Duke Energy Corporation (DUK)

Updated February 20th, 2019 by Samuel Smith

Key Metrics

Current Price:	$88	**5 Year CAGR Estimate:**	7.5%	**Volatility Percentile:**	5.7%
Fair Value Price:	$85	**5 Year Growth Estimate:**	4.0%	**Momentum Percentile:**	82.3%
% Fair Value:	104%	**5 Year Valuation Multiple Estimate:**	-0.7%	**Growth Percentile:**	22.0%
Dividend Yield:	4.2%	**5 Year Price Target**	$98	**Valuation Percentile:**	43.8%
Dividend Risk Score:	D	**Retirement Suitability Score:**	B	**Total Return Percentile:**	36.8%

Overview & Current Events

Duke Energy (DUK) 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.

In mid-February, DUK reported (2/14/19) solid FY 2018 earnings as operating EPS was up 3.3% year-over-year to $4.72, led by strong industrial demand. Management expects this solid growth momentum to continue, with midpoint of 2019 guidance standing at $5 operating EPS, in-line with their 4%-6% target growth rate through 2023 (extended by 1 year from previous guidance). They also guide for a payout ratio between 65% and 75%. Given that their current payout ratio sits on the high end of that spectrum, we expect the dividend to grow at a slower rate than their EPS over the next half decade (~3.5% per year). Overall, it was a pretty quiet quarter that did not substantially change our long term outlook.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$3.39	$4.02	$4.14	$3.71	$3.98	$4.13	$4.10	$3.71	$4.22	$4.72	***$5.00***	***$6.08***
DPS	$2.82	$2.91	$2.97	$3.03	$3.09	$3.15	$3.24	$3.36	$3.49	$3.60	***$3.71***	***$4.41***
Shares	436	443	445	704	706	707	688	700	700	705	***710***	***735***

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 continue generating 4% annual EPS growth over the next half decade. While management has guided for 4%-6% growth through 2023 - implying that the growth runway is attractive relative to historical norms – we view achieving the high end of this guidance as uncertain if not unlikely. That is because the key determiners of DUK's value proposition to investors will be how well they can execute on their ambitious $37 billion growth CapEx plan and if they can continue to garner favorable regulatory rulings in their operating regions. While they continue to achieve reasonable regulatory rulings, there are no guarantees this will continue, especially if government energy policies shift with the 2020 election. Even more concerning are the problems and cost overruns being experienced with the Atlantic Coast Pipeline project thus far, indicating that returns on DUK's projected CapEx may not be as high as forecast. We therefore take a cautious and conservative outlook on growth, projecting DUK achieving the low end of its guidance.

That being said, 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 should 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.

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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.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2023
Avg. P/E	13.3	12.7	13.8	17.5	17.4	17.9	18.2	21.3	19.9	18.6	***17.6***	***17.0***
Avg. Yld.	6.2%	5.7%	5.2%	4.7%	4.4%	4.3%	4.3%	4.3%	4.2%	4.2%	***4.2%***	***4.6%***

Duke's valuation has remained mostly steady throughout the past decade, with the exception of the period immediately following the Great Recession. Duke's price-to-earnings ratio has averaged 17 over the past decade, which we see as pretty close to fair value longer term. Today's price-to-earnings ratio of 17.6 is slightly in excess of fair value, and we therefore see a modest 0.7% headwind to annual total returns from a moderating valuation over time.

Safety, Quality, Competitive Advantage, & Recession Resiliency

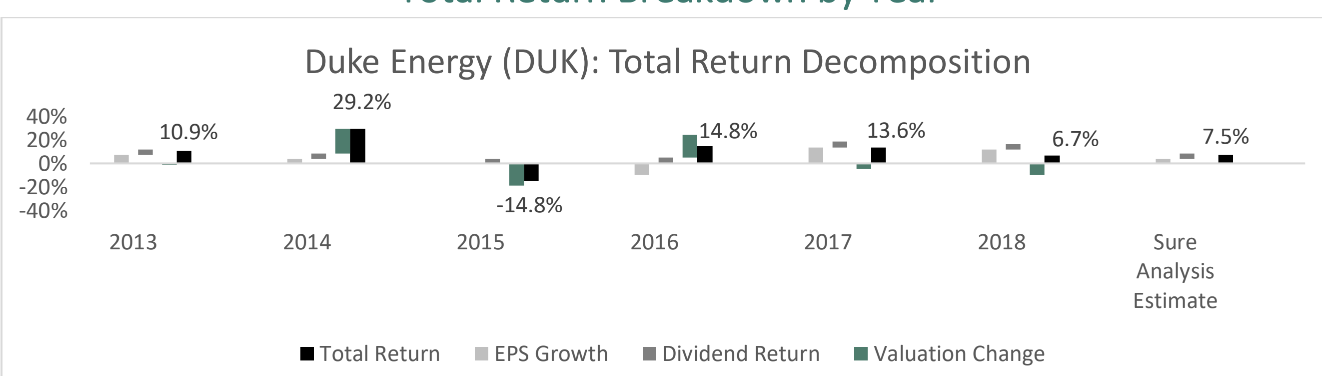
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	84%	73%	72%	82%	78%	76%	79%	91%	83%	76%	***74%***	***73%***

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. We expect earnings growth to slightly outpace dividend growth over the next several years, though, in order to bring the payout ratio back within management's target upper bound of 75%. 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

We expect Duke to produce 7.5% total annual returns, consisting of the 4.2% current yield, 4% earnings-per-share growth and a 0.7% headwind from a slightly lower valuation. It is a defensive dividend stock and earns a hold recommendation from Sure Dividend at current prices.

Total Return Breakdown by Year



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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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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	12731	14272	14529	17912	22756	22509	22371	22743	23565	24521
Gross Profit	8287	5522	5614	6677	9211	9086	9336	9768	10795	10530
Gross Margin	65.1%	38.7%	38.6%	37.3%	40.5%	40.4%	41.7%	42.9%	45.8%	42.9%
D&A Exp.	1846	1994	2026	2652	3229	3507	3613	3880	4046	N/A
Operating Profit	2669	3034	3104	3567	5269	4913	5154	5332	6035	5176
Op. Margin	21.0%	21.3%	21.4%	19.9%	23.2%	21.8%	23.0%	23.4%	25.6%	21.1%
Net Profit	1075	1320	1706	1768	2665	1883	2816	2152	3059	2666
Net Margin	8.4%	9.2%	11.7%	9.9%	11.7%	8.4%	12.6%	9.5%	13.0%	10.9%
Free Cash Flow	-926	-292	-691	-257	856	1202	-66	-1084	-1418	7186
Income Tax	758	890	752	623	1205	1225	1256	1156	1196	448

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets ($B)	57.04	59.09	62.53	113.86	114.78	120.56	121.16	132.76	137.91	145.39
Cash & Equivalents	1542	1670	2110	1424	1501	2036	383	392	358	442
Acc. Receivable	N/A	764	784	1516	1286	791	515	751	779	962
Inventories	1515	1318	1588	3223	3250	3459	3746	3522	3250	3084
Goodwill & Int.	4943	4325	4212	16365	16340	16321	16072	19425	19396	19303
Total Liab. ($B)	35.15	36.44	39.66	72.82	73.37	79.66	81.39	91.72	96.18	101.56
Accounts Payable	1390	1387	1433	2444	2391	2271	2350	2994	3043	3487
Long-Term Debt	17015	18426	21000	40518	41095	42382	42501	50382	53442	57939
Total Equity	21750	22522	22772	40863	41330	40875	39727	41033	41739	43817
D/E Ratio	0.78	0.82	0.92	0.99	0.99	1.04	1.07	1.23	1.28	1.32

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	2.0%	2.3%	2.8%	2.0%	2.3%	1.6%	2.3%	1.7%	2.3%	1.9%
Return on Equity	5.0%	6.0%	7.5%	5.6%	6.5%	4.6%	7.0%	5.3%	7.4%	6.2%
ROIC	2.9%	3.3%	4.0%	2.8%	3.2%	2.3%	3.4%	2.5%	3.3%	2.7%
Shares Out.	436	443	445	704	706	707	688	700	700	705
Revenue/Share	29.52	32.44	32.72	31.15	32.23	31.84	32.23	32.91	33.66	34.63
FCF/Share	-2.15	-0.66	-1.56	-0.45	1.21	1.70	-0.10	-1.57	-2.03	10.15

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