



September 1, 2017

CURRENT PRICE: \$87.09
RATING: BUY
PRICE TARGET: \$88
CURRENT YIELD: 4.1%

EPS Estimates - GAAP

	DEC 16A	DEC 17E
1Q	\$1.13	\$1.04A
2Q	\$1.07	\$1.01A
3Q	\$1.68	\$1.62
4Q	\$0.81	\$0.85
	\$4.69	\$4.52

Trading Data

52-WEEK PRICE RANGE: **\$87.95 - \$72.34**
SHARES OUTSTANDING: **700(M)**
MARKET CAP: **\$60,963(M)**
AVG. DAILY TRADING VOLUME: **2.3(M)**
S&P 500: **2,477**

Valuation Data

BOOK VALUE: **\$58.99**
PRICE TO BOOK: **1.48x**
DIVIDEND: **\$3.56**

Duke Energy (NYSE: DUK)

2Q17 results

Highlights

- Adjusted diluted 2Q17 earnings of \$1.01/share vs. \$1.07/share
- Segment Income improved at three operating units
- Affirms 2017 adjusted eps guidance of \$4.50-\$4.75/share
- 4.1% increase of annual dividend
- 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.



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Recent Earnings

DUK reported 2Q17 diluted earnings of \$0.98/share vs. \$0.74/share during 2Q16. The earnings improvement was the result of higher segment income at all three of the company's operating units. Total reportable segment income increased to \$782 million from \$721 million due to improvement in Electric Utilities/Infrastructure unit (\$720 million vs. \$704 million), Gas Utilities/Infrastructure unit (\$27 million vs. \$17 million), and Commercial/Renewables (\$26 million vs. \$11 million). Total operating revenues rose to \$5.56 billion from \$5.21 billion while operating expenses increased to \$4.18 billion from \$3.96 billion. Operating income improved to \$1.39 billion from \$1.26 billion, and EBIT increased to \$1.02 billion from \$877 million.

2Q17's adjusted diluted earnings decreased to \$1.01/share, from \$1.07/share during 2Q16, due mainly to the absence of International Energy's earnings, less favorable weather, and higher income tax resulting from a tax resolution during 2016. These were partly offset by higher retail revenues created by higher pricing/riders and strong retail volumes at the Electric Utilities/Infrastructure unit. Book value per share rose to \$58.99/share from \$57.98/share when comparing the two quarters.

SEGMENT RESULTS

ELECTRIC UTILITIES/INFRASTRUCTURE: Segment income rose to \$729 million from \$704 million due to increased pricing riders (+\$0.05/share), higher retail volumes (+\$0.03/share), and were partly offset by unfavorable weather (-\$0.05/share). Total operating revenues increased to \$5.16 billion from \$5.00 billion and operating expenses rose to \$3.80 billion from \$3.70 billion. Higher operating expenses were due to increases in fuel used in electric generation/purchased power (+2.5%), property/other taxes (+2.7%), operation/maintenance/other (+2.9%), and depreciation/amortization (+1.9%). Total retail sales decreased 0.3% to 51,469 GWh from 51,649 GWh. The decline was due to lower other energy sales (-2.8%) and unbilled sales (-34.3%) and were partly offset by higher residential (+2.1%), general service (+0.5%), and industrial (+0.6%).

GAS UTILITY/INFRASTRUCTURE: Segment Income rose to \$27 million from \$16 million. The increased results came from higher earnings produced by DUK's midstream pipeline investments. The improvement in operating revenues (\$301 million vs. \$99 million) more than offset a rise in operating expenses (\$252 million vs. \$71 million), as both figures include the results from last year's acquisition of Piedmont Natural Gas.

COMMERCIAL RENEWABLES: Segment income improved to \$26 million from \$11 million due to higher wind resource and production from new projects brought online during 2016. These positives were partly offset by lower solar investment tax credits. Operating revenues fell to \$110 million from \$112 million while operating expenses declined to \$104 million from \$120 million. The unit's operating profit improved to \$8 million from an operating loss of \$7 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). 2Q17's results recorded a \$94 million net expense vs. a \$107 million during 2Q16. The lower expenses for 2Q17 were impacted by lower costs to achieve the Piedmont Natural Gas merger. On an adjusted basis, the net expense increased to \$75 million from \$23 million. The increase came from higher income tax expense in 2Q17, compared to a favorable tax item during 2Q16, and higher interest expense related to acquisition financing related to the Piedmont acquisition.

RECENT DEVELOPMENTS

The company filed a rate case with the Kentucky Public Service Commission seeking a rate increases of approximately million for increased investment , new solar facilities, and the acquisition of Dayton Power & Light's share of East Bend Station.

DUK no longer plans to build the proposed Levy County nuclear power plant in Florida as part of a settlement with the state which includes a \$6 billion investment in grid modernization, smart meters, solar, and electric vehicle charging stations/battery storage.

DUK announced it will seek approval to cancel the Lee Nuclear power project in South Carolina and will seek permission from regulators to recover \$368 million associated with planning and pre-construction costs. Second US Appeals Court rejected a lawsuit by the Constitution gas pipeline owners (DUK-\$87.09, WMB-\$30.06, WGL-\$84.50) challenging NY State's decision to deny the project a water quality permit. The wording of the decision allows the project to continue to seek final federal approval.

DUK announced it would seek to add 500 MW of new wind capacity in the Carolinas by purchasing up to 20 year power agreements.

The company agreed to buy the 24.9 MW Shoreham Solar Commons project on Long Island NY. The Long Island Power Authority will purchase power from this facility under a 20-year agreement valued at \$177 million.

Duke unveiled plans to build three owned/operated solar projects in Kentucky, with construction beginning this year, and expectations of completion and being on line by early 2018. These solar facilities will generate approximately 6.8 MW and provide electricity to approximately 1,300 homes

FERC released a mostly favorable final environmental impact statement for the proposed 600-mile Atlantic Coast Pipeline. 48% of the pipeline ownership is held by Dominion Energy (D-\$78.33), DUK owns 47%, and Southern Company (SO-\$48.26) has a 5% stake. D spokespeople claims this report "provides a clear path for final approval" sometime this fall.



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Our Thoughts

A good earnings report by DUK after they reported 2Q17 diluted earnings of \$0.98/share vs. \$0.74/share during 2Q16. The earnings improvement was the result of higher segment income at all three of the company's operating units; Electric Utilities/Infrastructure, Gas Utilities/Infrastructure, and Commercial/Renewables. 2Q17's adjusted diluted earnings decreased to \$1.01/share, from \$1.07/share during 2Q16, due mainly to the absence of International Energy's earnings, less favorable weather, and higher income tax resulting from a tax resolution during 2016. These were partly offset by higher retail revenues created by higher pricing/riders and strong retail volumes at the Electric Utilities/Infrastructure unit. Management reaffirmed its 2017 adjusted earnings guidance of \$4.50-\$4.75/share.

We continue to recommend this stock for income/growth investors. DUK's 5 year operating goal is to grow annual earnings at a 4%-6% rate and potentially raise its annual dividend commensurate with profit growth. The company's earnings could benefit from recent merger/cost synergies with Progress Energy and last year's acquisition of Piedmont Natural Gas, thus expanding DUK's footprint in the natural gas business. These may be positives for income investors given DUK's stated intention of paying out 70%-75% of adjusted earnings to shareholders as dividends. In fact, the Board of Directors recently increased the annual dividend 4.1% to \$3.56/share. We rate DUK a BUY with a price target of \$88/share, equating to 1.49x 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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Duke Energy
Condensed Consolidated Statements of Operations
unaudited
(in millions, except per share amounts)

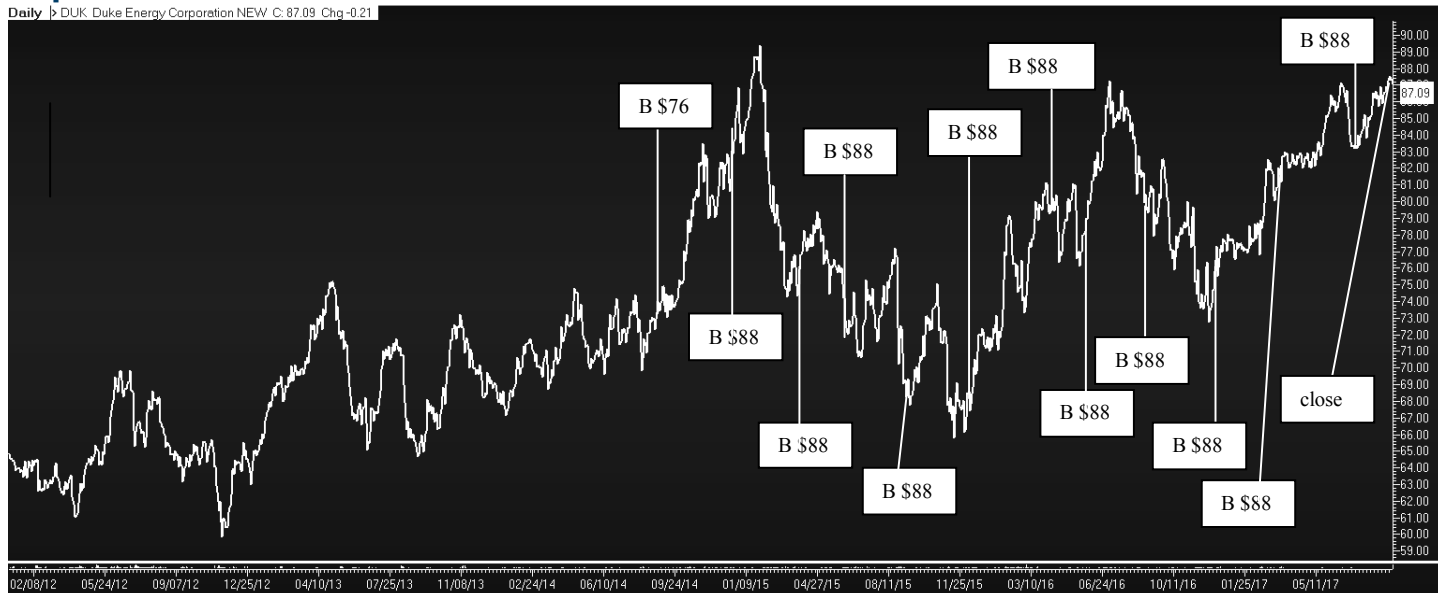
	1Q16	2Q16	3Q16	4Q16	2016	1Q17	2Q17	3Q17e	4Q17e	2017e
Operating Revenues:										
Regulated electric	\$5,503	\$4,965	\$6,303	\$4,450	\$21,221	\$4,913	\$5,118	\$5,089	\$4,532	\$19,652
Non-regulated electric/natgas/other	400	422	429	374	659	646	162	416	366	1,590
Regulated natural gas	169	97	89	508	863	170	275	464	473	1,382
Total Operating revenues	5,622	5,484	6,821	4,816	22,743	5,729	5,555	6,769	5,471	23,524
Operating Expenses:										
Fuel electric gen. & purchased power-reg	1,577	1,509	2,016	1,523	6,625	1,449	1,541	2,007	1,346	6,343
Cost of natural gas & coal sold	60	21	17	157	255	258	76	153	167	654
Operation, maintenance, & other	1,489	1,431	1,547	1,618	6,085	1,433	1,407	1,624	1,628	6,092
Depreciation & Amortization	814	813	837	830	3,294	859	835	832	852	3,378
Property & other taxes	297	293	303	339	1,142	304	307	348	355	1,314
Impairment charges	3	195	10		18		9			9
Total Operating expenses	4,298	4,344	4,805	3,982	17,429	4,303	4,175	4,964	4,343	17,785
Gains/losses sale of other assets (net)	9	5	6	7	27	11	7			18
Operating Income	1,333	1,145	2,022	841	5,341	1,437	1,387	1,805	1,123	5,752
Other Income/Expenses										
Equity in earnings of unconsolidated affiliates	8	15	60	98	15	29	36	8	11	84
Impairments/Gains on unconsol affiliates sales										
Other Income/Expenses	79	92	99	3454	324	86	81	53	24	244
Total other income/expenses	87	107	39	76	309	118	117	61	35	331
Interest expense	511	500	482	423	1,916	491	486	426	428	1,831
Income from Cont Ops before Income Taxes	909	752	1,579	494	3,734	1,081	1,018	1,440	730	4,269
Income tax expense	213	239	520	184	1,156	344	327	518	256	1,445
Income from Cont Ops before Income Taxes	696	513	1,059	310	2,579	717	691	922	474	2,804
Income from Discontinued Ops, net of Taxes	3	-1	122	124	408		-2	-12	3	-11
Net Income	699	512	1,181	-98	2,170	717	689	910	477	2,793
Net Income/loss attributable to non-controlling interest	-5	-3	-5	-5	-18	-1	-3	-5	-5	-14
Net Income attributable to Duke Energy Corp	\$694	\$509	\$1,176	(\$227)	\$2,152	\$716	\$686	\$905	\$472	2,779
Diluted EPS	\$1.01	\$0.74	\$1.52	(\$0.33)	\$3.11	\$1.02	\$0.98	\$1.31	\$0.68	\$3.99
Net Income from discon ops attributable shareholders										
Diluted EPS	\$1.01	\$0.74	\$1.52	(\$0.33)	\$3.11	\$1.02	\$0.98	\$1.31	\$0.68	\$3.99
Adjustments	\$0.12	\$0.33	\$0.16	\$1.14	\$1.58	\$0.02	\$0.03	\$0.31	\$0.17	\$0.53
Adjusted Diluted EPS	\$1.13	\$1.07	\$1.68	\$0.81	\$4.69	\$1.04	\$1.01	\$1.62	\$0.85	\$4.52



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Important Disclosures

Daily | DUKE Duke Energy Corporation NEW C: 87.09 Chg: -0.21



- 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 1.49x 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.
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