



July 10, 2017

**CURRENT PRICE:** \$83.19  
**RATING:** BUY  
**PRICE TARGET:** \$88  
**CURRENT YIELD:** 4.1%

**EPS Estimates - GAAP**

	DEC 16A	DEC 17E
1Q	\$1.13	\$1.04A
2Q	\$1.07	\$1.29
3Q	\$1.68	\$1.42
4Q	\$0.81	\$0.75
	<b>\$4.69</b>	<b>\$4.50</b>

**Trading Data**

52-WEEK PRICE RANGE: **\$87.75 - \$72.34**  
SHARES OUTSTANDING: **700(M)**  
MARKET CAP: **\$58,233(M)**  
AVG. DAILY TRADING VOLUME: **2.5(M)**  
S&P 500: **2,428**

**Valuation Data**

BOOK VALUE: **\$58.84**  
PRICE TO BOOK: **1.4x**  
DIVIDEND: **\$3.42**

**Duke Energy (NYSE: DUK)**

*1Q17 results*

**Highlights**

- Adjusted diluted 1Q17 earnings of \$1.04/share vs. \$1.13/share
- Natural gas adds \$0.14/share to 1Q17 results
- Affirms 2017 adjusted eps guidance of \$3.50-\$4.75/share
- Potential dividend increases with future earnings growth
- 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 4.1% dividend yield, has both dividend and 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 and recently acquired Piedmont Natural Gas.

*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.*



# EQUITY RESEARCH

## Recent Earnings

DUK reported 1Q17 earnings of \$1.02/share vs. \$1.01/share during 1Q16. Despite the warm winter weather and absence of International Energy (sold last year), Piedmont Natural Gas's contribution and lower O&M expense in the Electric Utilities/Infrastructure unit helped produce the slight gain in earnings. DUK recently aligned itself into four units—Electric Utilities/Infrastructure, Gas Utilities/Infrastructure, Commercial Renewables, and Other. Total reportable segment income rose to \$793 million from \$722 million as an increase in the Gas Utilities/Infrastructure Unit (\$133 million vs. \$32 million) were partly offset by lower results in Electric Utilities/Infrastructure (\$635 million vs. \$664 million) and Commercial Renewables (\$25 million vs. \$26 million). Other's operating loss decreased to -\$77 million from -\$148 million. Total operating revenues decreased to \$4.91 billion from \$5.05 billion, operating expenses rose to \$4.30 billion from \$4.14 billion, and operating income increased to \$1.44 billion from \$1.24 billion. 1Q17 adjusted earnings decreased to \$1.04/share from \$1.13/share during 1Q16.

## SEGMENT RESULTS

**ELECTRIC UTILITIES/INFRASTRUCTURE:** Reported and adjusted segment declined to \$635 million from \$664 million due to warm winter weather penalizing earnings by approximately \$0.14/share. This was partially offset by lower O&M expense (+\$0.08/share) from reduced storm restoration costs and continuing cost savings initiatives. An additional offset was higher retail volumes from increased pricing/riders/volumes (+0.04/share) resulting from new rates in Duke Energy Progress South Carolina, base rate adjustments in Florida, and energy efficiency rider revenues at Duke Energy Carolinas. Total GWh sales decreased 6.0% to 58,990 GWh from 62,731 GWh. The decrease came from declines in Residential (-7.4%), General Service (-1.7%), Other Energy sales (-1.4%), Unbilled sales (-171.8%) and Special Sales (-11.5%). These were partly offset by a slight increase in Industrial GWh sales (+0.3%).

**GAS UTILITIES/INFRASTRUCTURE:** Reported and adjusted segment income increased to \$133 million from \$32 million. The improvement came from the profit contribution from the recently acquired Piedmont Natural Gas (+\$0.14/share) and higher earnings from DUK's midstream pipeline investments (+\$0.01/share). Total gas sales from the Piedmont LDC throughput fell 14.3% and 11.3% from Duke Energy Midwest LDC. Overall operating revenues rose to \$670 million from \$170 million, due to the inclusion of Piedmont, and operating expenses increased to \$450 million from \$118 million.

**COMMERCIAL RENEWABLES:** Segment income decreased slightly to \$25 million from \$26 million. New wind projects added approximately +\$0.01/share while lower solar investment tax credits hurt earnings by -\$0.01/share. Operating revenues increased to \$128 million from \$114 million and operating expenses grew to \$125 million from \$109 million. Operating income decreased to \$5 million from \$6 million and tax credit benefits were higher at \$39 million vs. \$33 million.



OTHER: This unit includes corporate interest expense not allocated to DUK's business units, results from DUK's captive insurance company, and other investments including National Methanol Company (an equity method investment). This unit recorded a net expense of -\$77 million vs. -\$148 million, when comparing the two quarters. The improved quarterly results were due to lower merger-related costs and charges related to cost saving initiatives during 2016.

## RECENT DEVELOPMENTS

DUK's insurance companies say they are not obligated to pay for DUK's coal ash cleanup efforts claiming knew about the situation but did not reduce the threat of groundwater contamination. DUK claims the insurance policies generally promise to assist in helping to pay for property damage "caused by an occurrence" even if liability for an incident is not evident until decades later. As a result, DUK is taking the insurance companies to court seeking payments.

DUK and Siemens (SIEGY-\$69.18) announced they will jointly design/build a new advanced gas combustion turbine for the proposed 400 MW expansion at the Lincoln County Combustion Turbine generation site.

The company plans to spend \$10 billion to upgrade its North Carolina power grid during the next decade. The spending should reduce outages from storm damages, defend against cyber-attacks, lower physical threats to the system, expand renewable energy, and generate economic growth.

The company expanded into 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 10 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.



# EQUITY RESEARCH

## Our Thoughts

DUK reported 1Q17 earnings of \$1.02/share vs. \$1.01/share during 1Q16. Despite the warm winter weather and absence of International Energy (sold last year), Piedmont Natural Gas's contribution and lower O&M expense in the Electric Utilities/Infrastructure unit helped produce the slight gain in earnings. Integration cost for Piedmont decreased to \$10 million from \$74 million, when comparing the two quarters, while Piedmont added approximately \$0.14/share in earnings during 1Q17. Adjusted 1Q17 earnings decreased to \$1.04/share from \$1.13/share during 1Q16. During the 1Q17 earnings conference call, management confirmed 2017 adjusted earnings guidance of \$4.50-\$4.75/share.

This stock is recommended for income/growth investors seeking the potential of higher future dividends and price appreciation. DUK should continue to benefit from recent merger/cost synergies with Progress. Additionally, last year's acquisition of Piedmont Natural Gas will expand DUK's natural gas revenue streams and create new opportunities in this sector. One of Management's goals is to grow annual earnings 4%-6% during the next 3-5 years. Successfully growing future earnings could generate dividend increases given DUK's stated goal of paying out 70%-75% of adjusted earnings to shareholders as dividends. We rate DUK a BUY with a price target of \$88/share, equating to 1.5x the company'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)

	1Q16	2Q16	3Q16	4Q16	2016	1Q17	2Q17e	3Q17e	4Q17e	2017e
<b>Operating Revenues:</b>										
Regulated electric	\$5,503	\$4,965	\$6,303	\$4,450	\$21,221	\$4,913	\$5,089	\$5,089	\$4,532	\$19,623
Non-regulated electric/natgas/other	400	422	429	374	659	646	615	416	366	2,043
Regulated natural gas	169	97	89	508	863	170	292	464	473	1,399
<b>Total Operating revenues</b>	<b>5,622</b>	<b>5,484</b>	<b>6,821</b>	<b>4,816</b>	<b>22,743</b>	<b>5,729</b>	<b>5,996</b>	<b>6,769</b>	<b>5,471</b>	<b>23,965</b>
<b>Operating Expenses:</b>										
Fuel electric gen. & purchased power-reg	1,577	1,509	2,016	1,523	6,625	1,449	1,486	2,007	1,346	6,288
Cost of natural gas & coal sold	60	21	17	157	255	258	173	153	167	751
Operation, maintenance, & other	1,489	1,431	1,547	1,618	6,085	1,433	1,598	1,624	1,628	6,283
Depreciation & Amortization	814	813	837	830	3,294	859	837	832	852	3,380
Property & other taxes	297	293	303	339	1,142	304	341	348	355	1,348
Impairment charges	3	195	10		18		7			7
Total Operating expenses	4,298	4,344	4,805	3,982	17,429	4,303	4,442	4,964	4,343	18,052
Gains/losses sale of other assets (net)	9	5	6	7	27	11	6			17
<b>Operating Income</b>	<b>1,333</b>	<b>1,145</b>	<b>2,022</b>	<b>841</b>	<b>5,341</b>	<b>1,437</b>	<b>1,560</b>	<b>1,805</b>	<b>1,123</b>	<b>5,925</b>
<b>Other Income/Expenses</b>										
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	86	36	53	24	199
<b>Total other income/expenses</b>	<b>87</b>	<b>107</b>	<b>39</b>	<b>76</b>	<b>309</b>	<b>118</b>	<b>54</b>	<b>61</b>	<b>35</b>	<b>268</b>
Interest expense	511	500	482	423	1,916	491	493	426	428	1,838
Income from Cont Ops before Income Taxes	909	752	1,579	494	3,734	1,081	1,115	1,440	730	4,366
Income tax expense	213	239	520	184	1,156	344	362	518	256	1,480
Income from Cont Ops before Income Taxes	696	513	1,059	310	2,579	717	753	922	474	2,436
Income from Discontinued Ops, net of Taxes	3	-1	122	124	408		10	-12	3	-1
<b>Net Income</b>	<b>699</b>	<b>512</b>	<b>1,181</b>	<b>-98</b>	<b>2,170</b>	<b>717</b>	<b>783</b>	<b>910</b>	<b>477</b>	<b>2,887</b>
Net Income/loss attributable to non-controlling interest	-5	-3	-5	-5	-18	-1	-4	-5	-5	-15
<b>Net Income attributable to Duke Energy Corp</b>	<b>\$694</b>	<b>\$509</b>	<b>\$1,176</b>	<b>(\$227)</b>	<b>\$2,152</b>	<b>\$716</b>	<b>\$779</b>	<b>\$905</b>	<b>\$472</b>	<b>2,872</b>
<b>Diluted EPS</b>	<b>\$1.01</b>	<b>\$0.74</b>	<b>\$1.52</b>	<b>(\$0.33)</b>	<b>\$3.11</b>	<b>\$1.02</b>	<b>\$1.11</b>	<b>\$1.31</b>	<b>\$0.68</b>	<b>\$4.12</b>
Net Income from discon ops attributable shareholders										
Diluted EPS	\$1.01	\$0.74	\$1.52	(\$0.33)	\$3.11	\$1.02	\$1.11	\$1.31	\$0.68	\$4.12
Adjustments	\$0.12	\$0.33	\$0.16	\$1.14	\$1.58	\$0.02	\$0.18	\$0.11	\$0.07	\$0.38
<b>Adjusted Diluted EPS</b>	<b>\$1.13</b>	<b>\$1.07</b>	<b>\$1.68</b>	<b>\$0.81</b>	<b>\$4.69</b>	<b>\$1.04</b>	<b>\$1.29</b>	<b>\$1.42</b>	<b>\$0.75</b>	<b>\$4.50</b>





## Other Disclosures

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