



December 16, 2016

CURRENT PRICE: \$76.59
RATING: BUY
PRICE TARGET: \$88
CURRENT YIELD: 4.5%

EPS Estimates - GAAP

	DEC 15A	DEC 16E
1Q	\$1.22	\$1.13A
2Q	\$0.95	\$1.07A
3Q	\$1.47	\$1.68A
4Q	\$0.87	\$0.78
	\$4.54	\$4.66

Trading Data

52-WEEK PRICE RANGE: **\$87.75 - \$68.78**
 SHARES OUTSTANDING: **689(M)**
 MARKET CAP: **\$52,771(M)**
 AVG. DAILY TRADING VOLUME: **3.4(M)**
 S&P 500: **2,258**

Valuation Data

BOOK VALUE: **\$58.85**
 PRICE TO BOOK: **1.3x**
 DIVIDEND: **\$3.42**

Duke Energy (NYSE: DUK)

Good 3Q16 results & business realignment

Highlights

- Adjusted diluted 3Q16 earnings of \$1.68/share vs. \$1.47/share
- Warm weather benefits earnings results
- Sold Latin American assets to two buyers
- Realignment financial reporting segment structure
- 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%-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 4.5% 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 3Q16 diluted earnings of \$1.70/share vs. \$1.35/share during 3Q15. The improved results were due to warmer-than-normal weather throughout DUK's service territories (+\$0.14/share), a lower tax rate (+\$0.08/share), increased revenues from energy efficiency riders in the Carolinas and Ohio grid investment riders (+\$0.04/share), and weather normal retail volumes (+\$0.04/share). Regulated Utilities segment income rose to \$1.2 billion from \$905 million, while International Energy's fell to \$64 million from \$69 million and Commercial Portfolio's declined to (\$21 million) from \$20 million. Adjusted diluted earnings rose to \$1.68/share from \$1.47/share, when comparing the two quarters, due to higher results from the Regulated Utilities segment. Total operating revenues improved to \$6.82 billion from \$6.48 billion and total operating expenses rose to \$4.81 billion from \$4.80 billion. Book value per share increased to \$58.85/share from \$57.92/share.

SEGMENT RESULTS

The Regulated Utilities unit generated 3Q16 segment income of \$1.20 billion vs. \$905 million during 3Q15. The improved results came from favorable weather in all of Duke's service territories (+\$0.14/share), a lower effective tax rate produced by prior year income tax adjustments (+\$0.08/share), higher rider revenues related to energy efficiency/grid investment riders at Duke Energy Progress and Duke Energy Ohio (+\$0.05/share), increased weather-normal retail customer volumes (+\$0.04/share), and lower O&M expenses (+\$0.02/share) mainly from cost savings initiatives (+\$0.02/share). These positives were partly offset by higher storm-related costs (-\$0.02/share).

Operating revenues rose to \$6.43 billion from \$6.15 billion and operating expenses decreased to \$4.39 billion from \$4.48 billion. Operating income increased to \$2.05 billion from \$1.67 billion while EBIT improved to \$1.83 billion from \$1.44 billion.

Total GWh sales increased 7.6% to 74,268 GWh from 69,015 GWh. This occurred due to higher sales in Residential (+8.0%), General Services (+3.3%), Unbilled Sales (+61.1%), and Special Sales (+15.8%). These gains were partly offset by declines in Industrial (-1.0%) and other Energy Sales (-3.4%).

The Commercial Portfolio produced a segment loss of \$21 million during 3Q16 compared to \$8 million during 3Q15. 3Q16 results were impacted by a \$45 million after-tax impairment charge associated with the equity method investments in specific wind projects (excluded from adjusted earnings results). Adjusted results increased by \$0.02/share mainly due to additional wind/solar plants placed into service and higher wind resources.

Operating revenues increased to \$140 million from \$66 million and operating expenses rose to \$141 million from \$62 million. Operating income was \$0 and EBIT was -\$84 million.

International Energy recognized 3Q16 reported and adjusted segment income of \$64 million vs. \$69 million during 3Q15, equating to a decrease of \$0.01/share.



Other includes corporate interest expense not allocated to DUK's business units, results from DUK's captive insurance company, and other investments. This area produced 3Q16 net expense of \$189 million compared to \$45 million during 3Q15. 3Q16 results were impacted by higher costs of \$37 million to achieve mergers and \$12 million of charges related to current year cost savings initiatives.

In the area of Discontinued Operations DUK recognized an income tax benefit of \$122 million due to deferred tax liability adjustments related to the Midwest Generation Disposal Group and another previously sold business.

RECENT DEVELOPMENTS

Following recent acquisitions and agreements to sell International assets, DUK announced a realignment of its financial reporting segment structure, starting in 4Q16, into three primary business segments: Electric Utilities & Infrastructure, Gas Utilities & Infrastructure, and Commercial Renewables.

Electric Utilities & Infrastructure will contain DUK's regulated Electric Utilities in the Carolinas, Florida, and the Midwest and include the company's commercial transmission investments. Gas Utilities & Infrastructure will contain Piedmont Natural Gas, local gas distribution systems in OH, KY, and gas pipeline investments in the Atlantic Coast, Sabal Trail, Constitution, and Piedmont's pipelines. Commercial Renewables will include holding company interest expense and captive insurance results. Other will include DUK's National Methanol equity investment

On 10/3/16 DUK closed its acquisition of Piedmont Natural Gas expanding its natural gas business platform. The Piedmont purchase also gave DUK Piedmont's 24% stake in the Constitution Pipeline. DUK management expects the Piedmont acquisition to add \$0.08-\$10/share during 2017.

Following the acquisition of Piedmont Natural Gas, DUK sold 3% of its Atlantic Coast Pipeline to Dominion Resources (D-\$75.87), giving D a 48% ownership in the Pipeline and DUK a 47% ownership stake.

On 10/10/16 DUK announced an agreement to sell its Latin American generation assets to China Three Gorges Corporation and I Squared Capital. China Three Gorges will pay approximately \$1.2 billion to buy the Brazilian assets and assume this unit's debt. Management believes the transaction will be completed by 1Q17, following needed approvals from Brazil and China. I Squared Capital will buy the remaining South and Central American assets, in a separate transaction, for approximately \$1.2 billion. This deal is expected to close during 1Q17.

DUK plans to use the proceeds from the China Three Gorges and I Squared Capital deals to reduce Duke Energy Holding Company's debt and could add approximately \$0.05/share to next year's earnings based on current interest rates.

The Federal Energy Regulatory Commission issued a new 30-year operating license to DUK's Keowee-Toxaway Hydroelectric Project



DUK agreed to pay a \$1 million settlement related to an Ohio River oil spill in 2014. Additionally, the company agreed to pay a \$24 million settlement related to the ousting of CEO William Johnson following the merger with Progress Energy.

Our Thoughts

Good earnings results and a business reconfiguration for DUK during 3Q16. DUK reported 3Q16 diluted earnings of \$1.70/share vs. \$1.35/share during 3Q15. The improved results came from favorable weather in all of Duke's service territories (+\$0.14/share), a lower effective tax rate produced by prior year income tax adjustments (+\$0.08/share), higher rider revenues related to energy efficiency/grid investment riders at Duke Energy Progress and Duke Energy Ohio (+\$0.05/share), increased weather-normal retail customer volumes (+\$0.04/share), and lower O&M expenses (+\$0.02/share) mainly from cost savings initiatives (+\$0.02/share). These positives were partly offset by higher storm-related costs (-\$0.02/share). Adjusted diluted earnings rose to \$1.68/share from \$1.47/share, when comparing the two quarters, due to the strong results from the Regulated Utilities segment.

Investors should note following the sale of Latin American assets, totaling roughly \$2.4 billion, DUK announced a realignment of its financial reporting segment structure, starting in 4Q16, into three primary business segments: Electric Utilities & Infrastructure, Gas Utilities & Infrastructure, and Commercial Renewables. This new reporting structure will commence with 4Q16 results.

Earnings per share may be aided by DUK's recent moves as management believes the Piedmont acquisition could add \$0.08-\$0.10/share and the use of proceeds from the Latin American asset sales to reduce debt adding another \$0.05/share to 2017 earnings. We continue to recommend DUK's stock to income/growth oriented investors given the possibility of future dividend increases based on forward earnings growth. The recent sell-off in the utility sector offers potentially attractive entry points for new investors into this stock given DUK's current dividend yield of 4.5%. This stock is rated a BUY with an \$88 price target, equating to 1.5x 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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Duke Energy
Condensed Consolidated Statements of Operations
unaudited
(in millions, except per share amounts)

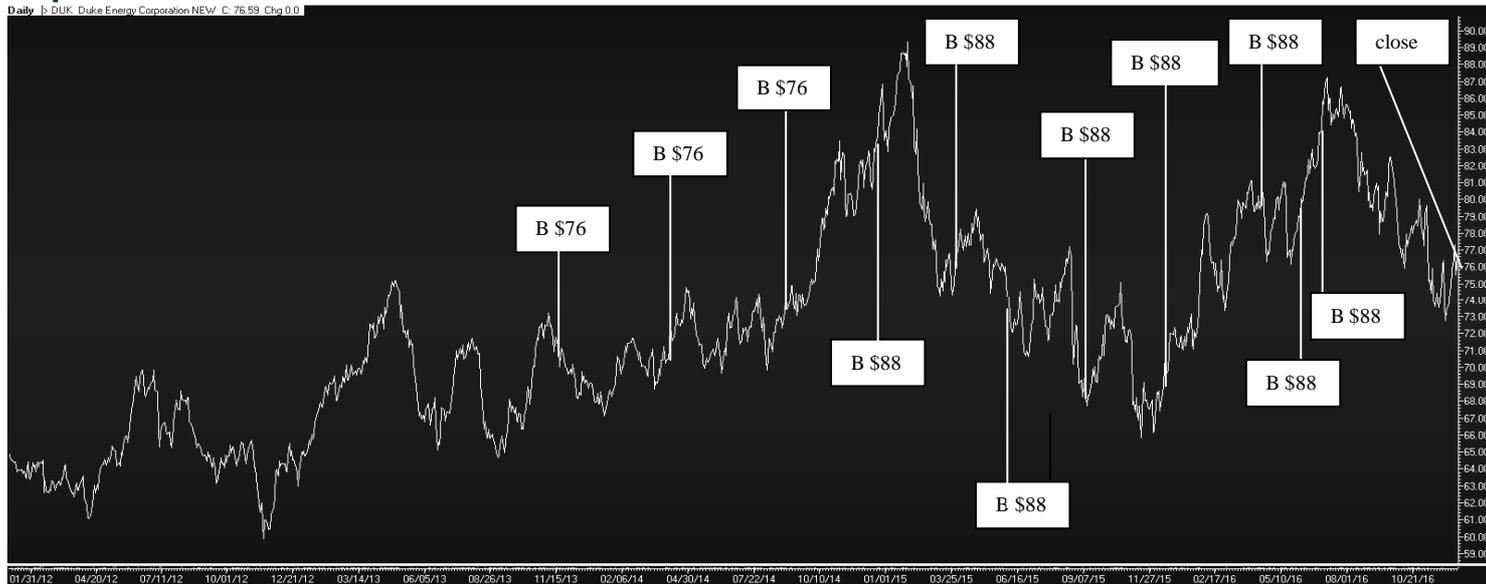
	1Q15	2Q15	3Q15	4Q15	2015	1Q16	2Q16	3Q16	4Q16e	2016e
Operating Revenues:										
Regulated electric	\$5,457	\$5,090	6,017	\$4,815	\$21,379	\$5,503	\$4,965	\$6,303	\$5,032	\$21,803
Non-regulated electric/hatgas/other	377	403	377	387	1,544	400	422	429	374	1,625
Regulated natural gas	231	96	89	120	536	169	97	89	132	487
Total Operating revenues	6,065	5,589	6,483	5,322	23,459	5,622	5,484	6,821	5,538	23,465
Operating Expenses:										
Fuel electric gen. & purchased power-reg	1,941	1,721	2,113	1,533	7,308	1,577	1,509	2,016	1,589	6,691
Fuel electric gen. & purch power-non reg	104	118	61	71	354	58	82	75	78	291
Cost of natural gas & coal sold	111	26	21	37	195	60	21	17	43	141
Operation, maintenance, & other	1,426	1,422	1,426	1,597	5,871	1,489	1,431	1,547	1,621	6,088
Depreciation & Amortization	777	790	774	803	3,144	814	813	837	809	3,273
Property & other taxes	264	279	293	299	1,135	297	293	303	304	1,197
Impairment charges			111	9	120	3	195	10		208
Total Operating expenses	4,623	4,356	4,799	4,349	18,127	4,298	4,344	4,805	4,444	17,981
Gains/losses sale of other assets (net)	14	13	4	4	35	9	5	6	7	27
Operating Income	1,456	1,246	1,688	977	5,367	1,333	1,145	2,022	1,101	5,601
Other Income/Expenses										
Equity in earnings of unconsolidated affiliates	13	23	17	16	69	8	15	60	17	100
Impairments/Gains on unconsol affiliates sales				7	7					
Other Income/Expenses	74	72	57	104	307	79	92	99	91	361
Total other income/expenses	87	95	74	127	383	87	107	39	108	341
Interest expense										
Income from Cont Ops before Income Taxes	1,140	938	1,360	699	4,137	909	752	1,579	797	4,037
Income tax expense	364	334	420	208	1,326	213	239	520	247	1,219
Income from Cont Ops before Income Taxes	776	604	940	491	2,811	696	513	1,059	550	2,818
Income from Discontinued Ops, net of Taxes	91	-57	-5	-9	20	3	-1	122	-16	108
Net Income	867	547	935	482	2,831	699	512	1,181	534	2,926
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	\$1,176	\$530	\$2,909
Diluted EPS										
Net Income from discon ops attributable shareholders	\$1.09	\$0.78	\$1.35	\$0.69	\$3.91	\$1.01	\$0.74	\$1.52	\$0.76	\$4.03
Diluted EPS	\$1.09	\$0.78	\$1.35	\$0.69	\$3.91	\$1.01	\$0.74	\$1.52	\$0.76	\$4.03
Adjustments	\$0.13	\$0.17	\$0.12	\$0.18	\$0.60	\$0.12	\$0.33	\$0.16	\$0.02	\$0.63
Adjusted Diluted EPS	\$1.22	\$0.95	\$1.47	\$0.87	\$4.54	\$1.13	\$1.07	\$1.68	\$0.78	\$4.66



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Important Disclosures

Daily | DUK: Duke Energy Corporation NEW | C: 75.59 | Chg: 0.0



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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Analyst owns/controls family account containing shares of Duke Energy

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- (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.

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