Duke Energy (DUK)

Updated July 8th, 2018 by Josh Arnold

Key Metrics

Current Price:	$82	**5 Year CAGR Estimate:**	8.1%	**Volatility Percentile:**	10.6%
Fair Value Price:	$80	**5 Year Growth Estimate:**	4.1%	**Momentum Percentile:**	34.5%
% Fair Value:	102%	**5 Year Valuation Multiple Estimate:**	-0.4%	**Valuation Percentile:**	56.4%
Dividend Yield:	4.4%	**5 Year Price Target**	$98	**Total Return Percentile:**	50.7%

Overview & Current Events

Duke Energy began operations in 1904 by providing power to a South Carolina cotton mill. Since that time, it has grown both organically and through mergers to become one of the largest providers of energy in the US. Today, it produces $24B in annual revenue and has a market capitalization of $57B.

The company's recently reported Q1 earnings were very well received by investors. The company beat expectations on the top and bottom line as revenue rose 7% and a significantly lower tax rate boosted after-tax margins. The electric utilities segment saw its operating income advance 28% as last year's Q1 had unseasonably warm weather, leading to lower power demand. A return to more normalized weather patterns in this year's Q1 helped boost demand and thus, Duke's results were much better. Duke reiterated its guidance for $4.55 to $4.85 in earnings-per-share for this year, helped in part by the colder winter weather, and from a tax rate that has fallen from 32% to 16%. Overall, easy comparisons and strong execution from Duke combined to create an excellent first quarter.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$3.03	$3.39	$4.02	$4.14	$3.71	$3.98	$4.13	$4.10	$3.71	$4.22	***$4.75***	***$5.80***
DPS	$2.70	$2.82	$2.91	$2.97	$3.03	$3.09	$3.15	$3.24	$3.36	$3.49	***$3.56***	***$4.00***

Duke's earnings-per-share have increased at an annual rate of 4% over the last decade. Growth has not been linear, but we expect to see Duke produce 4.1% earnings-per-share growth annually moving forward, in line with historical norms.

We see Duke as achieving this growth via organic customer growth and rate increases. Customer growth should continue as a low single digit tailwind for the foreseeable future, providing Duke with ever-higher base demand for its services. Of course, the weather can have a significant impact positively or negatively in any particular year, but overall, a low single digit tailwind from customer growth is very likely. In addition, rate increases will help boost revenue and earnings, as we've seen with Duke's recent rate increases in North Carolina and Kentucky. Duke, like any other power provider, must ask for rate increases from local authorities so they aren't assured. However, state regulators have been amicable to rate increase requests from Duke and should be moving forward. One offsetting factor in earnings-per-share growth is that Duke likes to issue common stock for general corporate purposes, leading to a higher share count over time. Its share count has risen from 424M in 2008 to more than 700M today. Share issuances are irregularly timed and sized so exact impact is difficult to predict, but this is a long-term habit for Duke and must be accounted for in estimates. Still, despite this, we see Duke as being able to hit roughly 4% earnings-per-share growth annually moving forward.

The dividend continues to rise at a low single digit pace, slightly under that of earnings-per-share growth. We expect this will continue, producing a $4-per-share payout by 2023 and keeping Duke firmly in the income stock category.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	17.3	13.3	12.7	13.8	17.5	17.4	17.9	18.2	21.3	19.9	***17.2***	***16.9***
Avg. Yld.	5.2%	6.2%	5.7%	5.2%	4.7%	4.4%	4.3%	4.3%	4.3%	4.2%	***4.4%***	***4.1%***

Disclosure: This analyst has no position in the security discussed in this article, and no plans to initiate one in the next 72 hours.

Duke's valuation has remained mostly steady throughout the past decade, with the exception of the period immediately succeeding the Great Recession. Duke's price-to-earnings ratio has averaged 16.9 from 2008 through 2017, which we see as fair value longer term. Today's price-to-earnings ratio of 17.2 is in line with this fair value estimate and as a result, we expect only a modest 0.4% annual headwind to total returns from a slightly lower valuation over time. The yield should remain above 4% as the dividend will likely grow nearly in line with earnings-per-share.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	62.0%	65.1%	38.7%	64.6%	58.4%	60.5%	61.0%	63.4%	69.7%	70.4%	***70.0%***	***70.0%***
Debt/A	60%	62%	62%	63%	64%	64%	66%	67%	69%	70%	***70%***	***70%***
Int. Cov.	4.3	3.4	3.9	3.9	2.8	3.5	3.5	3.6	2.9	3.1	***3.2***	***3.5***
Payout	89%	84%	73%	72%	82%	78%	76%	79%	91%	83%	***75%***	***69%***
Std. Dev.	18%	20%	10%	11%	12%	17%	11%	18%	15%	10%	***12%***	***14%***

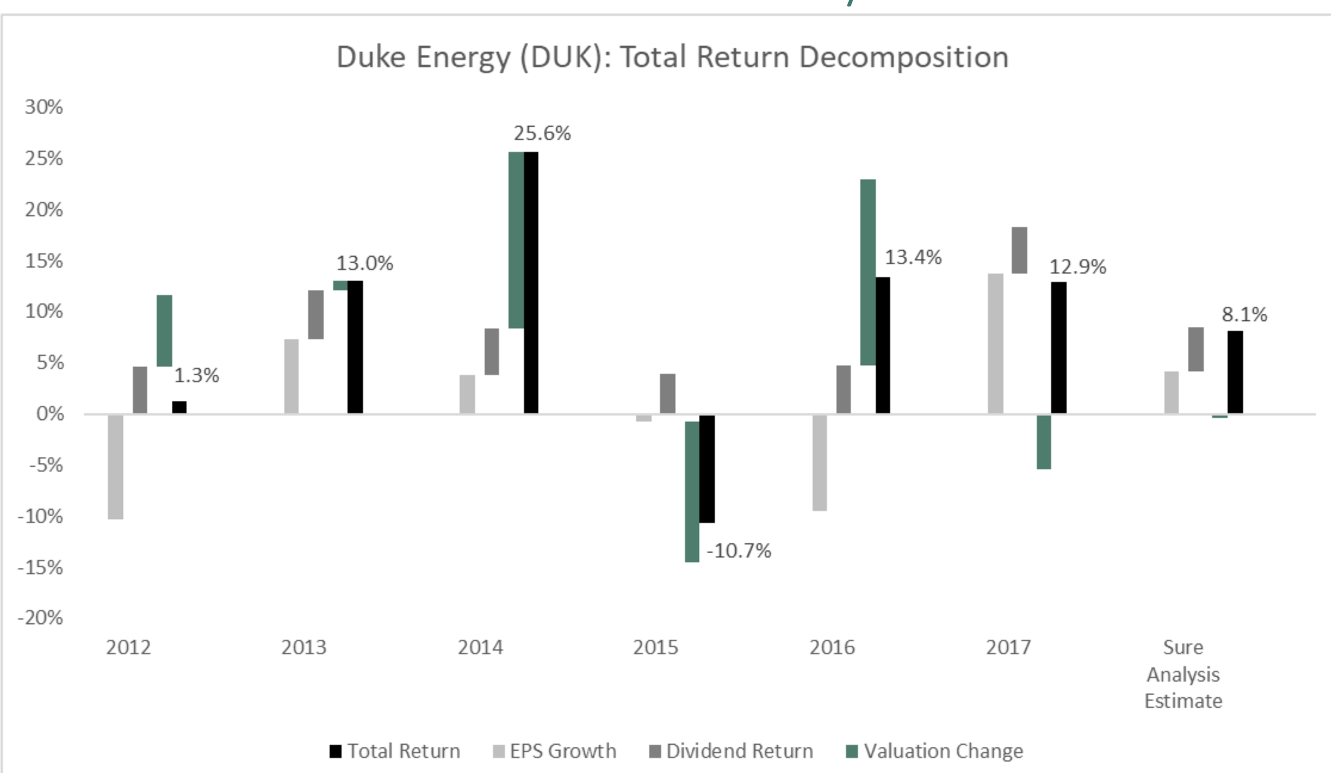
Duke's quality metrics have been largely stable throughout the past decade and we don't expect that will change. We expect margins to be flat looking forward – albeit at very high levels – and for its balance sheet leverage and interest coverage to remain steady.

Duke's competitive advantage is its near-monopoly in the areas it serves, which is not dissimilar to other regulated utilities. In addition, recession performance should be excellent as it grew earnings-per-share rather rapidly during the Great Recession. Indeed, this is a truly defensive stock with a high yield and decent growth prospects.

Final Thoughts & Recommendation

In total, we expect Duke to produce 8.1% total annual returns moving forward, consisting of the 4.4% current yield, 4.1% earnings-per-share growth and a 0.4% headwind from a slightly lower valuation. Duke isn't a high-growth stock and never will be, but for those seeking safety during recessions and a nice current yield, it is a hold at current prices.

Total Return Breakdown by Year



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