



September 25, 2018

CURRENT PRICE: \$78.80
RATING: BUY
PRICE TARGET: \$88
CURRENT YIELD: 4.7%

EPS Estimates

	DEC 17A	DEC 18E
1Q	\$1.04	\$1.28A
2Q	\$1.01	\$0.93A
3Q	\$1.59	\$1.50
4Q	\$0.94	\$0.94
	\$4.57	\$4.65

Trading Data

52-WEEK PRICE RANGE: \$91.80 - \$71.96
 SHARES OUTSTANDING: 704(M)
 MARKET CAP: \$55,475(M)
 AVG. DAILY TRADING VOLUME: 3.5(M)
 S&P 500: 2,915

Valuation Data

BOOK VALUE: \$59.63
 PRICE TO BOOK: 1.32x
 DIVIDEND: \$3.71

Duke Energy (NYSE: DUK)

2Q18 Earnings Report-Florence hits

Highlights

- Adjusted diluted 2Q18 earnings of \$0.93/share vs. \$1.01/share
- Earnings hurt by higher DD&A and maintenance costs
- Costs of Florence damage to be determined
- Increased annual dividend to \$3.71/share from \$3.56/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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EQUITY RESEARCH

Recent Earnings

DUK reported 2Q18 diluted earnings of \$0.71/share vs. \$0.98/share during 2Q17. The decrease occurred as increased revenues were not enough to offset a rise in operating expenses. Revenues grew to \$5.18 billion from \$5.12 billion, while operating expenses rose to \$4.67 billion from \$4.21 billion. The increase in expenses came from higher impairment charges (+\$163 million), DD&A (+\$138 million), operation/maintenance (+\$103 million), fuel used in electric generation/purchased power (+\$33 million), natural gas cost (+\$13 million), and property/other taxes (+\$8 million). As a result, operating income declined to \$979 million from \$1.35 billion. Adjusted diluted earnings decreased to \$0.93/share from \$1.01/share, when comparing the two quarters, due to a lower tax shield on DUK's holding company interest because of the new tax law, higher depreciation on a growing asset base, and higher O&M costs (including storm costs). These were partly offset by warmer weather and contributions from the Duke Energy Progress NC rate case. Despite the lower 2Q18 results, DUK management maintains its 2018 adjusted diluted earnings guidance of \$4.55-\$4.85/share.

SEGMENT RESULTS

ELECTRIC UTILITIES/INFRASTRUCTURE: 2Q18'S adjusted segment income declined to \$711 million from \$729 million. The lower results were due to higher DD&A (-\$0.07/share) from a growing asset base, O&M expense (-\$0.03/share) including storm repair costs, a FERC resolution regarding accounting issues (-\$0.02/share), and lower AFUDC equity (-\$0.02/share). These increases were partly offset by favorable weather (+\$0.07/share), higher rider revenues (+\$0.04/share), and a DEP rate case contribution (+\$0.02/share).

Total electric sales improved 2.4% to 62,920 GWh from 61,418 GWh. The improvement came from increases in Unbilled sales (+17.4%), Residential (+6.1%), and general services (+1.3%) and while other energy sales were flat. Partly offsetting these gains were declines in wholesale/other (0.7%) and industrial (-0.2%).

GAS UTILITIES/INFRASTRUCTURE: Adjusted and reported segment income rose to \$28 million during 2Q18 from \$27 million during 2Q17. Total revenues increased to \$318 million from \$301 million while total expenses rose to \$278 million from \$253 million mainly due to a rise in natural gas cost and DD&A. Total gas sales were higher by 24.3% at Piedmont Natural Gas LDC and 27.9% at Duke Energy Midwest. The average number of gas customers increased 1.6% for Piedmont Natural Gas LDC and 0.9% for Duke Energy Midwest.

COMMERCIAL RENEWABLES: Both adjusted and reported segment income improved to \$38 million from \$26 million when comparing 2Q18 to 2Q17. The higher results were due mainly to a favorable settlement on a contractual agreement. Revenues rose to \$119 million from \$110 million and expenses increased to \$113 million from \$104 million. When comparing the two quarters, renewable plant production rose 10.8% to 2,471 GWh from 2,231 GWh.



OTHER: This unit includes corporate interest expense not allocated to DUK's business unit, results from DUK's captive insurance company, and other unallocated corporate costs. For 2Q18, this unit reported a net loss of \$136 million compared to a \$94 million loss during 2Q17. 2Q18's results were impacted by Piedmont merger costs and treated as special items and excluded from adjusted earnings. On an adjusted basis, Other reported 2Q18 results of a \$121 million loss vs. a \$75 million net loss during 2Q17. The increased loss was due to a lower tax shield on holding company interest (-\$0.04/share) resulting from the new US corporate tax laws and higher interest expense (-\$0.02/share).

TAXES: DUK's consolidated reported effective tax rate for 2Q18 was 16.5% vs. 32.1% during 2Q17. 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 new 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

Rains from Hurricane Florence caused the collapse of a slope at the coal ash landfill located at the closed Sutton Power Station near Wilmington NC creating a breach at a connected dam.

As of 9/18/18, the company estimates it restored power to approximately 1.4 million customers in its NC service territory.

DUK said it would not build any new nuclear power generation during its recently announced 15 year plan to increase its generating capacity. Instead, management will focus on obtaining license extensions for its existing 7,400 MW nuclear fleet.

Despite the proposed Trump rollbacks of the Clean Power Plan, DUK announced it will not change plans to eliminate most of its coal plants and reduce greenhouse emissions. Thus far, DUK has reduced its carbon emissions by 31% since 2005 with plans to reduce them another 40% by 2030.

The company abandoned its request for proposals to purchase 500 MW of wind powered energy for its customers after calculating the proposals were not attractive enough for its business model.

DUK announced it would build a \$250 million LNG storage project unit in NC through its Piedmont Gas subsidiary, with a capacity of holding 1 billion cubic feet of natural gas.



Duke Energy Renewables completed its acquisition of Shoreham Solar Commons Project from Invenergy. This is a 24.9 MW project located in Long Island NY. Expectations for this project to produce annual tax revenues of \$700,000-\$900,000.

DUK is considering appealing a recent NC rate hike ruling. The company is seeking clarification on parts of a recent ruling rejecting nearly all of its' 11.6% rate hike request. As a result, the company incurred a \$50 million pre-tax impairment charge during 2Q18.

DUK won a preliminary legal round in a potential \$600 million lawsuit against more than two dozen insurance companies over their refusal to reimburse DUK's coal ash liability claims. This occurred following a NC judge's order for insurers to give DUK significant amounts of discovery information earlier denied by the insurance companies.

The company agreed to curb requests for legislative authority for annual rate increases to pay for its \$13 billion grid upgrade if the regulators approve a 3-year pilot program based on the original plan. This was part of a settlement agreed upon by environmental groups.

Work was resumed on the Atlantic Coast Pipeline after an order from FERC countering an earlier decision by the 4th US Circuit Court of Appeals panel which vacated two key federal permits issued for the 600 mile pipeline. This was done after the US Fish & Wildlife and the US National Park Services both issued replacement permits for the pipeline.

DUK raised its annual common stock dividend to \$3.71/share from \$3.56/share.

Our Thoughts

DUK reported 2Q18 diluted earnings of \$0.71/share vs. \$0.98/share during 2Q17 and adjusted diluted earnings decreased to \$0.93/share from \$1.01/share. The earnings decline was due to higher depreciation and amortization (from an increased asset base) and a rise in maintenance costs resulting from increased storms. Going forward, DUK will have to deal with repair costs from Hurricane Florence's advance into its NC service territory. DUK has yet to quantify storm damage cost but expect an update during the next few weeks. Given this aspect, we believe these costs may cause DUK's FY18 earnings to come in at the lower end of management's \$4.55-\$4.85/share guidance.

Despite the near-term effects of Florence we continue to rate DUK a BUY. The dividend yield of 4.7% should be attractive to income/growth investors seeking a utility with the potential of future earnings/dividend growth. In fact, the Board of Directors recently raised its annual common stock dividend to \$3.71/share from \$3.56/share. Going forward, dividend increases may continue if DUK successfully grows earnings. Our price target is \$88/share, equating to 1.47x its current book value of \$59.71/share.



Risks

Failure of DUK to grow cash flow/earnings. Declining earnings from its three operating units. Rising interest rates, increasing fuel prices, falling electric rates, negative rate case decisions, adverse tax or legal issues, or rising operating costs could have a negative impact on our price target. Additionally, negative equity/credit markets, large selling volumes in DUK's stock, terrorist attacks, wars, geopolitical events, US political issues, failure to comply with Sarbanes Oxley guidelines, or maintain accepted accounting standards could be risks to DUK and our price target for its stock.

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



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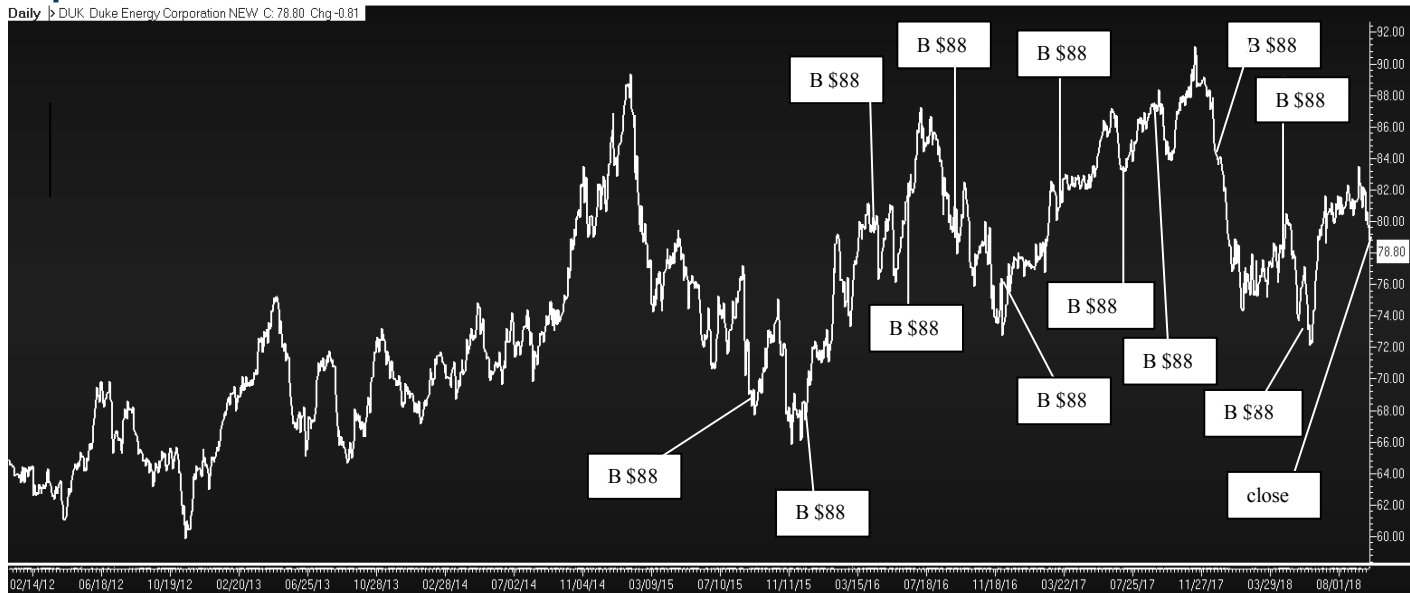
EQUITY RESEARCH

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

	1Q17	2Q17	3Q17	4Q17	2017	1Q18	2Q18	3Q18e	4Q18e	2018e
Operating Revenues:										
Regulated electric	\$4,913	\$5,118	\$6,091	\$4,995	\$21,777	\$5,284	\$ 5,178	\$6,041	4,923	\$21,426
Non-regulated electric/natgas/other	646	162	144	782	1,734	700	291	195	718	1,904
Regulated natural gas	170	275	247	32	654	151	174	209	94	628
Total Operating revenues	5,729	5,555	6,482	5,799	23,565	6,135	5,643	6,445	5,735	23,958
Operating Expenses:										
Fuel electric gen. & purchased power-reg	1,449	1,541	1,863	1,497	6,350	1,676	1,574	1,917	1,476	6,643
Cost of natural gas & coal sold	258	76	66	232	632	313	89	129	279	810
Operation, maintenance, & other	1,433	1,407	1,442	1,504	5,788	1,464	1,544	1,491	1,554	6,053
Depreciation & Amortization	859	835	900	1,023	3,527	967	973	926	933	3,799
Property & other taxes	304	307	313	309	1,233	316	315	314	317	1,262
Impairment charges		9	207	66	282	43	172			215
Total Operating expenses	4,303	4,175	4,793	4,550	17,812	4,779	4,667	4,777	4,659	18,882
Gains/losses sale of other assets (net)	11	7	6	4	28	100	3	6	7	117
Operating Income	1,437	1,387	1,695	812	5,781	1,256	979	1,674	1,083	4,992
Other Income/Expenses										
Equity in earnings of unconsolidated affiliates	29	36	36	18	119	-24	36	33	37	82
Impairments/Gains on unconsol affiliates sales										
Other Income/Expenses	86	81	88	97	352	86	110	81	94	371
Total other income/expenses	118	117	124	112	471	62	146	114	131	453
Interest expense										
Interest expense	491	486	498	511	1,986	515	518	524	526	2,083
Income from Cont Ops before Income Taxes	1,081	1,018	1,321	846	4,266	803	607	1,264	688	3,362
Income tax expense	344	327	364	161	1,196	181	100	276	144	701
Income from Cont Operations	717	691	957	705	3,070	622	507	988	544	2,661
Income (loss) from Discontinued Ops		-2	-2	-2	-6		-5	-3	-1	-9
Net Income										
Net Income	717	689	955	703	3,064	622	502	985	543	2,652
Net Income/loss attributable to non-controlling interest	-1	-3	-1		-5	-2	-2	-2	-1	-7
Net Income attributable to Duke Energy Corp	\$716	\$686	\$954	\$703	\$3,059	\$620	\$500	\$983	\$542	\$2,645
Diluted EPS										
Diluted EPS	\$1.02	\$0.98	\$1.36	\$1.00	\$4.36	\$0.88	\$0.71	\$1.40	\$0.77	\$3.76
Net Income from discon ops attributable shareholders										
Diluted EPS	\$1.02	\$0.98	\$1.36	\$1.00	\$4.36	\$0.88	\$0.71	\$1.40	\$0.77	\$3.76
Adjustments	\$0.02	\$0.03	\$0.23	\$0.06	\$0.21	\$0.40	\$0.22	\$0.10	\$0.17	\$0.89
Adjusted Diluted EPS	\$1.04	\$1.01	\$1.59	\$0.94	\$4.57	\$1.28	\$0.93	\$1.50	\$0.94	\$4.65

Important Disclosures

Daily | DUK Duke Energy Corporation NEW C:78.80 Chg:-0.81



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 1.47x book value/share

RISKS TO OUR PRICE TARGET: Failure of DUK to grow cashflow or earnings. Declining earnings from its' 3 operating units,. Risng interest rates, increasing fuel prices, falling electric rates, negative rate case decisions, adverse tax or legal issues, or rising operating costs could have a negative impact on our price target. Additionally, negative equity/credit markets, large selling volumes in DUK's stock, terrorist attacks, wars, geopolitical issues,US politics, failure to comply with Sarbanes Oxley guidelines, or maintain accepted accounting standards could be risks to our price target.

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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.
- (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.

The distribution of investment ratings for all companies in our coverage universe are as follows: (1) 37.5%, (2) 62.5%, (3) 0%

The distribution of investment ratings used for companies whom we have performed banking services in the last 12 months are (1) 100%, (2) 0%, (3) 0%

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