



November 28, 2018

CURRENT PRICE: \$87.60
RATING: BUY
PRICE TARGET: \$88
CURRENT YIELD: 4.2%

EPS Estimates

	DEC 17A	DEC 18E
1Q	\$1.04	\$1.28A
2Q	\$1.01	\$0.93A
3Q	\$1.59	\$1.65A
4Q	\$0.94	\$0.94
	\$4.57	\$4.80

Trading Data

52-WEEK PRICE RANGE: \$89.72 - \$71.96
 SHARES OUTSTANDING: 714(M)
 MARKET CAP: \$62,546(M)
 AVG. DAILY TRADING VOLUME: 3.7(M)
 S&P 500: 2,744

Valuation Data

BOOK VALUE: \$60.33
 PRICE TO BOOK: 1.45x
 DIVIDEND: \$3.71

Duke Energy (NYSE: DUK)

3Q18 Earnings Report

Highlights

- Adjusted diluted 3Q18 earnings of \$1.65/share vs. \$1.59/share
- Higher revenues offset increased expense-helped by lower taxes
- Narrowed 2018 adjusted earnings guidance to \$4.65-\$4.85/share
- Share price helped by recent stock market volatility
- 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 4.2% 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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EQUITY RESEARCH

Recent Earnings

DUK reported 3Q18 diluted earnings of \$1.51/share vs. \$1.36/share during 3Q17. The improvement occurred as an increase in total operating revenues (\$6.63 billion vs. \$6.48 billion) offset higher operating expenses (\$5.06 billion vs. \$4.83 billion), while benefitting from lower income taxes (\$168 million vs. \$364 million). Operating expenses' increase came from fuel used in electric generation/purchased power (+\$68 million), operation/maintenance/other expense (+\$108 million), depreciation/amortization (+\$139 million), and other taxes (+\$10 million). These were partly offset by lower impairment charges (-\$83 million) and cost of natural gas (-\$10 million). Adjusted diluted earnings rose to \$1.65/share from \$1.59/share due to higher retail electric sales and income tax benefits that were partly negated by higher storm restoration costs and share dilution. Adjusted segment income improved at the Electric Utilities/Infrastructure and Commercial Renewables units while declining in the Gas Utilities/Infrastructure unit.

SEGMENT RESULTS

ELECTRIC UTILITIES/INFRASTRUCTURE: Reported 3Q18 adjusted segment income of \$1.18 billion from \$1.10 billion during 3Q17. The improved results were produced by weather-related increases in retail sales (+\$0.05/share), favorable weather trends (+\$0.03/share), higher rider revenues (+\$0.03/share), rate case contributions from Duke Energy Progress and Duke Energy Carolinas (+\$0.02/share), and lower income taxes (+\$0.06/share). These were partly offset by higher depreciation/amortization expense (-\$0.05/share), Edwardsport Plant impairment charge (-\$0.03/share), and higher operations/maintenance expense (-\$0.03/share) from higher storm restoration expense during 3Q18. Management estimated costs related to Hurricane Florence will total approximately \$450 million, mainly by Duke Energy Progress (DEP). DUK plans to request permission to defer approximately \$370 million of incremental cost for recovery in DEP's next rate case. Additionally, the preliminary estimated costs from Hurricane Michael are around \$200 million and will be recorded during 4Q18.

Total electric sales improved 4.4% to 73,685 GWh from 70,561 GWh. The improvement came from higher sales to Residential (+5.4%), Wholesale/Other (+5.1%), Industrial (+4.7%), and General Services (+4.6%). These were partly offset by lower Unbilled sales (-76.8%) and flat Other Energy sales.

GAS UTILITIES/INFRASTRUCTURE: 3Q18 adjusted segment income decreased slightly to \$18 million from \$19 million during 3Q17. Growth from the Midstream business was offset by higher O&M expense. Total revenues rose 23.3% to \$144.77 million from \$117.39 million as Piedmont Local Gas Distribution improved 26.0% to \$135.40 million and was partly offset by a 5.4% Duke Midwest Energy LDC revenue decrease to \$9.37 million. The number of natural gas customers for Piedmont Natural Local Gas Distribution rose 1.3% while Duke Energy Midwest's improved 0.8%.



COMMERCIAL RENEWABLES: 3Q18's adjusted segment income rose to \$26 million from \$7 million from \$7 million during 3Q17. The higher results came from a new solar project (Shoreham Solar) placed into commercial service. This was reflected in renewable plant production rising 7.8% to 1,897 GWh from 1,760 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. This unit reported an adjusted net loss of \$40 million during 3Q18 vs. an adjusted net loss of \$20 million during 3Q17. The higher loss was due to a lower tax shield on holding company interest resulting from the new Tax Act (-\$0.03/share) and a favorable 2017 litigation settlement (-\$0.02/share) and were partly offset by higher tax optimization benefits (+\$0.02/share).

RECENT DEVELOPMENTS

During the 3Q18 conference call management narrowed its 2018 adjusted diluted earnings guidance range to \$4.65-\$4.85/share.

DUK recently announced 24 of its coal ash basins in NC and SC violated federal guidelines for disposal of hazardous byproducts from power generation units. Two basins, among those found to be non-compliant were the H.F. Lee and L.V. Sutton coal plants which spilled coal ash into nearby waterways during September's Hurricane Florence.

DUK completed the issuance of \$1 billion in green bonds. The company plans to use the bonds to finance eligible green energy projects including solar/energy storage in NC and SC

A US Court of Appeals' ruling stayed a federal water quality permit issued by the US Army Corps of Engineers for the Atlantic Coast Pipeline (ACP) needed for water crossings in parts of WV. An ACP project spokesperson said the delay should not have a major effect on the overall project. The ACP is owned by Dominion Energy (D-\$73.32), Southern Co. (SO-\$46.12), and DUK.

VA's Department of Environmental Quality issued permits for the ACP allowing for construction to begin in the state, pending FERC approval. FERC did approve VA tree cutting for this pipeline.

Environmental groups have filed legal challenges asking the Fourth US Circuit Court of Appeals to intervene in recent legal actions which paved the way for construction of the ACP.

The 125-mile Constitution Gas Pipeline (CGP), currently under construction, was granted 2 additional years, by US regulators, to obtain approvals needed to finish building the PA-to-NY pipeline. This is the 2nd two year extension



given to the pipeline since FERC approved original construction in 2014. The CGP pipeline is currently owned by subsidiaries of Williams Co. (WMB-\$25.34), Cabot Oil & Gas (COG-\$24.90), Alta Gas (ATGFF-\$10.60), and DUK.

DUK asked the NC Utilities Commission to allow the company to offer solar-leasing services to commercial and institutional customers in the state to provide access to renewable energy without paying upfront costs. DUK would create a new non-regulated subsidiary, without any support from the company's power generation unit, and would own/operate on-site solar facilities, allowing customers to install up to 1 MW of solar energy at business customer sites.

US nuclear operators stated the 25% tariff on uranium imports proposed by US uranium minors could increase cost for nuclear power generators by \$500 million - \$800 million per year.

OUR THOUGHTS

Overall, a good 3Q18 earnings report from DUK as the company reported 3Q18 diluted earnings of \$1.51/share vs. \$1.36/share during 3Q17. The improvement occurred as an increase in total operating revenues (\$6.63 billion vs. \$6.48 billion) offset higher operating expenses (\$5.06 billion vs. \$4.83 billion), while benefitting from lower income taxes (\$168 million vs. \$364 million). Adjusted diluted earnings rose to \$1.65/share from \$1.59/share due to higher retail electric sales and income tax benefits that were partly negated by higher storm restoration costs and share dilution.

DUK's stock, since our last report, has risen 11.2%, while the S&P 500 declined nearly 6%, due mainly to volatility in the equity markets causing many Wall Street investors to move into utility stocks. It would not be unusual for the utility sector, including DUK, to pull back in price should calm return to the overall stock market. However, we recommend this stock for income/growth investors since its earnings growth target of 4%-6% through 2022 could allow the Board of Directors to raise the common stock dividend on an annual basis. DUK is rated a BUY with an \$88 price target, equating to 1.45x its book value of \$60.33/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.

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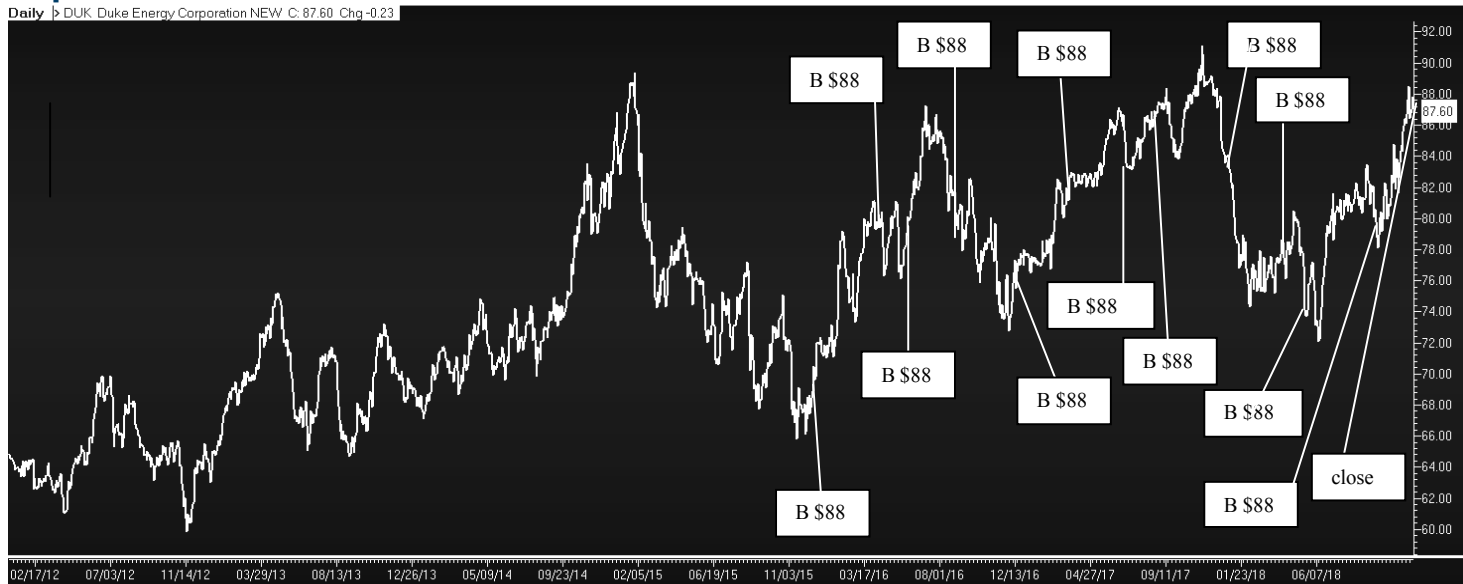
EQUITY RESEARCH

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

	1Q17	2Q17	3Q17	4Q17	2017	1Q18	2Q18	3Q18	4Q18e	2018e
Operating Revenues:										
Regulated electric	\$4,913	\$5,118	\$6,091	\$4,995	\$21,777	\$5,284	\$ 5,178	\$6,216	\$ 4,923	\$21,601
Non-regulated electric/natgas/other	646	162	144	782	1,734	700	291	230	718	1,939
Regulated natural gas	170	275	247	32	654	151	174	182	94	601
Total Operating revenues	5,729	5,555	6,482	5,799	23,565	6,135	5,643	6,628	5,735	24,141
Operating Expenses:										
Fuel electric gen. & purchased power-reg	1,449	1,541	1,863	1,497	6,350	1,676	1,574	1,931	1,476	6,657
Cost of natural gas & coal sold	258	76	66	232	632	313	89	58	279	739
Operation, maintenance, & other	1,433	1,407	1,442	1,504	5,788	1,464	1,544	1,584	1,554	6,146
Depreciation & Amortization	859	835	900	1,023	3,527	967	973	1,039	933	3,912
Property & other taxes	304	307	313	309	1,233	316	315	323	317	1,271
Impairment charges		9	207	66	282	43	172	124		339
Total Operating expenses	4,303	4,175	4,793	4,550	17,812	4,779	4,667	5,059	4,659	19,164
Gains/losses sale of other assets (net)	11	7	6	4	28	100	3	10	7	120
Operating Income	1,437	1,387	1,695	812	5,781	1,256	979	1,579	1,083	4,897
Other Income/Expenses										
Equity in earnings of unconsolidated affiliates	29	36	36	18	119	-24	36	37	37	86
Impairments/Gains on unconsol affiliates sales										
Other Income/Expenses	86	81	88	97	352	86	110	131	94	421
Total other income/expenses	118	117	124	112	471	62	146	168	131	507
Interest expense										
Interest expense	491	486	498	511	1,986	515	518	517	526	2,076
Income from Cont Ops before Income Taxes	1,081	1,018	1,321	846	4,266	803	607	1,230	688	3,228
Income tax expense	344	327	364	161	1,196	181	100	168	144	593
Income from Cont Operations	717	691	957	705	3,070	622	507	1,062	544	2,735
Income (loss) from Discontinued Ops		-2	-2	-2	-6		-5	4	-1	-10
Net Income										
Net Income	717	689	955	703	3,064	622	502	1,066	543	2,733
Net Income/loss attributable to non-controlling interest	-1	-3	-1		-5	-2	-2	16	-1	-11
Net Income attributable to Duke Energy Corp	\$716	\$686	\$954	\$703	\$3,059	\$620	\$500	\$1,082	\$542	\$2,744
Diluted EPS										
Diluted EPS	\$1.02	\$0.98	\$1.36	\$1.00	\$4.36	\$0.88	\$0.71	\$1.51	\$0.77	\$3.87
Net Income from discon ops attributable shareholders										
Diluted EPS	\$1.02	\$0.98	\$1.36	\$1.00	\$4.36	\$0.88	\$0.71	\$1.51	\$0.77	\$3.87
Adjustments	\$0.02	\$0.03	\$0.23	\$0.06	\$0.21	\$0.40	\$0.22	\$0.14	\$0.17	\$0.93
Adjusted Diluted EPS	\$1.04	\$1.01	\$1.59	\$0.94	\$4.57	\$1.28	\$0.93	\$1.65	\$0.94	\$4.80

Important Disclosures

Daily > DUK, Duke Energy Corporation NEW, C: 87.60 Chg: -0.23



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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