



September 2, 2016

CURRENT PRICE: \$80.24
RATING: BUY
PRICE TARGET: \$88
CURRENT YIELD: 4.3%

EPS Estimates - GAAP

| | DEC 15A | DEC 16E |
|----|---------------|---------------|
| 1Q | \$1.22 | \$1.13A |
| 2Q | \$0.95 | \$1.07A |
| 3Q | \$1.47 | \$1.61 |
| 4Q | \$0.87 | \$0.78 |
| | \$4.54 | \$4.59 |

Trading Data

52-WEEK PRICE RANGE: **\$87.31 - \$65.50**
 SHARES OUTSTANDING: **690(M)**
 MARKET CAP: **\$55,366(M)**
 AVG. DAILY TRADING VOLUME: **3.1(M)**
 S&P 500: **2,180**

Valuation Data

BOOK VALUE: **\$57.98**
 PRICE TO BOOK: **1.38x**
 DIVIDEND: **\$3.42**

Duke Energy (NYSE: DUK)

2Q16 earnings results- maintain BUY rating

Highlights

- Adjusted diluted 2Q16 earnings of \$1.07/share vs. \$0.95 /share
- Dividend increased 3.6%
- Selling International Energy assets
- 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 4.3% 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 2Q16 diluted earnings of \$0.74/share vs. \$0.78/share during 2Q15. The results were negatively impacted by an impairment charge (\$194 million pre-tax) on the carrying value of assets in its Central America business as DUK plans to sell these assets. Adjusted segment income rose in the Regulated Utilities (+\$86 million) and Commercial Power (+\$3 million) units, while there was a decline in International Energy (-\$9 million). Adjusted diluted earnings increased to \$1.07/share from \$0.95/share, when comparing the two quarters, due to higher contributions from the Regulated Utilities unit from higher retail revenues from pricing/rider recoveries, lower O&M expenses, and additional profits from the acquisition of the North Carolina Eastern Municipal Power Agency (NCEMPA). Total operating revenues decreased to \$5.49 billion from \$5.60 billion and operating expenses declined to \$4.34 billion from \$4.37 billion. Book value per share rose to \$57.98/share from \$57.56/share.

SEGMENT RESULTS

The Regulated Utilities unit generated 2Q16 adjusted segment income of \$718 million vs. \$632 million, equating to an increase of \$0.13/share. The higher results were due to a rise in retail revenues produced by increased pricing and riders (+\$0.08/share) and lower O&M expenses (+\$0.05/share) from favorable outage costs and recent cost saving initiatives. Additionally, results were bolstered by improved net margins (+\$0.03/share) due primarily to long-term wholesale contract associated from the NCEMPA purchase in 2015.

Operating revenues decreased to \$5.10 billion from \$5.22 billion and operating expenses fell to \$3.77 billion from \$4.00 billion. Operating income rose to \$1.33 billion from \$1.22 billion while other income rose to \$74 million from \$59 million.

Total GWh sales declined 1.5% to 51,649 GWh from 52,416 GWh. This occurred as due to decreases in residential sales (-1.7%), general service sales (-0.6%), industrial sales (-0.6%), other energy sales (-2.7%), and unbilled sales (-10.6%). These declines came from lower sales at Duke Energy Carolinas (-1.7%), Duke Energy Progress (-3.2%), Duke Energy Florida (-1.2%), and Duke Energy Ohio (-1.6%), and were partly offset by higher results from Duke Energy Indiana (+1.6%).

The Commercial Portfolio unit produced adjusted segment income of \$14 million vs. \$11 million, equating to an increase of \$0.01/share. This improvement was produced by increased investments in the Atlantic Coast and Sabal Tail pipelines. 2Q16's earnings per share results reflect last year's sale of DUK's Midwest Generation business (-\$0.15/share) and was partly offset by higher earnings from the renewable energy portfolio (+\$0.01/share) and investments in the Atlantic Coast and Sabal Tail pipelines (+\$0.01/share).

Operating revenues increased to \$112 million from \$75 million and operating expenses rose to \$382 million from \$232 million. The operating loss was -\$113 million, vs. \$54 million, and other income was flat at \$22 million. GWh renewable plant generation increased to 1,758 GWh from 1,373 GWh.



International Energy adjusted segment income decreased to \$43 million from \$52 million, equating to a decrease of \$0.02/share. The lower results came from a decline in quarterly profits at National Methanol Company (-\$0.02/share) and a higher effective tax rate (-\$0.02/share). These positives were partly offset by stronger results in the Latin American operations (+\$0.03/share) due to improved hydrology in Brazil despite weaker foreign currency exchange rates.

Operating revenues fell to \$270 million from \$287 million and operating expenses rose to \$382 million from \$232 million. Operating income decreased to -\$113 million from \$54 million and other income decreased to \$23 million from \$31 million. GWh sales increased to 5,625 GWh from 4,520 GWh.

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 an adjusted net expense of \$36 million vs. \$37 million. The decrease in net expenses came from a change in the effective tax rate (+\$0.02/share) and higher net interest expense (-\$0.01/share).

RECENT DEVELOPMENTS

As part of its strategy to exit the bulk of its International Energy business, DUK is considering bids on its Latin American power assets, including approximately 4,400 MW of generating capacity in Central and South America.

The Federal Energy Regulatory Commission issued a new 30-year operating license for DUK's Keowee-Toxaway Hydroelectric Project. This will allow DUK to continue operating the Jocassee Pumped Storage Hydro Station, Keowee Hydro Station, and associated lakes.

During the 2Q16 earnings conference call, DUK stated it would spend approximately \$1.3 billion on coal ash remediation during the next few years on its first four sites and potentially spend an additional \$700 million - \$1 billion on other sites. Management stated it would give an update on coal ash spending in 2017.

DUK affirmed its adjusted diluted earnings guidance of \$4.50-\$4.70/share during 2016 and increased its annual common stock dividend by 3.6% to \$3.42/share.



EQUITY RESEARCH

Our Thoughts

DUK's 2Q16 diluted earnings of \$0.74/share, vs. \$0.78/share during 2Q15, were negatively impacted by an impairment charge (\$194 million pre-tax) on the carrying value of assets in its Central America business as DUK looks to sell this unit. Otherwise, adjusted segment income rose in the Regulated Utilities (+\$86 million) and Commercial Power (+\$3 million) units, while there was a decline in International Energy (-\$9 million). Adjusted diluted earnings increased to \$1.07/share from \$0.95/share, when comparing the two quarters, due to higher contributions from the Regulated Utilities unit from higher retail revenues from pricing/rider recoveries, lower O&M expenses, and additional profits from the acquisition of the North Carolina Eastern Municipal Power Agency (NCEMPA).

Management continues to move the company down-the-road towards its stated earnings growth goal of 4%-6% per year by 2020 and potentially allowing DUK to increase the common stock dividend. To this end, DUK has shifted its operating model towards regulated businesses with an emphasis on the natural gas infrastructure and more gas-generated power plants. This is exemplified by the company's recent \$2 billion investment in the Atlantic Coast pipeline project, the Sabal Trail pipeline, and the acquisition of Piedmont Natural Gas.

DUK is recommended for income/growth oriented investors seeking potential future increases of the annual dividend and its share price. Should management deliver on its goal of growing profits 4%-6% annually going towards 2020, then Wall Street could reward these efforts with a higher share price as both earnings, and dividends, rise during the next few years. In fact, DUK's annual dividend was recently raised 3.6% to \$3.42/share. Our rating on this stock is a BUY with 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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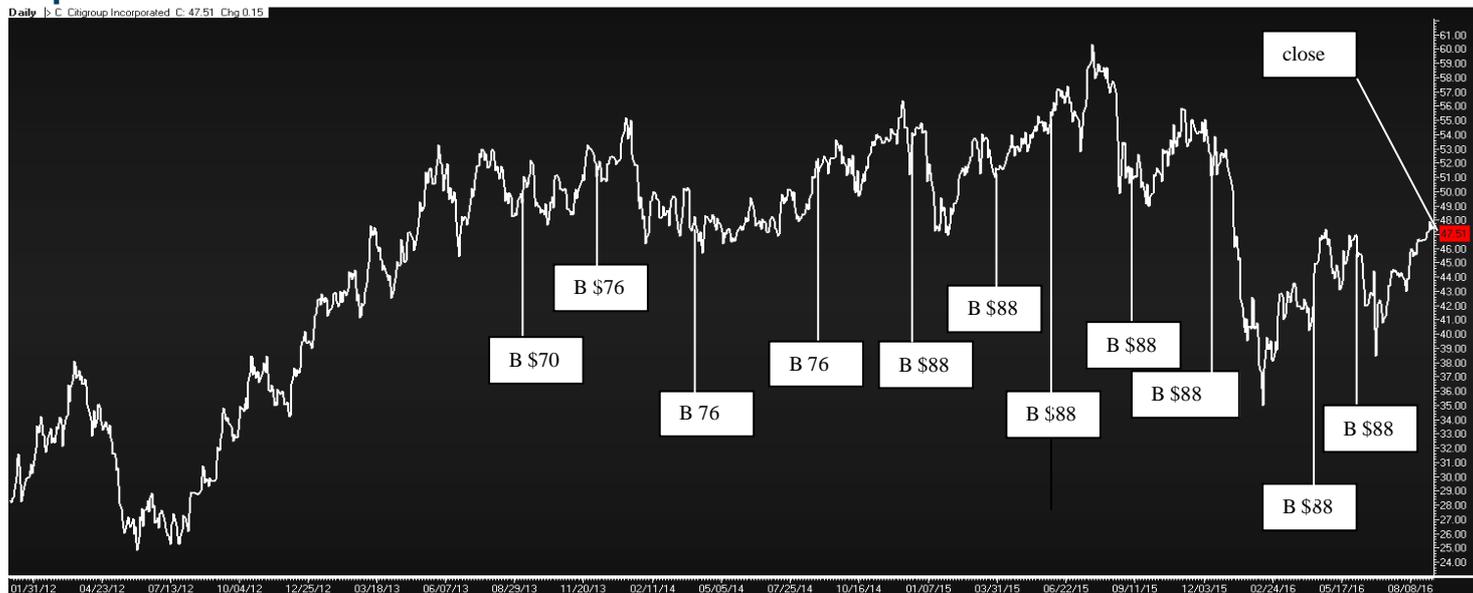
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Duke Energy
Condensed Consolidated Statements of Operations
unaudited
(in millions, except per share amounts)

| | 1Q15 | 2Q15 | 3Q15 | 4Q15 | 2015 | 1Q16 | 2Q16 | 3Q16e | 4Q16e | 2016e |
|--|---------|---------|--------|---------|----------|---------|---------|---------|---------|----------|
| Operating Revenues: | | | | | | | | | | |
| Regulated electric | \$5,457 | \$5,090 | 6,017 | \$4,815 | \$21,379 | \$5,503 | \$4,965 | \$6,276 | \$5,032 | \$21,776 |
| Non-regulated electric/natgas/other | 377 | 403 | 377 | 387 | 1,544 | 400 | 422 | 381 | 374 | 1,577 |
| Regulated natural gas | 231 | 96 | 89 | 120 | 536 | 169 | 97 | 78 | 132 | 476 |
| Total Operating revenues | 6,065 | 5,589 | 6,483 | 5,322 | 23,459 | 5,622 | 5,484 | 6,935 | 5,538 | 23,579 |
| Operating Expenses: | | | | | | | | | | |
| Fuel electric gen. & purchased power-reg | 1,941 | 1,721 | 2,113 | 1,533 | 7,308 | 1,577 | 1,509 | 2,196 | 1,589 | 6,871 |
| Fuel electric gen. & purch power-non reg | 104 | 118 | 61 | 71 | 354 | 58 | 82 | 73 | 78 | 291 |
| Cost of natural gas & coal sold | 111 | 26 | 21 | 37 | 195 | 60 | 21 | 38 | 43 | 162 |
| Operation, maintenance, & other | 1,426 | 1,422 | 1,426 | 1,597 | 5,871 | 1,489 | 1,431 | 1,459 | 1,621 | 6,000 |
| Depreciation & Amortization | 777 | 790 | 774 | 803 | 3,144 | 814 | 813 | 786 | 809 | 3,222 |
| Property & other taxes | 264 | 279 | 293 | 299 | 1,135 | 297 | 293 | 298 | 304 | 1,192 |
| Impairment charges | | | 111 | 9 | 120 | 3 | 195 | | | 198 |
| Total Operating expenses | 4,623 | 4,356 | 4,799 | 4,349 | 18,127 | 4,298 | 4,344 | 4,850 | 4,444 | 17,936 |
| Gains/losses sale of other assets (net) | 14 | 13 | 4 | 4 | 35 | 9 | 5 | 14 | 7 | 35 |
| Operating Income | 1,456 | 1,246 | 1,688 | 977 | 5,367 | 1,333 | 1,145 | 1,899 | 1,101 | 5,478 |
| Other Income/Expenses | | | | | | | | | | |
| Equity in earnings of unconsolidated affiliates | 13 | 23 | 17 | 16 | 69 | 8 | 15 | 12 | 17 | 51 |
| Impairments/Gains on unconsol affiliates sales | | | | 7 | 7 | | | | | |
| Other Income/Expenses | 74 | 72 | 57 | 104 | 307 | 79 | 92 | 53 | 91 | 315 |
| Total other income/expenses | 87 | 95 | 74 | 127 | 383 | 87 | 107 | 65 | 108 | 367 |
| Interest expense | | | | | | | | | | |
| Income from Cont Ops before Income Taxes | 1,403 | 403 | 402 | 405 | 1,613 | 511 | 500 | 408 | 412 | 1,831 |
| Income tax expense | 1,140 | 938 | 1,360 | 699 | 4,137 | 909 | 752 | 1,556 | 797 | 4,014 |
| Income from Cont Ops before Income Taxes | 364 | 334 | 420 | 208 | 1,326 | 213 | 239 | 499 | 247 | 1,198 |
| Income from Discontinued Ops, net of Taxes | 776 | 604 | 940 | 491 | 2,811 | 696 | 513 | 1,057 | 550 | 2,818 |
| Income from Discontinued Ops, net of Taxes | 91 | -57 | -5 | -9 | 20 | 3 | -1 | -28 | -16 | -42 |
| Net Income | 867 | 547 | 935 | 482 | 2,831 | 699 | 512 | 1,029 | 534 | 2,774 |
| Net Income/loss attributable to non-controlling interest | -3 | -4 | -3 | -5 | -15 | -5 | -3 | -5 | -4 | -17 |
| Net Income attributable to Duke Energy Corp | \$864 | \$543 | \$932 | \$477 | \$2,816 | \$694 | \$509 | \$1,024 | \$530 | \$2,757 |
| Diluted EPS | | | | | | | | | | |
| Net Income from discon ops attributable shareholders | \$1.09 | \$0.78 | \$1.35 | \$0.69 | \$3.91 | \$1.01 | \$0.74 | \$1.48 | \$0.76 | \$4.12 |
| Diluted EPS | \$1.09 | \$0.78 | \$1.35 | \$0.69 | \$3.91 | \$1.01 | \$0.74 | \$1.48 | \$0.76 | \$3.99 |
| Adjustments | \$0.13 | \$0.17 | \$0.12 | \$0.18 | \$0.60 | \$0.12 | \$0.33 | \$0.13 | \$0.02 | \$0.60 |
| Adjusted Diluted EPS | \$1.22 | \$0.95 | \$1.47 | \$0.87 | \$4.54 | \$1.13 | \$1.07 | \$1.61 | \$0.78 | \$4.59 |

Important Disclosures

Daily | C. Citigroup Incorporated | 47.51 | Chg 0.15



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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