



May 25, 2018

CURRENT PRICE: \$75.81
RATING: BUY
PRICE TARGET: \$88
CURRENT YIELD: 4.7%

EPS Estimates

	DEC 17A	DEC 18E
1Q	\$1.04	\$1.28A
2Q	\$1.01	\$1.02
3Q	\$1.59	\$1.61
4Q	\$0.94	\$0.95
	\$4.57	\$4.85

Trading Data

52-WEEK PRICE RANGE: **\$91.80 - \$72.93**
 SHARES OUTSTANDING: **701(M)**
 MARKET CAP: **\$53,143(M)**
 AVG. DAILY TRADING VOLUME: **3.2(M)**
 S&P 500: **2,721**

Valuation Data

BOOK VALUE: **\$59.63**
 PRICE TO BOOK: **1.27x**
 DIVIDEND: **\$3.56**

Duke Energy (NYSE: DUK)

Good 1Q18 Earnings Report

Highlights

- Adjusted diluted 1Q18 earnings of \$1.28/share vs. \$1.04/share
- Adj. Segment Income improved by weather & customer growth
- Refund of DUK's AMT tax credits (\$1.1 billion) will add to cash flow
- Confirms 2018 adjusted eps guidance to \$4.55-\$4.85/share
- Maintain BUY rating & \$88 price target

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 4.7% 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.

100 Concourse Boulevard, Suite 101
 Glen Allen, Virginia 23059

804.612.9700 ■ 800.612.1484
 804.527.1104

www.CapitolSecurities.com

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Recent Earnings

DUK reported 1Q18 diluted earnings of \$0.88./share vs. \$1.08/share during 1Q17. Adjusted diluted earnings during 1Q18 rose to \$1.28/share from \$1.08/share during 1Q17. The difference between 1Q18's diluted earnings and adjusted earnings per share were due to a loss on DUK's sale of its retired Beckjord plant in Ohio, recognition of a valuation allowance related to the Tax Cuts & Jobs Act of 2017, charges related to Duke Energy Progress NC rate case order, and impairment related to the Constitution pipeline. The improvement in adjusted earnings was mainly from a return to normal weather during 1Q18, as well as growth from investments in DUK's electric and gas utilities. GAAP revenues, when comparing 1Q18 and 1Q17, improved to \$6.14 billion from \$5.72 billion and operating expenses increased to \$4.78 billion from \$4.34 billion. DUK's book value per share rose to \$59.63/share from \$58.84/share.

SEGMENT RESULTS

ELECTRIC UTILITIES/INFRASTRUCTURE: 1Q18's adjusted segment income increased to \$816 million from \$635 million during 1Q17. The higher results came from improved weather conditions (+\$0.16/share), increased retail revenues/pricing and riders due to additional investments (+\$0.06/share), lower income tax expense (+\$0.06/share), and a decrease in operation/maintenance expense (+\$0.04/share) from timing of spending as well as lower storm restoration costs. These positives were partly offset by higher depreciation expense (-\$0.08/share). GAAP segment income increased to \$750 million from \$635 million as results were impacted by those factors mentioned above and a \$66 million charge related to Duke Energy Progress NC rate case order.

Total Electric sales improved 7.7% to 63,529 GWh from 58,990 GWh. The improvement came from Residential (+18.3), Wholesale/Other (+11.3%), and General Service (+5.1%), while being partly offset by unbilled sales (-100%), Other Energy sales (-2.8%), and Industrial (-1.6%).

GAS UTILITY/INFRASTRUCTURE: 1Q18's adjusted segment income rose to \$158 million from \$133 million during 1Q17. The higher results came from customer growth of 1.8%, when comparing the two quarters, and increased investments at Piedmont Natural Gas, including higher rate base from integrity management investments, and required infrastructure for the W.S. Lee Plant. Total gas sales rose by 16.2% at Piedmont Natural Gas and 20.4% at Duke Energy Midwest. GAAP segment income declined to \$116 million from \$133 million due to a \$42 million after-tax impairment charge related to the Constitution Pipeline investment.

COMMERCIAL RENEWABLES: Both adjusted and GAAP segment income decreased to \$20 million from \$25 million. The lower results came from lower wind resources versus last year's quarter. When comparing the two quarters, renewable plant production decreased 4.5% to 2,180 GWh from 2,285 GWh.



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OTHER: This unit includes corporate interest expense not allocated to DUK's business unit, results from DUK's captive insurance company, and other investments including National Methanol Company (an equity method investment). This unit recognized a GAAP loss in 1Q18 of \$266 million vs. \$77 million during 1Q17, as results were impacted by an \$82 million after-tax loss on the sale of the Beckjord Plant, the recognition of a \$76 million allowance related to the Tax Act, and costs related to the Piedmont Gas merger. On an adjusted basis, this unit recognized a net loss of \$95 million vs. a net loss of \$67 million, when comparing the two quarters. This was due to higher interest expense (-\$0.02/share) and higher income taxes (-\$0.02/share). Income taxes were impacted by a lower tax shield on holding company interest as a result of the Tax Act (-\$0.03/share) and was partially offset by a favorable state audit tax settlement (+\$0.01/share).

TAXES: DUK's consolidated reported effective tax rate for 1Q18 was 22.5% vs. 32.4% during 1Q17. The consolidated adjusted effective tax rate when comparing the two quarters was 15.7% vs. 32.5%. The decrease in both tax rates was due to the impacts of the Tax Act. The company noted its cash flow will benefit from its \$1.1 billion of AMT tax credits which are now refundable under the Tax Act as these credits will be refunded to the company regardless of whether there is reportable taxable income.

RECENT DEVELOPMENTS

DUK plans to sell five Carolina hydroelectric plants to privately-held Northbrook Energy for an undisclosed amount. These five facilities have a combined 18. MW generation capacity and includes the Bryson, Franklin, and Mission hydro stations in the Nantahala area, and the Tuxedo and Gaston Shoals hydro stations in the Green/Broad River Basin. DUK has a 5 year agreement to purchase the power generated by these plants.

A Federal Appeals court invalidated a US Fish & Wildlife service permit for an approximate 10 mile stretch of the Atlantic Coast Pipeline. DUK, Dominion Energy (D-\$64.17) and Southern Co. (SO-\$44.52) all have ownership interests in this pipeline and will seek a revised permit.

The Atlantic Coast Pipeline was granted FERC permission to begin construction in the state of West Virginia.

During March, DUK completed a \$1.6 billion equity offering and issued \$50 million of equity through its dividend reinvestment program during 1Q18.

DUK filed two rate cases last year for Duke Energy Progress and Duke Energy Carolinas. This past February, the NC Utilities Commission issued an order in the DEP case, approving rates associated with DUK's new \$8.1 billion rate base, including investments in four solar projects and gas-fired generation at Sutton and Asheville. This decision approved a 9.9% ROE on a 52% equity component of the capital structure. The order also approved DUK's request to amortize \$234 million, of \$240 million requested, in deferred costs regarding coal ash cost recovery.



In April, DUK requested, to the Florida Public Service Commission, recovery of its investment in Citrus County and increasing revenues by approximately \$200 million per year.

DUK anticipates its 25 megawatt Shoreham solar facility will come online during 2Q18.

Our Thoughts

DUK had a solid quarter of earnings with reported adjusted EPS of \$1.28/share vs. \$1.04/share. The improvement was due mainly to a return to normal weather during 1Q18, as well as growth from investments in DUK's electric and gas utilities. During the earnings call, management reaffirmed 2018 earnings guidance of \$4.55-\$4.85/share and believes annual earnings could grow at CAGR of 4%-6% through 2022. Additionally, DUK noted its cash flow will benefit from its \$1.1 billion of AMT tax credits which are now refundable under the Tax Act as these will be refunded to the company-which we view as very positive.

Although DUK's shares have declined recently, due to rising interest rates, we continue to rate this stock a BUY for income/growth investors. While the direction of the stock is uncertain over a short term basis due to interest rates, a decline in rates could push DUK's shares higher over the longer term. This stock pays an attractive dividend yield of 4.7% and offers the potential of annual dividend increases as earnings grow at a 4%-6% rate going towards 2022. Our price target is \$88/share, equating to 1.48x its book value of \$59.63/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.

Steven F. Marascia
Director of Research
Capitol Securities Management
804-612-9715



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Duke Energy
Condensed Consolidated Statements of Operations
unaudited
(in millions, except per share amounts)

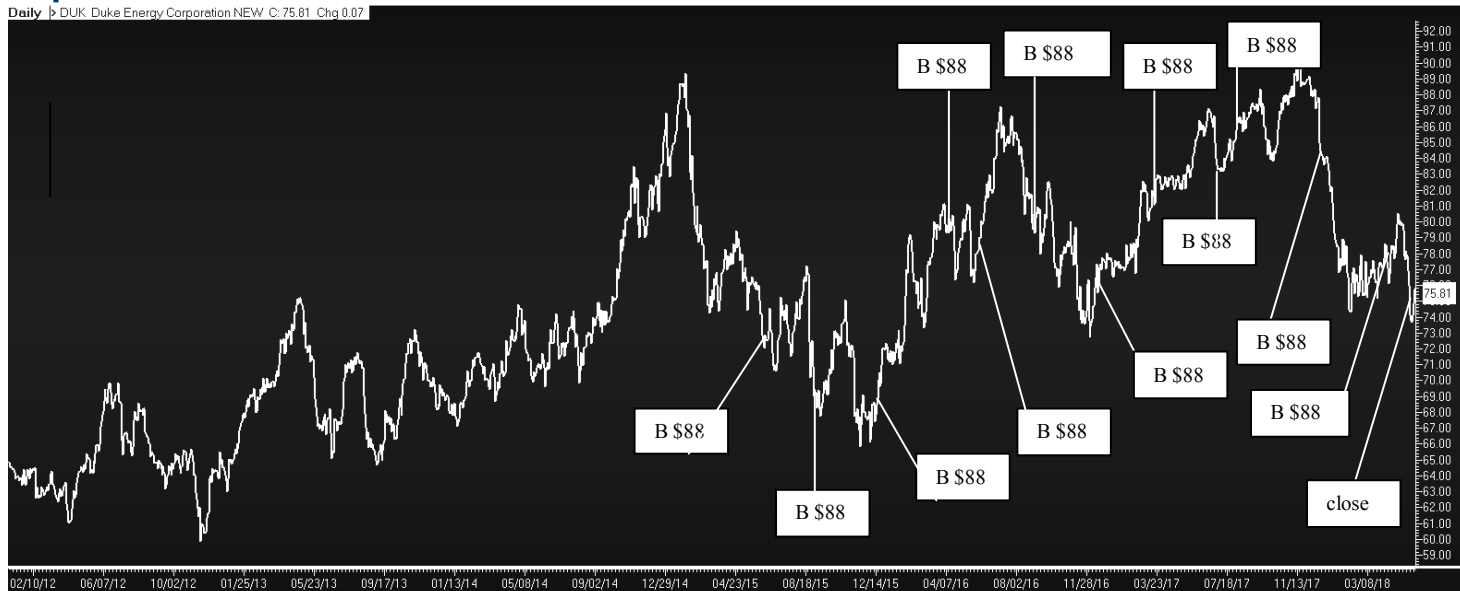
	1Q17	2Q17	3Q17	4Q17	2017	1Q18	2Q18e	3Q18e	4Q18e	2018e
Operating Revenues:										
Regulated electric	\$4,913	\$5,118	\$6,091	\$4,995	\$21,777	\$5,284	\$ 5,019	\$6,041	4,923	\$21,267
Non-regulated electric/natgas/other	646	162	144	782	1,734	700	226	195	718	1,839
Regulated natural gas	170	275	247	32	654	151	283	209	94	737
Total Operating revenues	5,729	5,555	6,482	5,799	23,565	6,135	5,528	6,445	5,735	23,843
Operating Expenses:										
Fuel electric gen. & purchased power-reg	1,449	1,541	1,863	1,497	6,350	1,676	1,528	1,917	1,476	6,597
Cost of natural gas & coal sold	258	76	66	232	632	313	104	129	279	825
Operation, maintenance, & other	1,433	1,407	1,442	1,504	5,788	1,464	1,459	1,491	1,554	5,968
Depreciation & Amortization	859	835	900	1,023	3,527	967	878	926	933	3,704
Property & other taxes	304	307	313	309	1,233	316	311	314	317	1,258
Impairment charges		9	207	66	282		43			43
Total Operating expenses	4,303	4,175	4,793	4,550	17,812	4,779	4,280	4,777	4,659	18,495
Gains/losses sale of other assets (net)	11	7	6	4	28	100	9	6	7	122
Operating Income	1,437	1,387	1,695	812	5,781	1,256	1,257	1,674	1,083	5,270
Other Income/Expenses										
Equity in earnings of unconsolidated affiliates	29	36	36	18	119	-24	27	33	37	73
Impairments/Gains on unconsol affiliates sales										
Other Income/Expenses	86	81	88	97	352	86	83	81	94	344
Total other income/expenses	118	117	124	112	471	62	110	114	131	417
Interest expense										
Income from Cont Ops before Income Taxes	1,081	1,018	1,321	846	4,266	803	848	1,264	688	3,603
Income tax expense	344	327	364	161	1,196	181	187	276	144	788
Income from Cont Operations	717	691	957	705	3,070	622	661	988	544	2,815
Income (loss) from Discontinued Ops		-2	-2	-2	-6		-2	-3	-1	-6
Net Income										
Net Income	717	689	955	703	3,064	622	659	985	543	2,809
Net Income/loss attributable to non-controlling interest	-1	-3	-1		-5	-2	-1	-2	-1	-6
Net Income attributable to Duke Energy Corp	\$716	\$686	\$954	\$703	\$3,059	\$620	\$658	\$983	\$542	\$2,803
Diluted EPS										
Net Income from discon ops attributable shareholders										
Diluted EPS	\$1.02	\$0.98	\$1.36	\$1.00	\$4.36	\$0.88	\$0.94	\$1.40	\$0.77	\$3.99
Adjustments	\$0.02	\$0.03	\$0.23	\$0.06	\$0.21	\$0.40	\$0.08	\$0.21	\$0.17	\$0.86
Adjusted Diluted EPS	\$1.04	\$1.01	\$1.59	\$0.94	\$4.57	\$1.28	\$1.02	\$1.61	\$0.94	\$4.85



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Important Disclosures

Daily | DUK Duke Energy Corporation NEW C: 75.81 Chg 0.07



- 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 1.48x 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.
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