



June 3, 2016

**CURRENT PRICE:** \$80.08  
**RATING:** BUY  
**PRICE TARGET:** \$88  
**CURRENT YIELD:** 4.1%

### EPS Estimates - GAAP

	DEC 15A	DEC 16E
1Q	\$1.22	\$1.13A
2Q	\$0.95	\$0.91
3Q	\$1.47	\$1.61
4Q	\$0.87	\$0.78
	<b>\$4.54</b>	<b>\$4.43</b>

### Trading Data

52-WEEK PRICE RANGE: **\$81.39 - \$65.50**  
 SHARES OUTSTANDING: **689(M)**  
 MARKET CAP: **\$58,520(M)**  
 AVG. DAILY TRADING VOLUME: **3.0(M)**  
 S&P 500: **2,099**

### Valuation Data

BOOK VALUE: **\$57.98**  
 PRICE TO BOOK: **1.38x**  
 DIVIDEND: **\$3.30**

## Duke Energy (NYSE: DUK)

*Earnings results- maintain BUY rating*

### Highlights

- Adjusted diluted 1Q16 earnings of \$1.13/share vs. \$1.24 /share
- Warm winter weather impacted results
- Share repurchase program added \$0.04/share to earnings
- Affirmed 2016 adjusted earnings guidance of \$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 1%-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. 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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# EQUITY RESEARCH

## Recent Earnings

DUK reported 1Q16 diluted earnings of \$1.01/share vs. \$1.22/share during 1Q15. The lower results were produced by warmer-than-normal winter weather in its service territory and the absence of contributions from the Midwest Generation business sold in 2015. DUK's three operating results delivered mixed results with improvement in adjusted segment income from International Energy (\$123 million vs. \$36 million) and declines in Regulated Utilities (\$695 million vs. \$774 million) and Commercial (\$27 million vs. \$101 million). 1Q16's adjusted diluted earnings per share decreased to \$1.13/share from \$1.24/share during 1Q15. The lower results came from mild winter weather, the absence of the Midwest Generation business, and higher winter storm repair costs. DUK initiated a share repurchase program, connected to the proceeds from the Midwest Generation business sale, and retired approximately 19.8 million shares of common stock. 1Q16's share repurchase added approximately \$0.04/share to DUK's earnings.

## SEGMENT RESULTS

Regulated Utilities' adjusted segment income decreased to \$695 million from \$774 million when comparing 1Q16 to 1Q15. The decrease was due to warmer-than-normal winter weather mainly in its Carolina and Midwest service territories (-\$0.10/share), higher depreciation/amortization expense (-\$0.06/share) mainly from additional in-plant service, including recently acquired NCEMPA assets, and higher O&M expenses (-\$0.01/share). These higher O&M costs came from winter storm costs and the NCEMPA purchase while being partly offset by lower outage costs and ongoing cost efficiency initiatives. These negatives were partly countered by higher revenues from increased pricing/riders produced by the NCEMPA rider and energy efficiency programs.

When comparing the two quarters, total GWH sales decreased 0.7% to 62,731 GWh from 63,201 GWh. These results were due to lower sales by Duke Energy Ohio (-9.8%), Duke Energy Carolinas (-3.8%), Duke Energy Florida (-0.2%), and were partly offset by increases at Duke Progress Energy (+2.3%) and Duke Energy Indiana (+7.6%).

International Energy's 1Q16 adjusted segment income rose to \$123 million from \$36 million during 1Q15. The improved results were due to lower tax expense (+\$0.11/share), and improved Brazilian results (+\$0.05/share) from improved hydrology. These two positives were partly offset by weaker foreign currency exchange rates (\$0.02/share).

Commercial Portfolio reported adjusted segment income of \$27 million during 1Q16 vs. \$101 million during 1Q15. The decline came from the absence of earnings from the Midwest Generation business (-\$0.12/share) and was slightly offset by improved results from the renewables portfolio (+\$0.01/share).

Other, includes corporate interest expense not allocated to the three business units, results from DUK's captive insurance company, other investments, and quarterly income tax levelization adjustments. This area produced adjusted net expense of \$68 million during 1Q16 vs. \$30 million during 1Q15. The lower results were due to tax adjustments in the prior year (-\$0.04/share) and higher interest expense (-\$0.01/share).



## RECENT DEVELOPMENTS

The NC Department of Environmental Quality proposed DUK be required to clean up its coal ash ponds in NC by 2024. This agency requested the company dig up and close ash pits at eight sites by 2019 and 25 other locations by 2024. DUK responded by saying they see significant risks in meeting the excavation date deadline and if the proposal is not revised, then they could place a significant impact on customer costs and hinder economic development.

DUK announced plans to invest \$3 billion in renewable energy capacity over the next five years. This will include a \$500 million investment in NC solar farms. Additionally, management said it would modernize the existing electric grid system.

Acquired six NC solar projects from Community Energy for an undisclosed amount. These facilities will generate approximately 5 MW.

The company also acquired two 5 MW solar projects in eastern NC from ET Capital for an undisclosed amount. The site is located in Garysburg NC and will provide power to area homes and some power will be sold to Dominion NC Power under a 15-year agreement.

DUK received approval from NC regulators to transition its Asheville plant to clean energy facility at a projected cost of \$1 billion. DUK plans to construct two 280 MW combined cycle natural gas-fueled electric generating units to replace an existing 376 MW coal plant planned for a 2020 retirement. A contingent request for a third gas unit was denied by the regulators.

In conjunction with its upcoming purchase of Piedmont Natural Gas (PNY-\$) the company sold an additional 1.875 million shares of DUK common stock.



## Our Thoughts

1Q16 diluted earnings declined to \$1.01/share when compared to \$1.22/share during 1Q15. Lower earnings were the result of warmer-than-normal winter weather in its service territory and the absence of contributions from the Midwest Generation business sold in 2015. There was an increase in IE's adjusted segment income and declines in both Regulated Utilities and Commercial. 1Q16's adjusted diluted earnings per share decreased to \$1.13/share from \$1.24/share during 1Q15. The lower results came from mild winter weather, the absence of the Midwest Generation business, and higher winter storm repair costs. Going forward, earnings contributions from International Energy will change since DUK intends to sell assets from this unit.

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 and believes annual earnings growth could average 4%-6% going towards 2020. If DUK delivers on this business goal, then dividend increases may occur on an 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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# EQUITY RESEARCH

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

	1Q15	2Q15	3Q15	4Q15	2015	1Q16	2Q16e	3Q16e	4Q16e	2016e
<b>Operating Revenues:</b>										
Regulated electric	\$5,457	\$5,090	6,017	\$4,815	\$21,379	\$5,503	\$5,018	\$6,276	\$5,032	\$21,829
Non-regulated electric/hatgas/other	377	403	377	387	1,544	400	405	381	374	1,560
Regulated natural gas	231	96	89	120	536	169	241	78	132	620
<b>Total Operating revenues</b>	<b>6,065</b>	<b>5,589</b>	<b>6,483</b>	<b>5,322</b>	<b>23,459</b>	<b>5,622</b>	<b>5,664</b>	<b>6,935</b>	<b>5,538</b>	<b>23,759</b>
<b>Operating Expenses:</b>										
Fuel electric gen. & purchased power-reg	1,941	1,721	2,113	1,533	7,308	1,577	1,792	2,196	1,589	7,154
Fuel electric gen. & purch power-non reg	104	118	61	71	354	58	121	73	78	330
Cost of natural gas & coal sold	111	26	21	37	195	60	24	38	43	165
Operation, maintenance, & other	1,426	1,422	1,426	1,597	5,871	1,489	1,435	1,459	1,621	6,004
Depreciation & Amortization	777	790	774	803	3,144	814	776	786	809	3,185
Property & other taxes	264	279	293	299	1,135	297	294	298	304	1,193
Impairment charges			111	9	120	3				
<b>Total Operating expenses:</b>	<b>4,623</b>	<b>4,356</b>	<b>4,799</b>	<b>4,349</b>	<b>18,127</b>	<b>4,298</b>	<b>4,442</b>	<b>4,850</b>	<b>4,444</b>	<b>18,034</b>
Gains/losses sale of other assets (net)	14	13	4	4	35	9	6	14	7	36
<b>Operating Income</b>	<b>1,456</b>	<b>1,246</b>	<b>1,688</b>	<b>977</b>	<b>5,367</b>	<b>1,333</b>	<b>1,228</b>	<b>1,899</b>	<b>1,101</b>	<b>5,561</b>
<b>Other Income/Expenses</b>										
Equity in earnings of unconsolidated affiliates	13	23	17	16	69	8	25	12	17	62
Impairments/Gains on unconsol affiliates sales				7	7					
Other Income/Expenses	74	72	57	104	307	79	46	53	91	269
<b>Total other income/expenses</b>	<b>87</b>	<b>95</b>	<b>74</b>	<b>127</b>	<b>383</b>	<b>87</b>	<b>71</b>	<b>65</b>	<b>108</b>	<b>251</b>
<b>Interest expense</b>	<b>403</b>	<b>403</b>	<b>402</b>	<b>405</b>	<b>1,613</b>	<b>511</b>	<b>405</b>	<b>408</b>	<b>412</b>	<b>1,736</b>
Income from Cont Ops before Income Taxes	1,140	938	1,360	699	4,137	909	894	1,556	797	4,156
Income tax expense	364	334	420	208	1,326	213	277	499	247	1,236
Income from Cont Ops before Income Taxes	776	604	940	491	2,811	696	617	1,057	550	2,920
Income from Discontinued Ops, net of Taxes	91	-57	-5	-9	20	3	-12	-28	-16	-54
<b>Net Income</b>	<b>867</b>	<b>547</b>	<b>935</b>	<b>482</b>	<b>2,831</b>	<b>699</b>	<b>605</b>	<b>1,029</b>	<b>534</b>	<b>2,867</b>
Net Income/loss attributable to non-controlling interest	-3	-4	-3	-5	-15	-5	-4	-5	-4	-18
<b>Net Income attributable to Duke Energy Corp</b>	<b>\$864</b>	<b>\$543</b>	<b>\$932</b>	<b>\$477</b>	<b>\$2,816</b>	<b>\$694</b>	<b>\$601</b>	<b>\$1,024</b>	<b>\$530</b>	<b>\$2,849</b>
<b>Diluted EPS</b>										
Net Income from discon ops attributable shareholders	\$1.09	\$0.78	\$1.35	\$0.69	\$3.91	\$1.01	\$0.87	\$1.48	\$0.76	\$4.12
Diluted EPS	\$1.09	\$0.78	\$1.35	\$0.69	\$3.91	\$1.01	\$0.87	\$1.48	\$0.76	\$4.12
Adjustments	\$0.13	\$0.17	\$0.12	\$0.18	\$0.60	\$0.12	\$0.04	\$0.13	\$0.02	\$0.31
<b>Adjusted Diluted EPS</b>	<b>\$1.22</b>	<b>\$0.95</b>	<b>\$1.47</b>	<b>\$0.87</b>	<b>\$4.54</b>	<b>\$1.13</b>	<b>\$0.91</b>	<b>\$1.61</b>	<b>\$0.78</b>	<b>\$4.43</b>





## Other Disclosures

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