



March 16, 2017

CURRENT PRICE: \$81.62
RATING: BUY
PRICE TARGET: \$88
CURRENT YIELD: 4.2%

EPS Estimates - GAAP

	DEC 16A	DEC 17E
1Q	\$1.13	\$1.42
2Q	\$1.07	\$1.04
3Q	\$1.68	\$1.42
4Q	\$0.81	\$0.75
	\$4.69	\$4.63

Trading Data

52-WEEK PRICE RANGE: \$87.75 - \$72.34
 SHARES OUTSTANDING: 691(M)
 MARKET CAP: \$56,399(M)
 AVG. DAILY TRADING VOLUME: 3.1(M)
 S&P 500: 2,381

Valuation Data

BOOK VALUE: \$58.63
 PRICE TO BOOK: 1.4x
 DIVIDEND: \$3.42

Duke Energy (NYSE: DUK)

4Q16 results & business realignment

Highlights

- Adjusted diluted 4Q16 earnings of \$0.81/share vs. \$0.87/share
- Natural gas becomes larger part of operations
- Sold Latin American assets
- Realigned 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 2%-4% 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 4.2% 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 four business units; Electric Utilities/Infrastructure, Gas Utilities/Infrastructure, Commercial Renewables, and Other. DUK provides electricity and natural gas to its customers, serving approximately 7.2 million electric customers in NC, SC, FL, IN, OH, and KY. DUK operates 150,900 miles of electric distribution lines and a 20,900-mile transmission system. The company has approximately 58,345 megawatts (MW) of electrical generating capacity with its plants fueled by coal, oil, natural gas, hydroelectric, renewables, 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 4Q16 diluted earnings of (\$0.33)/share compared to \$0.69/share during 4Q15. The earnings decline was due mainly to the loss experienced from the sale of the company's International Energy unit during 4Q16. Following the sale of its international unit and the acquisition of Piedmont Energy, DUK reformed itself into four operating units—Electric Utilities/Infrastructure, Gas Utilities/Infrastructure, Commercial Renewables, and Other. Electric Utilities/Infrastructure's 4Q16 segment income decreased to \$483 million from \$569 million, Gas Utilities rose to \$89 million from \$14 million, and commercial renewables declined to \$10 million from \$17 million. Other generated operating expense of \$209 million during the quarter compared to a \$170 million expense during 4Q16. FY16's diluted earnings decreased to \$3.11/share from \$4.05/share during FY15. For FY16, DUK experienced higher segment income in Electric Utilities/Infrastructure (\$3.04 billion vs. \$2.82 billion) and Gas Utilities (\$152 million vs. \$73 million) and a decline in Commercial Renewables (\$23 million vs. \$52 million). Adjusted diluted earnings during 4Q16 fell to \$0.81/share from \$0.87/share during 4Q15 and FY16's adjusted diluted earnings rose to \$4.69/share from \$4.54/share. DUK's book value increased to \$58.63/share from \$57.78/share.

SEGMENT RESULTS

The Electric Utilities/infrastructure unit's adjusted segment income decreased to \$483 million from \$588 million when comparing results from 4Q16 and 4Q15. The lower results came from higher O&M expense (-\$0.08/share) from higher planned spending, increased effective tax rate (-\$0.06/share), coming from the lack of a prior year benefit, higher interest expense (-\$0.03/share) related to higher debt levels, and increased depreciation/amortization expense (-\$0.03/share) resulting from additional plants in service. These negatives were offset by favorable weather (+\$0.03/share) and higher AFDUC equity (+\$0.02/share) from higher capital investments. Total GWh sales increased 1.2% during 4Q16 to 49,094 GWh from 48,528 during 4Q15. The improvement came from increases in residential (+5.0%) and general service (+1.3%). These gains were partly offset by decreases in industrial (-0.6%) and other energy sales (-2.0%). Total GWh sources rose 0.5% to 58,345 GWh from 58,052 GWh.

The Gas Utilities/Infrastructure unit produced 4Q16 reported and adjusted segment income of \$89 million compared to \$14 million during 4Q15. These higher results came from the contribution from recently acquired Piedmont Natural Gas (+\$0.10/share) and higher earnings from DUK's midstream pipeline investments (+\$0.01/share) coming mainly from its ownership stake in the Atlantic Coast pipeline. Total sales from Piedmont Natural Gas rose 7.1% and Duke Energy Midwest sales improved 27.4%. This unit's operating revenues, due to the addition of Piedmont, increased to \$543 million from \$122 million and operating expense rose to \$379 million from \$93 million.

Commercial Renewables' segment income decreased to \$10 million during 4Q16 from \$17 million during 4Q15. When comparing these two periods, adjusted segment income fell to \$10 million from \$19 million. The decline in quarterly results came mainly from lower investment credits due to lower solar investments and was partly offset by higher production tax credits from new wind facilities placed into service. Operating revenues improved to \$119 million from \$86 million and operating expenses increased to \$123 million from \$96 million.



The “Other” unit includes corporate interest expense not attributed to the other three business units, results from DUK’s captive insurance company, other investments including National Methanol Company, an equity method investment, and Midwest Generation business results (sold in 2015). This unit reported net expense of \$209 million during 4Q16 compared to \$170 million during 4Q15. Results were also impacted by higher merger costs, and were partially offset by lower charges related to cost saving efforts.

RECENT DEVELOPMENTS

Following the sale of its international unit and the acquisition of Piedmont Energy, DUK reformed itself into four operating units—Electric Utilities/Infrastructure, Gas Utilities/Infrastructure, Commercial Renewables, and Other.

DUK sold its Brazilian power operations to China Three Gorges for \$1.2 billion and sold its businesses in Chile, Ecuador, Guatemala, El Salvador, and Argentina to Squared Capital for approximately \$1.2 billion. Duke expects to net \$1.9 billion and use the proceeds to pay down debt.

Westinghouse’s \$352 million claim against DUK, regarding a cancelled contract to build a Florida nuclear plant, was dismissed by a Florida court of law.

DUK agreed to pay a \$1 million settlement regarding an Ohio River spill in 2014. In another legal settlement, the company agreed to pay \$27 million related to the CEO ouster case involving its merger with Progress Energy.

During the 4Q16 earnings conference calls DUK management outlined the following goals.

Strengthen DUK’s energy delivery system, invest \$25 billion to create a smart energy grid, and invest \$11 billion to generate cleaner energy through natural gas and renewables. One objective is to have natural gas produce 35% of its electrical generation. Another is to reduce carbon emissions in 2026, from 2005 levels, by 35%.

Expand the natural gas infrastructure to meet customer needs and double the earnings contribution from the natural gas business. The acquisition of Piedmont Energy allows DUK to operate a five-state gas distribution business serving approximately 1.5 million customers. Additionally, the acquisition provides investments in midstream gas pipelines. DUK is investing in the Atlantic Coast, Sabal Trail, and Constitution pipelines. Given the coordinated infrastructure planning between its electric and gas utilities, DUK believes its natural gas platform could account for 15% of its portfolio during the next 10y years, up from current level of 8%, and generate additional earnings.

Management provided 2017 adjusted earnings guidance of \$4.50-\$4.70/share and reemphasized its goal of 4%-6% annual earnings growth during the next five years. During this time period the Electric Utilities/Infrastructure, representing 89% of adjusted earnings, could grow 4%-5% annually, Gas Utilities/Infrastructure, 8% of expected 2017 adjusted earnings, could grow 10%-12% annually, and Commercial Renewables, 3% of anticipated 2017 earnings, could grow 8%-12% annually.



Our Thoughts

We continue to rate DUK a BUY and this stock is recommended for income/growth investors seeking the potential of an increasing future dividend stream and share price appreciation. While the company is in a period of transition following its purchase of Piedmont Energy, and moving towards a larger contribution from its natural gas assets, management's goal is grow annual earnings 4%-6%. Potential future earnings growth could generate dividend increases given DUK's goal of paying out 70%-75% of adjusted earnings to shareholders as dividends. Going forward, a rising dividend/earnings stream could cause an increase in investor demand for DUK's stock and push its shares towards our price target of \$88/share. Our \$88 target price equates to DUK trading at 1.5x book value.

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)

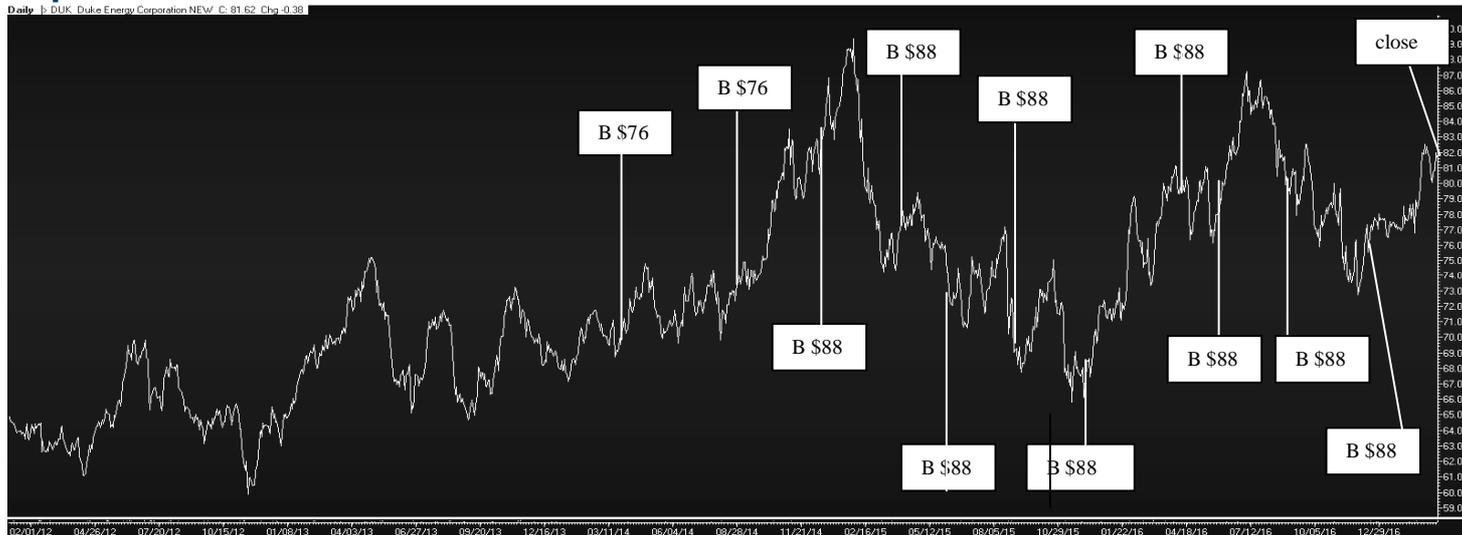
	1Q16	2Q16	3Q16	4Q16	2016	1Q17e	2Q17e	3Q17e	4Q17e	2017e
Operating Revenues:										
Regulated electric	\$5,503	\$4,965	\$6,303	\$4,450	\$21,221	\$5,316	\$4,858	\$5,089	\$4,532	\$19,795
Non-regulated electric/natgas/other	400	422	429	374	659	409	433	416	366	1,624
Regulated natural gas	169	97	89	508	863	524	492	464	473	1,953
Total Operating revenues	5,622	5,484	6,821	4,816	22,743	6,249	5,783	6,769	5,471	24,272
Operating Expenses:										
Fuel electric gen. & purchased power-reg	1,577	1,509	2,016	1,523	6,625	1,587	1,486	2,007	1,346	6,426
Cost of natural gas & coal sold	60	21	17	157	255	164	173	153	167	657
Operation, maintenance, & other	1,489	1,431	1,547	1,618	6,085	1,572	1,598	1,624	1,628	6,377
Depreciation & Amortization	814	813	837	830	3,294	833	837	832	852	3,354
Property & other taxes	297	293	303	339	1,142	342	341	348	355	1,386
Impairment charges	3	195	10		18		7			7
Total Operating expenses	4,298	4,344	4,805	3,982	17,429	4,498	4,442	4,964	4,343	18,302
Gains/losses sale of other assets (net)	9	5	6	7	27	8	6			14
Operating Income	1,333	1,145	2,022	841	5,341	1,759	1,335	1,805	1,123	6,022
Other Income/Expenses										
Equity in earnings of unconsolidated affiliates	8	15	60	98	15	29	18	8	11	66
Impairments/Gains on unconsol affiliates sales										
Other Income/Expenses	79	92	99	3454	324	93	96	53	24	266
Total other income/expenses	87	107	39	76	309	122	114	61	35	332
Interest expense	511	500	482	423	1,916	424	422	426	428	1,700
Income from Cont Ops before Income Taxes	909	752	1,579	494	3,734	1,457	1,027	1,440	730	4,654
Income tax expense	213	239	520	184	1,156	495	349	518	256	1,618
Income from Cont Ops before Income Taxes	696	513	1,059	310	2,579	962	678	922	474	3,036
Income from Discontinued Ops, net of Taxes	3	-1	122	124	408	-25	10	-12	3	-15
Net Income	699	512	1,181	-98	2,170	936	688	910	477	3,011
Net Income/loss attributable to non-controlling interest	-5	-3	-5	-5	-18	-5	-4	-5	-5	-19
Net Income attributable to Duke Energy Corp	\$694	\$509	\$1,176	(\$227)	\$2,152	\$931	\$684	\$905	\$472	42,992
Diluted EPS										
Net Income from discon ops attributable shareholders	\$1.01	\$0.74	\$1.52	(\$0.33)	\$3.11	\$1.35	\$0.99	\$1.31	\$0.68	\$4.33
Diluted EPS	\$1.01	\$0.74	\$1.52	(\$0.33)	\$3.11	\$1.35	\$0.99	\$1.31	\$0.68	\$4.33
Adjustments	\$0.12	\$0.33	\$0.16	\$1.14	\$1.58	\$0.07	\$0.05	\$0.11	\$0.07	\$0.30
Adjusted Diluted EPS	\$1.13	\$1.07	\$1.68	\$0.81	\$4.69	\$1.42	\$1.04	\$1.42	\$0.75	\$4.63



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Important Disclosures

Daily | DUKE Energy Corporation NEW | C: 81.62 | Chg: -0.38



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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- (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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