Duke Energy (DUK)

Updated August 10th, 2018 by Josh Arnold

Key Metrics

Current Price:	$81	**5 Year CAGR Estimate:**	8.5%	**Volatility Percentile:**	12.0%
Fair Value Price:	$80	**5 Year Growth Estimate:**	4.1%	**Momentum Percentile:**	23.5%
% Fair Value:	101%	**5 Year Valuation Multiple Estimate:**	-0.2%	**Valuation Percentile:**	60.5%
Dividend Yield:	4.6%	**5 Year Price Target**	$98	**Total Return Percentile:**	52.9%

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 $24 billion in annual revenue and trades with a market capitalization of $58 billion.

Duke reported Q2 earnings on 8/2/18 and results were mixed. Revenue rose but higher expenses – which increased 11% - led to a decline of 8% for earnings-per-share to 93 cents on an adjusted basis. Duke said higher storm repair costs as well as higher amortization and depreciation contributed to lower earnings in its core electric utilities business, while weather and a rate case increase helped offset some of that impact. However, the largest negative impact was from higher interest expense, which removed 7 cents per share of earnings in Q2. Duke continues to see higher retail volumes in addition to an ever-growing customer base, so it was able to reiterate earnings-per-share guidance for the year despite the earnings miss in Q2. We've left our estimate for 2018 unchanged at $4.75 per share.

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	***$3.72***	***$4.50***

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 are certainly not 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 424 million in 2008 to more than 710 million 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. In total, the Q2 report has not shifted our view of Duke one way or the other.

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 $4.50-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	***17.1***	***16.9***
Avg. Yld.	5.2%	6.2%	5.7%	5.2%	4.7%	4.4%	4.3%	4.3%	4.3%	4.2%	***4.6%***	***4.6%***

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 17.1 is in line with this fair value estimate and as a result, we expect only a modest 0.2% annual headwind to total returns from a slightly lower valuation over time. The yield should remain well above 4% as the dividend will likely grow roughly 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%	***78%***	***78%***
Std. Dev.	18%	20%	10%	11%	12%	17%	11%	18%	15%	10%	***12%***	***14%***

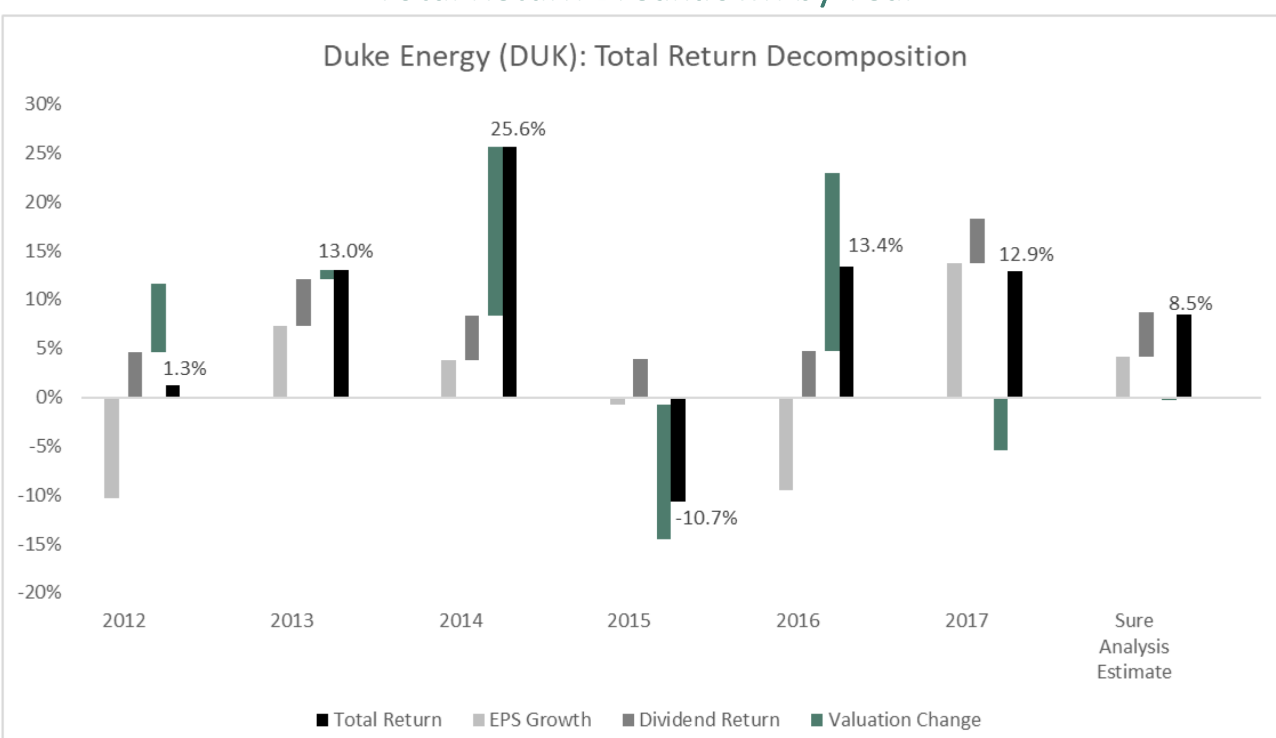
Duke's quality metrics have been largely stable throughout the past decade and we do not expect that will change. We expect margins to be flat looking forward – albeit at very high levels – and for its balance sheet leverage and interest coverage to remain steady. Duke's negative impact on Q2 earnings from interest expense is something for shareholders to watch moving forward as it does have a significant portion of its assets encumbered by debt. Management has a stated plan to reduce leverage moving forward as it plans to boost cash flow against the amount of debt it takes on, so we are not concerned. However, it is something to keep in mind given Duke's current interest coverage.

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 8.5% total annual returns moving forward, consisting of the 4.6% current yield, 4.1% earnings-per-share growth and a 0.2% headwind from a slightly lower valuation. Duke is not 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



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