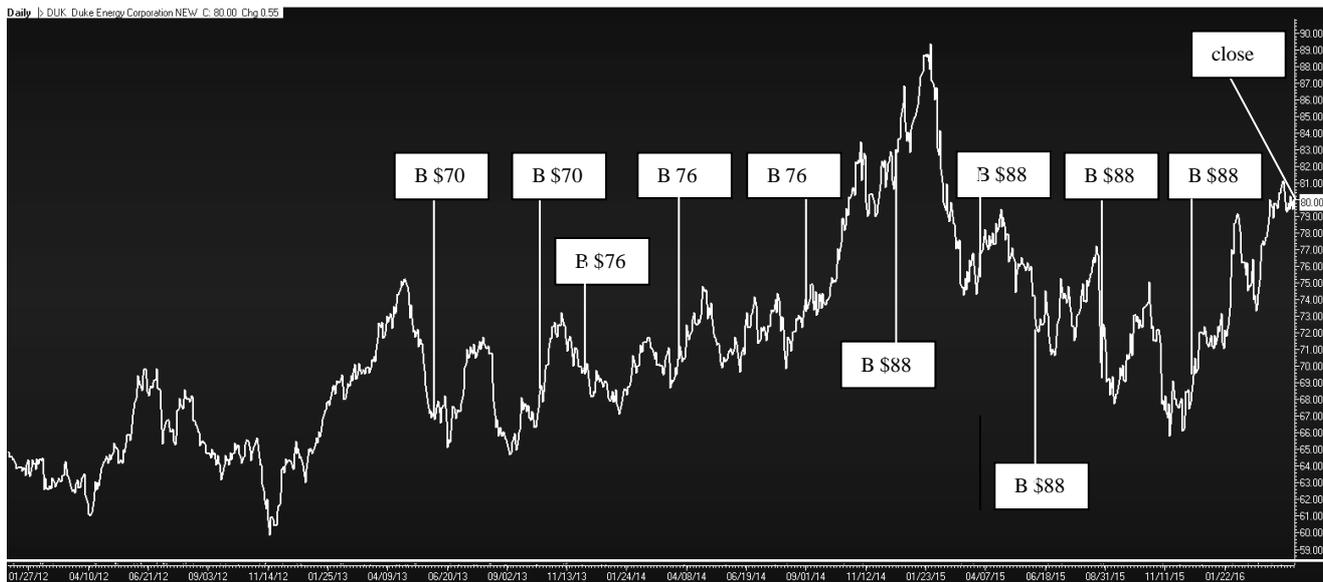
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Duke Energy
Condensed Consolidated Statements of Operations
unaudited
(in millions, except per share amounts)

| | 1Q15 | 2Q15 | 3Q15 | 4Q15 | 2015 | 1Q16e | 2Q16e | 3Q16e | 4Q16e | 2016e |
|--|---------------|---------------|---------------|---------------|----------------|---------------|---------------|----------------|---------------|----------------|
| Operating Revenues: | | | | | | | | | | |
| Regulated electric | \$5,457 | \$5,090 | 6,017 | \$4,815 | \$21,379 | \$5,599 | \$5,018 | \$6,276 | \$5,032 | \$21,925 |
| Non-regulated electric/hatgas/other | 377 | 403 | 377 | 387 | 1,544 | 361 | 405 | 381 | 374 | 1,521 |
| Regulated natural gas | 231 | 96 | 89 | 120 | 536 | 292 | 241 | 78 | 132 | 743 |
| Total Operating revenues | 6,065 | 5,589 | 6,483 | 5,322 | 23,459 | 6,252 | 5,664 | 6,935 | 5,538 | 24,189 |
| Operating Expenses: | | | | | | | | | | |
| Fuel electric gen. & purchased power-reg | 1,941 | 1,721 | 2,113 | 1,533 | 7,308 | 1,886 | 1,792 | 2,196 | 1,589 | 7,463 |
| Fuel electric gen. & purch power-non reg | 104 | 118 | 61 | 71 | 354 | 101 | 121 | 73 | 78 | 373 |
| Cost of natural gas & coal sold | 111 | 26 | 21 | 37 | 195 | 122 | 24 | 38 | 43 | 227 |
| Operation, maintenance, & other | 1,426 | 1,422 | 1,426 | 1,597 | 5,871 | 1,441 | 1,435 | 1,459 | 1,621 | 5,956 |
| Depreciation & Amortization | 777 | 790 | 774 | 803 | 3,144 | 782 | 776 | 786 | 809 | 3,153 |
| Property & other taxes | 264 | 279 | 293 | 299 | 1,135 | 291 | 294 | 298 | 304 | 1,187 |
| Impairment charges | | | 111 | 9 | 120 | | | | | |
| Total Operating expenses: | 4,623 | 4,356 | 4,799 | 4,349 | 18,127 | 4,623 | 4,442 | 4,850 | 4,444 | 18,359 |
| Gains/losses sale of other assets (net) | 14 | 13 | 4 | 4 | 35 | 11 | 6 | 14 | 7 | 38 |
| Operating Income | 1,456 | 1,246 | 1,688 | 977 | 5,367 | 1,640 | 1,228 | 1,899 | 1,101 | 5,868 |
| Other Income/Expenses | | | | | | | | | | |
| Equity in earnings of unconsolidated affiliates | 13 | 23 | 17 | 16 | 69 | 16 | 25 | 12 | 17 | 70 |
| Impairments/Gains on unconsol affiliates sales | | | | 7 | 7 | | | | | |
| Other Income/Expenses | 74 | 72 | 57 | 104 | 307 | 75 | 46 | 53 | 91 | 265 |
| Total other income/expenses | 87 | 95 | 74 | 127 | 383 | 91 | 71 | 65 | 108 | 335 |
| Interest expense | 403 | 403 | 402 | 405 | 1,613 | 406 | 405 | 408 | 412 | 1,231 |
| Income from Cont Ops before Income Taxes | 1,140 | 938 | 1,360 | 699 | 4,137 | 1,325 | 894 | 1,556 | 797 | 4,572 |
| Income tax expense | 364 | 334 | 420 | 208 | 1,326 | 424 | 277 | 499 | 247 | 1,997 |
| Income from Cont Ops before Income Taxes | 776 | 604 | 940 | 491 | 2,811 | 901 | 617 | 1,057 | 550 | 2,822 |
| Income from Discontinued Ops, net of Taxes | 91 | -57 | -5 | -9 | 20 | -34 | -12 | -28 | -16 | -92 |
| Net Income | 867 | 547 | 935 | 482 | 2,831 | 867 | 605 | 1,029 | 534 | 3,035 |
| Net Income/loss attributable to non-controlling interest | -3 | -4 | -3 | -5 | -15 | -5 | -4 | -5 | -4 | -18 |
| Net Income attributable to Duke Energy Corp | \$864 | \$543 | \$932 | \$477 | \$2,816 | \$862 | \$601 | \$1,024 | \$530 | \$3,017 |
| Diluted EPS | | | | | | | | | | |
| Net Income from discon ops attributable shareholders | \$1.09 | \$0.78 | \$1.35 | \$0.69 | \$3.91 | \$1.24 | \$0.87 | \$1.48 | \$0.76 | \$4.35 |
| Diluted EPS | \$1.09 | \$0.78 | \$1.35 | \$0.69 | \$3.91 | \$1.24 | \$0.87 | \$1.48 | \$0.76 | \$4.35 |
| Adjustments | \$0.13 | \$0.17 | \$0.12 | \$0.18 | \$0.60 | \$0.06 | \$0.04 | \$0.13 | \$0.02 | \$0.29 |
| Adjusted Diluted EPS | \$1.22 | \$0.95 | \$1.47 | \$0.87 | \$4.54 | \$1.30 | \$0.91 | \$1.61 | \$0.82 | \$4.64 |

Important Disclosures

Daily | DUK: Duke Energy Corporation NEW C: 80.00 Chg: 0.55



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 1.52x book value/share

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Analyst owns/controls family account containing shares of Duke Energy

Stock ratings used in this report are defined as follows:

- (1) Buy – 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) 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.
- (3) Sell – 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) 43%, (2) 57%, (3) 0%

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