Duke Energy (DUK)

Updated November 7th, 2018 by Josh Arnold

Key Metrics

Current Price:	$84	**5 Year CAGR Estimate:**	7.5%	**Volatility Percentile:**	7.7%
Fair Value Price:	$80	**5 Year Growth Estimate:**	4.1%	**Momentum Percentile:**	43.6%
% Fair Value:	105%	**5 Year Valuation Multiple Estimate:**	-1.0%	**Growth Percentile:**	27.0%
Dividend Yield:	4.4%	**5 Year Price Target**	$98	**Valuation Percentile:**	43.4%
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Total Return Percentile:**	38.5%

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 $60 billion.

Duke reported Q3 earnings on 11/2/18 and results were strong enough to warrant a guidance boost from management. Operating revenue was up 2%, led by strong industrial demand, which rose in the mid-single digits. Duke's recent struggles with residential demand seems to be abating as that number was up 1.8% on an adjusted basis, thanks to a 1.5% increase in residential customers. The company also reaffirmed its long-term guidance of 4% to 6% compound annual growth through 2022 after robust Q3 results. In total, the company's adjusted earnings-per-share increased to $1.65 from $1.59 in the year-ago quarter. The bottom end of guidance was raised to a new range of $4.65 to $4.85; our estimate of $4.75 for this year remains unchanged. Overall, Duke's outlook is improving after a nice Q3 report.

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	***$3.71***	***$4.50***
Shares	424	436	443	445	704	706	707	688	700	700	***725***	***745***

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, similar to what the company produced in Q3. 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 continue to 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 720 million today. Share issuances are irregularly timed and sized so the exact impact is difficult to predict, but this is a long-term habit for Duke and must be accounted for in estimates. The Q3 report has not significantly moved our view of Duke, although it was another quarter of positive results and a slight guidance boost.

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. The current 4.4% yield is right in line with the company's historical norms, and we do not see the yield deviating much from where it sits today. We see dividend growth slightly outpacing growth in the share price, producing a 4.6% yield by 2023, but the bottom line is that Duke should continue to be a strong choice for income investors.

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.

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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	***17.8***	***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%***	***4.6%***

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 17.8 is slightly in excess of fair value, and we therefore see a modest 1% headwind to annual total returns from a moderating valuation over time.

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%***

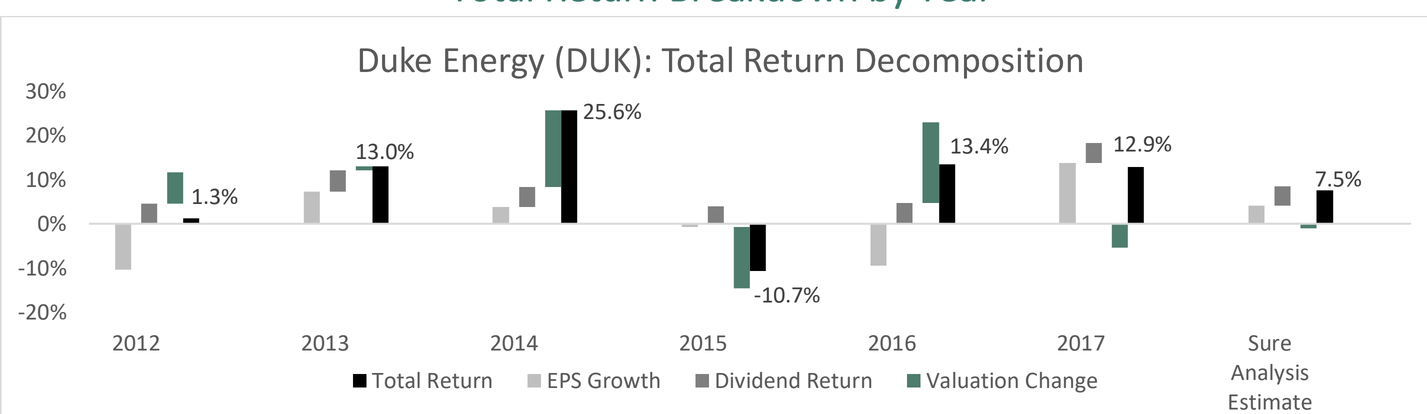
Duke's quality metrics have been largely stable throughout the past decade and we do not expect that will change. We expect margins to be flat looking forward – albeit at very high levels – and for its balance sheet leverage and interest coverage to remain steady. Management has a stated plan to reduce leverage moving forward as it plans to boost cash flow against the amount of debt it takes on, so we are not concerned. The payout ratio is relatively high, but the dividend is well-covered, and should be for the foreseeable future. Indeed, we expect the dividend and earnings growth to roughly keep pace with each other over the next several years.

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 7.5% total annual returns moving forward, consisting of the 4.4% current yield, 4.1% earnings-per-share growth and a 1% 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



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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	13207	12731	14272	14529	17912	22756	22509	22371	22743	23565
Gross Profit	8187	8287	5522	5614	6677	9211	9086	9336	9768	10795
Gross Margin	62.0%	65.1%	38.7%	38.6%	37.3%	40.5%	40.4%	41.7%	42.9%	45.8%
D&A Exp.	1834	1846	1994	2026	2652	3229	3507	3613	3880	4046
Operating Profit	2527	2669	3034	3104	3567	5269	4913	5154	5332	6035
Op. Margin	19.1%	21.0%	21.3%	21.4%	19.9%	23.2%	21.8%	23.0%	23.4%	25.6%
Net Profit	1362	1075	1320	1706	1768	2665	1883	2816	2152	3059
Net Margin	10.3%	8.4%	9.2%	11.7%	9.9%	11.7%	8.4%	12.6%	9.5%	13.0%
Free Cash Flow	-1120	-926	-292	-691	-257	856	1202	-66	-1084	-1418
Income Tax	616	758	890	752	623	1205	1225	1256	1156	1196

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets ($B)	53.08	57.04	59.09	62.53	113.86	114.78	120.56	121.16	132.76	137.91
Cash & Equivalents	986	1542	1670	2110	1424	1501	2036	383	392	358
Acc. Receivable	N/A	N/A	764	784	1516	1286	791	515	751	779
Inventories	1135	1515	1318	1588	3223	3250	3459	3746	3522	3250
Goodwill & Int.	5400	4943	4325	4212	16365	16340	16321	16072	19425	19396
Total Liabilities	31926	35154	36437	39661	72822	73371	79658	81385	91720	96177
Accounts Payable	1477	1390	1387	1433	2444	2391	2271	2350	2994	3043
Long-Term Debt	14439	17015	18426	21000	40518	41095	42382	42501	50382	53898
Total Equity	20988	21750	22522	22772	40863	41330	40875	39727	41033	41739
D/E Ratio	0.69	0.78	0.82	0.92	0.99	0.99	1.04	1.07	1.23	1.29

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	2.7%	2.0%	2.3%	2.8%	2.0%	2.3%	1.6%	2.3%	1.7%	2.3%
Return on Equity	6.5%	5.0%	6.0%	7.5%	5.6%	6.5%	4.6%	7.0%	5.3%	7.4%
ROIC	4.0%	2.9%	3.3%	4.0%	2.8%	3.2%	2.3%	3.4%	2.5%	3.3%
Shares Out.	424	436	443	445	704	706	707	688	700	700
Revenue/Share	31.27	29.52	32.44	32.72	31.15	32.23	31.84	32.23	32.91	33.66
FCF/Share	-2.65	-2.15	-0.66	-1.56	-0.45	1.21	1.70	-0.10	-1.57	-2.03

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.