Duke Energy
A Samba Reset

Implied 2016 guidance is merely flattish with reduced 2015
Guidance for 2015 was reduced from $4.55-$4.75 to $4.55-$4.65, now in line with UBSe $4.59 but below prior consensus by a nickel. At the midpoint, this is comprised of $0.30 from International (down from $0.60 in 2014), $4.13 from core utilities and the commercial segment (renewables remaining after the sale of the merchant coal fleet earlier this year), and $0.17 of favorable weather. For 2016, management now expects only the remaining core regulated and commercial businesses to grow 4%-6% into 2016 from 2015E guidance of $4.13, implying a midpoint of $4.34 for these segments. For International, little to no improvement is expected from 2015E guidance of ~$0.30 for International. While DUK won't provide formal explicit 2016 guidance until the 4Q report in Feb, this implies total 2016 guidance of approximately ~$4.65. Our 2016E est is reduced to $4.65 from $4.90 primarily for lower International results.

Long-term EPS CAGR guidance is reset off 2016; DUK needs to prove itself
Management rebased its long-term 4%-6% EPS CAGR guidance off 2016 vs the previous 2013 $4.33 base. In combination with flat International results for 2016, this has the effect of reducing 2016-2019 implied guidance by as much as -$0.35 to -$0.40. We've reduced our estimates by another -$0.20 to assume little to no recovery from the International segment, resulting in a 4.7% CAGR from 2016E. Notably, this implies only a 3.0% CAGR on the prior 2013A-2017E metric, a substantial miss from prior guidance. While the new 2016 base would appear to set an achievable goal with potential upside from Brazil, we think the lower reset nevertheless places the burden of proof on management to execute well going forward.

Piedmont acquisition is incremental to guidance and our estimates
The acquisition of Piedmont Natural Gas is not expected to close until the end of 2016 and is not a factor in either 2016 guidance or the long-term CAGR. We calculate that the deal is accretive by about ~$0.10 and adds ~50 bps to the long-term EPS CAGR.

Valuation: Reducing PT $3 to $71 for lower estimates
Our valuation is based on our 2017 P/E estimate. The recent PNY acquisition announcement helps fill the earnings gap from international, but high transaction multiple leaves limited accretion and in our view raises questions about lack of investment opportunities for Duke's cash flows.

Equities

Americas
Electric Utilities

12-month rating	**Neutral**
12m price target	**US$71.00**
	Prior: US$74.00
Price	**US$67.76**

RIC: DUK.N **BBG:** DUK US

Trading data and key metrics

52-wk range	US$89.36-67.74
Market cap.	US$46.9bn
Shares o/s	692m (COM)
Free float	97%
Avg. daily volume ('000)	1,227
Avg. daily value (m)	US$88.2
Common s/h equity (12/15E)	US$40.3bn
P/BV (12/15E)	1.2x
Net debt / EBITDA (12/15E)	4.3x

EPS (UBS, diluted) (US$)

	12/15E			
	From	To	% ch	Cons.
Q1	1.24	1.24	0	1.24
Q2	0.95	0.95	0	0.95
Q3E	1.50	1.36	-9	1.47
Q4E	0.88	1.01	14	0.92
12/15E	4.59	4.59	0	4.61
12/16E	4.90	4.65	-5	4.81
12/17E	5.06	4.86	-4	5.04

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Highlights (US$m)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Revenues	19,624	24,598	23,925	25,150	25,674	26,346	27,025	27,651
EBIT (UBS)	5,026	5,885	6,511	6,432	6,693	7,042	7,387	7,638
Net earnings (UBS)	2,480	3,067	3,214	3,181	3,213	3,357	3,519	3,688
EPS (UBS, diluted) (US$)	4.32	4.35	4.55	4.59	4.65	4.86	5.09	5.34
DPS (US$)	3.03	3.09	3.16	3.28	3.39	3.54	3.69	3.94
Net (debt) / cash	(38,875)	(39,594)	(40,498)	(41,140)	(45,508)	(47,969)	(50,527)	(48,441)

Profitability/valuation	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
EBIT margin %	25.6	23.9	27.2	25.6	26.1	26.7	27.3	27.6
ROIC (EBIT) %	10.8	9.5	10.7	11.0	10.9	10.7	10.7	10.9
EV/EBITDA (core) x	9.0	10.1	9.6	9.2	9.1	6.8	6.5	6.3
P/E (UBS, diluted) x	14.9	16.0	16.2	14.8	14.6	13.9	13.3	12.7
Equity FCF (UBS) yield %	(3.2)	0.4	0.0	0.7	(4.3)	(.0)	(.0)	10.2
Net dividend yield %	4.7	4.5	4.3	4.8	5.0	5.2	5.4	5.8

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of US$67.76 on 06 Nov 2015 19:38 EST

Investment Thesis

Duke Energy

12-month rating **Neutral**

12m price target **US$71.00**

Investment case

Duke Energy has strong ratebase growth through 2018 that is buttressed by a plan to hold O&M flat through 2016 and supported by cash proceeds from the sale of the Midwest merchant generation portfolio in 1H15. Management has planned ~$42B of capital investment from 2015-2019. The sale of merchant gen happened ahead of schedule for $2.8B. The International segment is undergoing stress from the drought in Brazil, low oil pricing effects on its National Methanol business, and F/X.

Upside scenario

Our upside case rests on execution of management's capital spending plan plus additional projects not in the plan. A faster and more robust recovery in Brazil and the ability to cut costs beyond holding O&M flat through 2016 would also be upside. Furthermore, the opportunity to invest In coal ash remediation greater than our $2.0B-$2.5B estimate could all together drive upside to above $78 per share.

Downside scenario

However, any major problem with the international segment, including unhedged FX rates, a prolonged drought condition in Brazil, or a substantial and continued and sustained declines in the price of Brent crude could drive a lower valuation. Substantial lower revisions to the regulated capital spending plan and/or the inability of management to earn its authorized ROEs at the utilities or execute on its planned 4%-6% long-term earnings growth plan off a 2016 base would also drive downside to below $66 per share.

Upcoming catalysts

Nov 19	IURC Edwardsport Settlement testimony
Jan 21	IURC Joint intervenors testimony
Feb 18, 2016	IURC rebuttals
April 18, 2016	IURC Edwardsport settlement hearings
1H16	IURC Edwardsport settlement expected order
4Q15	Financing order for CR3 asset securitization

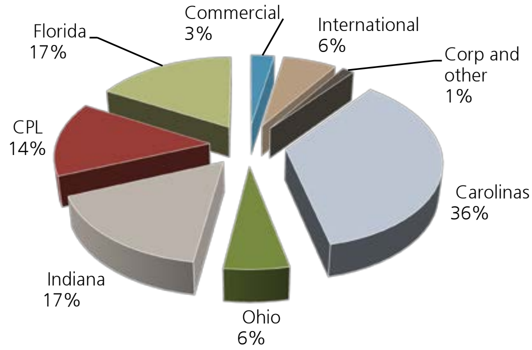
Business description

Duke Energy (Duke), based in Charlotte, North Carolina, is the largest US electric power holding company with over $100bn in assets, which generates, transmits, and distributes electricity to over seven million customers in the Carolinas, Kentucky, Indiana, Ohio, and Florida. Duke owns and operates approximately 8,700 MW of unregulated generation, primarily in the Midwest, and has more than 4,000 MW of electric generation in Latin America. In February 2014, Duke announced its intention to divest its Midwest commercial generation business (6,600MW).

Industry outlook

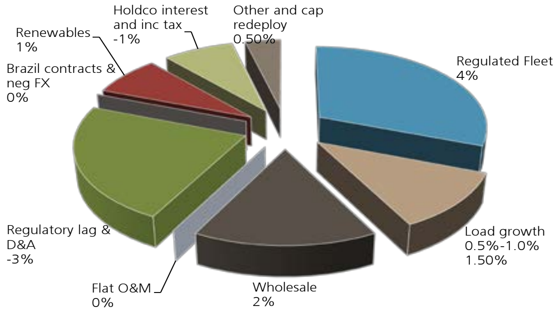
The electric utility industry is projected to experience weak or negative electric demand growth in coming years as a tepid economy and energy efficiency dampen demand. In the unregulated merchant power space, we see limited potential for a meaningful recovery from currently low power prices due to limited projected demand growth, growth of subsidized renewables, and potential for only modest further retirements. At regulated utilities, we believe rising interest rates and robust valuations are a challenge to the sector, particularly as earnings growth stalls once EPA-mandated growth capex slow mid-decade. We expect cost-cutting and strategic planning to be a key theme across both regulated and competitive companies, with M&A at modest (at best) premiums designed to extract cost synergies. We believe utilities with high parent leverage will disproportionately suffer, as they are unable to recoup from rising interest rates.

EBITDA by Segment, 2017E (%)



Source: Company filings, UBS estimates

Sources of 4-6% EPS growth through 2017E



Source: Company filings, UBS estimates

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Rebasing requires management to prove itself

The rebasing of long-term 4%-6% guidance out to 2016 from the previous 2013 base effectively reduces guidance by -$0.35 to -$0.40 as the company essentially wipes the slate clean from a few years of poor International results. While this does indeed appear to set the stage for apparently achievable goals going forward, we think the rather large miss vs prior guidance places the burden of proof firmly on the company to execute well over the next few years.

Many investors ask if now is the time? Just as mgmt has needed to rebase, the key question at EEI and into 4Q will be proving out confidence in 4-6% EPS growth at the core utilities segment. With shares trading at -1x turn to the group on both '17E and '18E P/E, closing the gap will likely involve bolstering confidence. The pending acquisition of PNY, and discussion of any future rate activity will play into regulated risk views.

Other news this year has been more positive, including the earlier-than-expected sale of Midwest Genco (and better-than-expected 1Q results there) along with the much earlier-than-expected closing of the NCEMPA asset purchase, each of which should help DUK keep with its 2015 guidance range of $4.55-$4.65 and implied early indication of ~$4.65 for 2016. As we highlight in our earnings table below, we remain below consensus from 2016E-2019E and assume a 4.7% EPS CAGR, which includes continued poor results from the International segment through the forecast period.

We expect the recent acquisition announcement for Piedmont Natural Gas to be about $0.10 accretive in 2017+, adding about 50 bps to the EPS CAGR, albeit at a notably high premium paid that limits the accretion beyond the $0.10. Mgmt did not specify within its confidence range whether the core EPS growth excludes this acquisition (presumably PNY accretion is reflected within range of EPS uplift).

We see the securitization of Crystal River 3 as improving overall FCF in early 2016, but see a wider disappointment around EPS growth into 2017.

<u>More broadly, we continue to see SMIDs poised to do better than large caps in 2H15</u>: As a last point on large-cap stories, we emphasize that while a major constituent to the UTY, we see the relative outperformance of small-mid-caps (SMIDs) as more concerning – and likely the greater source of relative downside for DUK (rather than equity competition from other large-cap regulated utilities). With the added clarity on EPS guidance, we see a best case in the medium term allowing the discount to disappear, but no premium is really possible; our $71 target reflects this outcome.

<u>For additional context, please refer links to relevant recent reports below:</u>

8/26/15 The Duke of North Carolina
8/10/15 Targeting a Samba Surprise
5/5/15 Even More Cash Coming
2/26/15 Cashing in and Beefing Up
1/5/15 More Than Just an Oil Slick
11/6/14 Put Up Your Dukes

What's new with DUK?

Duke Energy extending review process for Foothills transmission project (Western Carolinas Modernization Project): On October 8th Duke announced that it was delaying its announced $1.1B Western Carolinas Modernization Project which was announced in May due to more than expected pushback from local property owners. After receiving extensive feedback from stakeholders, the company will retire and replace the 376 MW Asheville coal plant in NC with the construction of two 280 MW CCGTs in 2020 with the option for a 190 MW simple cycle unit by 2023. Total investment remains just over $1B. By comparison, the original plan had included a larger 650 MW natural gas-fired power plant (~$750mn); a transmission substation near Campobello, SC, and a 40-mile, 230 kV line (~$320mn). "Most" of this capex is incremental to DUK's February 5-year capital plan that called for $41.75B of total capex from 2015E-2019E, including $2.95B of "discretionary" spend (a minority portion is considered part of the discretionary bucket). We believe this could add as much as $0.05-$0.08 EPS incremental to prior expectations by 2019 if approved. It remains to be seen how the potential revisions to the project will impact the ultimate cost.

Duke forecasts 0.5%-1.0% annual demand growth in the region and sees adding new capacity as a necessity.

- **Waiting for lessons learned from NIPSCO in Indiana:** DUK plans to file a new grid modernization plan in Indiana by the end of the year after the first one was rejected by the Indiana Utility Regulatory Commission (IURC) on May 8. The original $1.9B plan was filed under Indiana's SB 560, which allows the IURC to approve riders for a "transmission, distribution, and storage system improvement charge (TDSIC)". Of the plan, we believe that about ~$300M was found questionable for eligibility under the law, with the company expected to continue to pursue approvals for these projects under normal ratemaking procedures rather than the rider process. The remaining ~$1.6B would then begin construction later than planned in 2016 if ultimately approved under a rider. Duke expects to re-file its plan later this year with a primary focus on added details to support its spending. Management commented that it is closely following the Northern Indiana Public Service Company's (NIPSCO; NiSource subsidiary) $1.1Bn 'seven-year plan' which was rejected even after achieving a settlement. We would expect Duke to utilize the clarity gained from the NIPSCO case to help form its updated filing shortly thereafter.

Duke still expects to update its Indiana infrastructure plan later this year but now can use NIPSCO's latest filing as a model to improve the probability of success. Mgmt believes the issue relates to adding more supporting detail.

- **Major gas pipelines moving along.** A formal FERC application for the Atlantic Coast Pipeline was filed in Sept, with approval expected in 2016 and commercial operation in late 2018. At Sabal Trail, FERC approval is expected in early 2016 with commercial operation in 2017.

- **Edwardsport settlement significantly de-risks the project:** On September 18th, DUK filed a settlement of all operating and capital costs through 2017 for the Edwardsport Integrated Gasification Combined Cycle (IGCC) coal-fired power plant. Settling parties include the Indiana Office of Utility Consumer Counselor, the Duke Energy Indiana Industrial Group and Nucor Steel-Indiana. The agreement is subject to approval from Indiana regulators (expected 1H16) and if approved would increase customer bills by ~2%. The company expects to take a $90M pretax charge in 3Q15, including $85M of deferred operating costs since the company declared the plant "in-service" in June 2013 and an additional $5M cash provision for legal fees, bill credits, battery storage research, low-income energy assistance, and the Indiana Utility Ratepayer Trust. The Edwardsport charges will be *excluded from operating EPS*. The plant's total

Effectively resolves all outstanding IGCC dockets and more.

expected capital cost remains unchanged at ~$3.5B, for which the company has already written down $900M, with max recovery capped to $2.595B capital plus $85M of O&M and depreciation, which were recognized under this settlement. The current level of capital spending has yet to exceed the company's ~$3.5B budget; however, there is a narrow margin.

The settlement effectively resolves all pending IGCC dockets, including the combined IGCC 12 & 13 (including subdocket FAC-99 and other pending fuel proceedings). It also resolves IGCC 14 & 15 for costs through Sept 2014 and March 2015, respectively. Future filings are expected to be made annually rather than the current twice a year. Going forward, recoverable base operating and maintenance expense calendar year 2016 and 2017 are capped at $73.3Mn and $76.8Mn, respectively, while recoverable capital expenses for 2016 and 2017 are also capped at $36.1M and $16.9M, respectively (including ongoing capital additions in 2015 after April 1).

The agreement would appear to end the long-running controversy over DUK's in-service declaration and subsequent use of power (to power the gasifier) when output was zero ("net negative generation"), the costs of which were made eligible for fuel-clause recovery rather than capitalized as they would have been before the plant was "in-service". Challengers had noted that purchased power for the plant appeared much larger than the usual "negative generation" seen in other much smaller plants. The larger scale of costs was then cited as evidence that the plant should never have been declared in-service in June 2013, and thus some portion of the O&M and purchased power that has been in rates since IGCC 10 (Sept 2013) should have been capitalized (and possibly subject to write-downs) rather than deferred for cash recovery as O&M.

- **Previous Edwardsport appeal still pending:** In September 2014, the Indiana Court of Appeals ruled that the Indiana Utility Regulatory Commission (IURC) must reconsider its IGCC 9 rate-increase decision of April 2013 which had authorized Duke Energy to recover $61 million of financing costs it had incurred due to construction delays on the 618-MW Edwardsport IGCC plant. On Feb 25, 2015, the IURC issued a new order upholding its prior decision, although intervenors have appealed this new order to the Indiana Court of Appeals. That appeal is still pending.

- **Also achieving resolution on federal and North Carolina disputes:** DUK closed a 15-year old legal saga that began with a lawsuit against DUK for making alleged "major modifications" on 25 coal-fired plants without installing the required "best available emissions controls". Under the settlement agreement, DUK agrees to close 2 of 5 units at its 1,140-MW Allen plant in NC and will also shut a third unit not part of the case, all by Dec 31, 2024 (42 months earlier than planned). The remaining 555 MW will continue to operate and there will be no layoffs associated with the agreement. Additionally, DUK agrees to spend $4.4M on environmental projects and donations and a $975K federal civil penalty.

  Later in September Duke settled with the North Carolina Department of Environmental Quality (NCDEQ) over claims of groundwater contamination at its Sutton and 13 other North Carolina coal assets. The original fine from March was $25.1Mn which Duke appealed and the parties ultimately settled on $7Mn along with Duke remediating the Asheville (more details on the Asheville site below), Belews Creek, and Lee assets.

- **Last but not least, settling Crystal River 3:** Duke reached a proposed settlement in September regarding the Crystal River 3 regulatory asset proceeding which includes a reduction of the proposed securitization value to $1.283Bn from $1.3Bn, driving an estimated $15Mn pre-tax charge *to operating EPS in 3Q15*. DUK had filed for PSC approval of a $170.3M electric base rate increase for 20 years beginning Jan 2016 based on the amortization of a $1.3B regulatory asset. As part of the settlement the intervenors have agreed to not dispute the asset prudency. The securitization was facilitated by the passage of SB 288/HB 7109 in June and the next step is for the Florida Public Service Commission to approve the financing plan. If all goes according to plan, the securitization bonds could be issued with a recovery charge in place as early as February 2016. Proceeds from the securitization could be used to pay down maturing debt at the Florida subsidiary.

  Details of the full Crystal River agreement are available here.
  (Docket # 150148-EI)

- **Continuing to add wind capacity:** Duke signed its latest wind deal in early September with a 50% purchase of the 211MW Mesquite Creek via its Sumitomo joint venture. The total commercial wind and solar portfolio is expected to total 2,700 MW by the end of this year.

- **Regulated solar progress.** DUK remains on track to complete construction of 128 MW of utility-scale solar in North Carolina by the end of this year and is moving forward with investments in both South Carolina and Florida.

In the unlikely scenario that the PSC does not approve the securitization, non-securitized recovery method would still be available.

Reduced 2015 guidance despite favorable weather

Guidance was reduced from $4.55-$4.75 to $4.55-$4.65, now in line with UBSe $4.60 but below prior consensus by a nickel (although this has since come down). Management cites weakness from International partially offset by favorable weather in the US and extra accretion from the earlier-than-expected $1.5B, 19.8M share repurchase program completed in 2Q. Management is also expecting a -$0.04 impact from a higher effective tax rate as the result of a possible extension of bonus depreciation.

At the midpoint, this is comprised of $0.30 from International (down from $0.60 in 2014), $4.13 from core utilities and the commercial segment (renewables remaining after the sale of the merchant coal fleet earlier this year), and $0.17 of favorable weather.

Implied 2016E results flattish with 2015E

The company intends to present formal 2016 guidance in Feb 2016 with 4Q earnings results, although some factor guidance was given during the 3Q call. Looking ahead on a year-over-year basis, there's the negative comparison to +$0.17 of weather vs normal YTD 2015, a full year of NCEMPA assets for which we estimate an incremental +$0.04 (based on +$0.04 in 2H15), modest retail load growth of 0.5%-1.0%, lower O&M, growth in renewables, lost Genco earnings offset with stock repurchases, and improved hydro in Brazil along with inflation-indexed contracts there and stable oil pricing.

More specifically, for 2016, management now expects only the remaining core regulated and commercial businesses to grow 4%-6% into 2016 from 2015E guidance of $4.13, implying a midpoint of $4.34 for these segments. For

International, little to no improvement is expected from 2015E guidance of $0.30 for International. This implies total 2016 guidance of approximately ~$4.65.

As a reminder, the Piedmont transaction is not expected to close until the end of 2016.

Pullback from 4%-6% long-term growth objectives as rebasing to 2016

Although no explicit guidance has yet been given for 2016, new long-term guidance is for 4%-6% total EPS growth off a new 2016 base. The point of the rebasing from the prior 2013 $4.33 base is to skip over the past few years of deteriorating International results due to poor Brazilian hydrology, plunging Brent crude prices that partially correlate to MBTE for National Methanol, and increasingly unfavorable currency exchange rates, particularly the Brazilian Real. This follows the 2Q disclosure which had subtly shifted to "targeting" 4%-6% growth in light of International "macroeconomic challenges". As illustrated in the earnings table below, the rebasing on flattish 2016 results has the effect of reducing long-term guidance from 2016E-2019E by as much as -$0.35 to -$0.40.

While the Piedmont acquisition is not embedded in either long-term guidance CAGRs or our estimates, we estimate that the deal is accretive by $0.10-$0.13/sh in 2017/2018 (2.0-3.0%) with 5%-7% O&M synergies and $0.08-$0.11/sh excluding synergies. We calculate that this improves the long term CAGR by about 50 bps.

Reducing our estimates for lower International

Bottom line is that while the rebasing on 2016 certainly gives the new long-term CAGR guidance a fresh start, management will have to prove itself in the coming years given the degree to which the prior targets are expected to be missed.

Our prior estimates were already substantially below consensus at the low 4% end of the guidance range. We've reduced our estimates another -$0.20 for a slower recovery of International, which we now assume stays at flat at the ~$0.30 level for 2016 and then grows 4.5%-5.0% annually thereafter. This results in an overall 4.7% EPS CAGR from 2016E-2019E. We've also noted that our 2013A-2017E estimates grow at only 3.0%, illustrating the degree to which we think DUK will miss its earlier 4%-6% target off a 2013 base.

We think the bottom line is that while the rebasing on 2016 certainly gives the new long-term CAGR guidance a fresh start, management will have to prove itself in the coming years given the degree to which the prior targets are expected to be missed.

Figure 1: DUK Estimates, 2013A-2019E

	2013A	2014A	2015E	2016E	2017E	2018E	2019E
UBSe Total DUK	$4.35	$4.55	$4.59	$4.65	$4.86	$5.09	$5.34
UBSe International		*0.60*	*0.30*	*0.31*	*0.32*	*0.33*	*0.36*
Prior UBSe	$4.35	$4.55	$4.59	$4.90	$5.06	$5.26	$5.66
Consensus			$4.60	$4.77	$5.01	$5.33	$5.75
Guidance			$4.55-$4.65				
UBSe 2013-2017 CAGR					3.0%		
UBSe 2016-2019 CAGR							4.7%
Prior LT Guidance: Grow EPS 4%-6% through 2017 off 2013 guidance $4.33							
4% growth	*$4.33*	*$4.50*	*$4.68*	*$4.87*	*$5.06*	*$5.26*	*$5.47*
5% growth	*$4.33*	*$4.54*	*$4.77*	*$5.01*	*$5.26*	*$5.52*	*$5.80*
6% growth	*$4.33*	*$4.58*	*$4.86*	*$5.15*	*$5.46*	*$5.79*	*$6.14*
New LT Guidance: Grow EPS 4%-6% off 2016				*UBSe*			
4% growth				*$4.65*	*$4.84*	*$5.03*	*$5.23*
5% growth				*$4.65*	*$4.88*	*$5.13*	*$5.38*
6% growth				*$4.65*	*$4.93*	*$5.22*	*$5.54*
Implied reduction to guidance at 5% midpoint				*($0.36)*	*($0.37)*	*($0.39)*	*($0.41)*

Source: Company Filings, FactSet, and UBS Estimates

Miss for 3Q largely on higher O&M. Reported 3Q adjusted $1.47 vs UBSe $1.50 and cons $1.54. Operations and maintenance expense was a nickel higher than expected for the timing of planned work, increased NCEMPA asset costs, and storm costs. As anticipated, these factors were offset by +$0.09 of favorable weather. International was lower by -$0.02, with half from FX. Brazil results were a bit better than expected, helped by lower purchased power costs this quarter, although Brazil continues to be a drag this year at -$0.25 YTD. Lower 3Q MTBE pricing continues to hurt National Methanol by a penny, totalling -$0.04 YTD. For the TTM, residential cust growth of 1.3% continues to be offset by lower usage trends to result in -0.2% sales growth, although for 3Q alone, residential sales grew a more robust +1.0%. Overall TTM retail sales growth increased +0.3%, driven by +1.1% TTM industrial growth.

Valuation: Reduce PT $3 to $71 on lower estimates

Our valuation is based on a 2017 P/E methodology with an in-line multiple versus utility peers. Our PT comes down $3 for our $0.20 reduction to our 2017E estimate.

Figure 2: DUK P/E Valuation

Duke Energy Valuation: P/E Derived on 2017 EPS					
Downside Case		**Base Case**		**Upside Case**	
2017 EPS	$4.86	2017 EPS	$4.86	2017 EPS	$4.86
P/E Multiple	14.2x	P/E Multiple	14.7x	P/E Multiple	15.2x
Premium/(Discount)	-5%	Premium/(Disc	0%	Premium/(Disc(	5.0%
Value	**$66.00**	**Value**	**$71.00**	**Value**	**$78.00**

Source: Company Filings, FactSet, and UBS Estimates

Acquisition of Piedmont at 27x 2017E P/E

For our full note including accompanying accretion tables and debt metrics, please see 8/26/15 The Duke of North Carolina.

Duke announced the acquisition of Piedmont Natural Gas (PNY) for $4.9Bn equity value ($60/sh vs $42/sh Friday close) as another electric utility executes on natural gas M&A. Piedmont is concentrated in North Carolina (70% of rate base) and also has ownership in the Atlantic Coast and Constitution pipelines. Piedmont has been growing EBITDA and ratebase at ~9% along with 1.6-2.0% customer growth, notable premiums to Duke's ~4% earnings growth target (<2% 2010A-2015E EPS CAGR) and ~1% customer growth.

Modest accretion as high purchase price a drag

We estimate ~2% EPS accretion for the $4.9Bn transaction, with a 50 bps improvement in long-term EPS CAGR.

We estimate that the deal is accretive by $0.10-$0.13/sh in 2017/2018 (2.0-3.0%) with synergies and $0.08-$0.11/sh excluding synergies. From the Duke-Progress transaction in 2011 Duke management commented that it believed the synergies on that deal would be in the range of 5-7% total non-fuel O&M, consistent with other transactions. For the Piedmont transaction management commented that synergies were not a consideration in the accretion and we view them as immaterial as well. Given the magnitude of debt financing (details below), a 50bp increase in the interest rate would reduce accretion by ~$0.01-$0.02/sh.

Would "enhance" EPS growth

Management states that the deal "enhances" Duke's long-term 4-6% EPS target. We estimate about 50 bps of enhancement from $0.10/sh EPS accretion (~2%) for the 2013A-2017E EPS CAGR. The $6.7Bn enterprise value is expected to be financed with (1) assumption of $1.8Bn; (2) a $500-$750Mn equity forward; (3) holding company debt; and (4) cash. Potential sources of cash include a dividend from Florida to Duke Corp from the Crystal River 3 securitization ($600Mn) and Latin American repatriation ($300Mn).

Accretion premised on heavy debt financing

Duke is financing the $6.7Bn enterprise value by assuming $1,800Mn of Piedmont debt, issuing $500-$750Mn equity via a forward sale, and pointed at ~$1Bn of cash indicating that the remaining ~$3.3Bn will be financed with Duke holding company debt. The incremental after-tax interest expense on the deal will erase nearly half of Piedmont's consensus 2017E earnings. The ~75% debt-to-total capitalization implied for the deal is on the high-end of the spectrum as utilities continue to take advantage of historically low interest rates to execute on M&A.

Figure 3: Piedmont Financing

Piedmont Transaction Financing (UBSe $Mn)	
Enterprise Value	6,700
Assumption of PNY Debt	1,800
DUK Equity ($500-$750Mn)	625
DUK Cash (~$1Bn)	1,000
DUK Holding Co Debt	3,275
Debt-to-Capitalization	76%
After-Tax Interest (at 4%)	85
PNY Consensus 2017 NI	180

Source: Company Filings, FactSet, and UBSe

Transaction expected to close in 4Q16

The deal requires approval from the North Carolina commission as well as the US Department of Justice and FTC. Approval is not required in South Carolina and Tennessee but management commented that it has been communicating with the relevant regulators to keep them informed. The transaction is also subject to majority shareholder approval of Piedmont but not Duke.

Deal sets new high watermark for the industry

Duke's proposed acquisition of Piedmont continues the upward trend in 2015 of implied takeout P/E multiples and is well above both Southern Company/AGL Resources in August (21.6x 2017E) and Emera-TECO in September (21.2x 2017E).

The DUK-PNY transaction represents a 42% premium to Friday's close of $42.22 and a 65% premium to where shares traded as recently as last month.

Continuation of growing interest in natural gas and emphasis on sales growth

Following the Southern/AGL Resources deal in August 2015, TECO/New Mexico Gas Company in May 2013, and numerous pipeline stakes we see electric utilities increasingly interested in gas infrastructure. As electric demand stagnates (Duke previously characterized as "anemic") we expect to see more interest in gas utilities and utes that see real growth.

Duke Energy (DUK.N)

Income statement (US$m)	12/12	12/13	12/14	12/15E	% ch	12/16E	% ch	12/17E	12/18E	12/19E
Revenues	**19,624**	**24,598**	**23,925**	**25,150**	*5.1*	**25,674**	*2.1*	**26,346**	**27,025**	**27,651**
Gross profit	12,056	15,414	15,458	16,322	*5.6*	16,791	*2.9*	17,404	18,061	18,638
EBITDA (UBS)	**7,315**	**8,693**	**9,577**	**9,573**	*0.0*	**9,952**	*4.0*	**10,411**	**10,853**	**11,205**
Depreciation & amortisation	(2,289)	(2,808)	(3,066)	(3,142)	*2.5*	(3,258)	*3.7*	(3,370)	(3,466)	(3,567)
EBIT (UBS)	**5,026**	**5,885**	**6,511**	**6,432**	*-1.2*	**6,693**	*4.1*	**7,042**	**7,387**	**7,638**
Associates & investment income	0	0	0	0	-	0	-	0	0	0
Other non-operating income	0	0	0	0	-	0	-	0	0	0
Net interest	(1,242)	(1,546)	(1,622)	(1,678)	*-3.5*	(1,913)	*-14.0*	(2,048)	(2,149)	(2,205)
Exceptionals (incl goodwill)	0	0	0	0	-	0	-	0	0	0
Profit before tax	**3,784**	**4,339**	**4,889**	**4,754**	*-2.8*	**4,780**	*0.6*	**4,994**	**5,238**	**5,433**
Tax	(1,290)	(1,261)	(1,669)	(1,567)	*6.1*	(1,561)	*0.4*	(1,631)	(1,713)	(1,738)
Profit after tax	**2,494**	**3,078**	**3,220**	**3,187**	*-1.0*	**3,219**	*1.0*	**3,363**	**3,525**	**3,694**
Preference dividends	0	0	0	0	-	0	-	0	0	0
Minorities	(14)	(11)	(6)	(6)	*0.0*	(6)	*0.0*	(6)	(6)	(6)
Extraordinary items	(715)	(416)	(1,336)	0	-	0	-	0	0	0
Net earnings (local GAAP)	**1,765**	**2,651**	**1,878**	**3,181**	*69.4*	**3,213**	*1.0*	**3,357**	**3,519**	**3,688**
Net earnings (UBS)	**2,480**	**3,067**	**3,214**	**3,181**	*-1.0*	**3,213**	*1.0*	**3,357**	**3,519**	**3,688**
Tax rate (%)	34.1	29.1	34.1	33.0	*-3.4*	32.7	*-0.9*	32.7	32.7	32.0

Per share (US$)	12/12	12/13	12/14	12/15E	% ch	12/16E	% ch	12/17E	12/18E	12/19E
EPS (UBS, diluted)	4.32	4.35	4.55	4.59	*0.9*	4.65	*1.4*	4.86	5.09	5.34
EPS (local GAAP, diluted)	3.08	3.76	2.66	4.59	*72.7*	4.65	*1.4*	4.86	5.09	5.34
EPS (UBS, basic)	4.32	4.35	4.55	4.59	*0.9*	4.65	*1.4*	4.86	5.09	5.34
Net DPS (US$)	3.03	3.09	3.16	3.28	*3.6*	3.39	*3.5*	3.54	3.69	3.94
Cash EPS (UBS, diluted)[1]	8.31	8.32	8.88	9.12	*2.7*	9.37	*2.7*	9.74	10.11	10.50
Book value per share	58.07	58.65	57.93	58.35	*0.7*	59.60	*2.1*	60.91	62.31	63.71
Average shares (diluted)	573.92	705.75	707.00	693.30	*-1.9*	690.96	*-0.3*	690.96	690.96	690.96

Balance sheet (US$m)	12/12	12/13	12/14	12/15E	% ch	12/16E	% ch	12/17E	12/18E	12/19E
Cash and equivalents	1,424	1,501	2,036	1,294	*-36.4*	1,048	*-19.0*	709	751	2,837
Other current assets	8,698	9,015	9,539	10,776	*13.0*	10,946	*1.6*	11,158	11,358	7,667
Total current assets	**10,122**	**10,516**	**11,575**	**12,070**	*4.3*	**11,995**	*-0.6*	**11,867**	**12,109**	**10,504**
Net tangible fixed assets	68,558	69,490	70,037	71,895	*2.7*	78,387	*9.0*	83,042	87,951	92,184
Net intangible fixed assets	16,365	16,340	16,321	16,321	*0.0*	16,321	*0.0*	16,321	16,321	16,321
Investments / other assets	18,811	18,433	22,776	22,776	*0.0*	22,776	*0.0*	22,776	22,776	22,776
Total assets	**113,856**	**114,779**	**120,709**	**123,063**	*2.0*	**129,479**	*5.2*	**134,007**	**139,157**	**141,786**
Trade payables & other ST liabilities	6,174	5,701	5,912	7,662	*29.6*	7,757	*1.2*	7,855	7,961	8,091
Short term debt	3,855	2,943	5,321	4,392	*-17.46*	4,392	*0.00*	2,514	2,514	2,514
Total current liabilities	**10,029**	**8,644**	**11,233**	**12,054**	*7.3*	**12,149**	*0.8*	**10,369**	**10,475**	**10,605**
Long term debt	36,351	38,152	37,213	38,042	*2.2*	42,164	*10.8*	46,164	48,764	48,764
Other long term liabilities	26,442	26,575	31,364	32,649	*4.1*	33,985	*4.1*	35,391	36,867	38,394
Preferred shares	93	0	0	0	-	0	-	0	0	0
Total liabilities (incl pref shares)	**72,915**	**73,371**	**79,810**	**82,746**	*3.7*	**88,298**	*6.7*	**91,923**	**96,106**	**97,763**
Common s/h equity	40,941	41,408	40,899	40,317	*-1.4*	41,180	*2.1*	42,083	43,051	44,023
Minority interests	0	0	0	0	-	0	-	0	0	0
Total liabilities & equity	**113,856**	**114,779**	**120,709**	**123,063**	*2.0*	**129,479**	*5.2*	**134,007**	**139,157**	**141,786**

Cash flow (US$m)	12/12	12/13	12/14	12/15E	% ch	12/16E	% ch	12/17E	12/18E	12/19E
Net income (before pref divs)	1,765	2,651	1,878	3,181	*69.4*	3,213	*1.0*	3,357	3,519	3,688
Depreciation & amortisation	2,289	2,808	3,066	3,142	*2.5*	3,258	*3.7*	3,370	3,466	3,567
Net change in working capital	(63)	(921)	(713)	513	-	(75)	-	(114)	(93)	3,820
Other operating	330	1,200	1,171	1,285	*9.8*	1,336	*3.9*	1,405	1,476	1,527
Operating cash flow	**4,321**	**5,738**	**5,402**	**8,121**	*50.3*	**7,732**	*-4.8*	**8,018**	**8,367**	**12,603**
Tangible capital expenditure	(5,501)	(5,526)	(5,384)	(7,800)	*-44.9*	(9,750)	*-25.0*	(8,025)	(8,375)	(7,800)
Intangible capital expenditure	0	0	0	0	-	0	-	0	0	0
Net (acquisitions) / disposals	(451)	0	(54)	0	-	0	-	0	0	0
Other investing	(239)	629	155	0	-	0	-	0	0	0
Investing cash flow	**(6,191)**	**(4,897)**	**(5,283)**	**(7,800)**	*-47.6*	**(9,750)**	*-25.0*	**(8,025)**	**(8,375)**	**(7,800)**
Equity dividends paid	(1,752)	(2,188)	(2,234)	(2,263)	*-1.3*	(2,342)	*-3.5*	(2,446)	(2,550)	(2,722)
Share issues / (buybacks)	23	9	25	0	-	0	-	0	0	0
Other financing	(773)	(1,137)	(1,102)	(1,124)	*-2.00*	(1,287)	*-14.44*	(1,377)	(1,445)	(1,499)
Change in debt & pref shares	1,950	933	2,779	(100)	-	4,122	-	2,122	2,600	0
Financing cash flow	**(552)**	**(2,383)**	**(532)**	**(3,487)**	*NM*	**493**	-	**(1,701)**	**(1,395)**	**(4,222)**
Cash flow inc/(dec) in cash	**(2,422)**	**(1,542)**	**(413)**	**(3,166)**	*NM*	**(1,525)**	*51.8*	**(1,708)**	**(1,402)**	**582**
FX / non cash items	1,736	1,619	948	2,425	*155.7*	1,279	*-47.2*	1,369	1,444	1,505
Balance sheet inc/(dec) in cash	**(686)**	**77**	**535**	**(742)**	-	**(246)**	*66.8*	**(339)**	**42**	**2,087**

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.[1]Cash EPS (UBS, diluted) is calculated using UBS net income adding back depreciation and amortization.

Duke Energy (DUK.N)

Valuation (x)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
P/E (local GAAP, diluted)	21.0	18.5	27.8	14.8	14.6	13.9	13.3	12.7
P/E (UBS, diluted)	14.9	16.0	16.2	14.8	14.6	13.9	13.3	12.7
P/CEPS	7.8	8.3	8.3	7.4	7.2	7.0	6.7	6.5
Equity FCF (UBS) yield %	(3.2)	0.4	0.0	0.7	(4.3)	(.0)	(.0)	10.2
Net dividend yield (%)	4.7	4.5	4.3	4.8	5.0	5.2	5.4	5.8
P/BV x	1.1	1.2	1.3	1.2	1.1	1.1	1.1	1.1
EV/revenues (core)	3.4	3.6	3.9	3.5	3.5	2.7	2.6	2.6
EV/EBITDA (core)	9.0	10.1	9.6	9.2	9.1	6.8	6.5	6.3
EV/EBIT (core)	13.1	15.0	14.2	13.6	13.5	10.1	9.6	9.3
EV/OpFCF (core)	13.1	15.0	14.2	13.6	13.5	10.1	9.6	9.3
EV/op. invested capital	1.4	1.4	1.5	1.5	1.5	1.1	1.0	1.0

Enterprise value (US$m)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Market cap.	37,120	48,931	52,148	46,890	46,890	46,890	46,890	46,890
Net debt (cash)	28,746	39,235	40,046	40,819	43,324	46,738	46,738	46,738
Buy out of minorities	0	0	0	0	0	0	0	0
Pension provisions/other	0	0	0	0	0	0	0	0
Total enterprise value	**65,866**	**88,166**	**92,194**	**87,709**	**90,213**	**93,628**	**93,628**	**93,628**
Non core assets	0	0	0	0	0	(22,776)	(22,776)	(22,776)
Core enterprise value	**65,866**	**88,166**	**92,194**	**87,709**	**90,213**	**70,852**	**70,852**	**70,852**

Growth (%)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Revenue	35.1	25.3	-2.7	5.1	2.1	2.6	2.6	2.3
EBITDA (UBS)	33.0	18.8	10.2	0.0	4.0	4.6	4.2	3.2
EBIT (UBS)	36.1	17.1	10.6	-1.2	4.1	5.2	4.9	3.4
EPS (UBS, diluted)	-1.3	0.6	4.6	0.9	1.4	4.5	4.8	4.8
Net DPS	1.9	2.0	2.3	3.6	3.5	4.4	4.2	6.8

Margins & Profitability (%)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Gross profit margin	61.4	62.7	64.6	64.9	65.4	66.1	66.8	67.4
EBITDA margin	37.3	35.3	40.0	38.1	38.8	39.5	40.2	40.5
EBIT margin	25.6	23.9	27.2	25.6	26.1	26.7	27.3	27.6
Net earnings (UBS) margin	12.6	12.5	13.4	12.6	12.5	12.7	13.0	13.3
ROIC (EBIT)	10.8	9.5	10.7	11.0	10.9	10.7	10.7	10.9
ROIC post tax	7.1	6.8	7.1	7.4	7.4	7.2	7.2	7.4
ROE (UBS)	7.8	7.4	7.8	7.8	7.9	8.1	8.3	8.5

Capital structure & Coverage (x)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Net debt / EBITDA	5.3	4.6	4.2	4.3	4.6	4.6	4.7	4.3
Net debt / total equity %	95.0	95.6	99.0	102.0	110.5	114.0	117.4	110.0
Net debt / (net debt + total equity) %	48.7	48.9	49.8	50.5	52.5	53.3	54.0	52.4
Net debt/EV %	59.0	44.9	43.9	46.9	50.4	67.7	71.3	68.4
Capex / depreciation %	NM	196.8	175.6	NM	NM	NM	NM	NM
Capex / revenue %	28.0	22.5	22.5	NM	NM	NM	NM	28.2
EBIT / net interest	4.0	3.8	4.0	3.8	3.5	3.4	3.4	3.5
Dividend cover (UBS)	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4
Div. payout ratio (UBS) %	70.1	71.1	69.5	71.4	72.9	72.9	72.5	73.8

Revenues by division (US$m)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Others	19,624	24,598	23,925	25,150	25,674	26,346	27,025	27,651
Total	**19,624**	**24,598**	**23,925**	**25,150**	**25,674**	**26,346**	**27,025**	**27,651**

EBIT (UBS) by division (US$m)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Others	5,026	5,885	6,511	6,432	6,693	7,042	7,387	7,638
Total	**5,026**	**5,885**	**6,511**	**6,432**	**6,693**	**7,042**	**7,387**	**7,638**

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

Forecast returns

Forecast price appreciation	+4.8%
Forecast dividend yield	4.9%
Forecast stock return	+9.7%
Market return assumption	5.9%
Forecast excess return	+3.8%

Statement of Risk

Risks to our estimates and price targets include: unfavorable terms of regulatory approval, including clawback to customers of synergies; mild weather; unfavorable environmental legislation; unexpected plant outages; commodity price risk; foreign country and currency risk; and unattained merger synergies.

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UBS Investment Research: Global Equity Rating Definitions

12-Month Rating	Definition	Coverage[1]	IB Services[2]
Buy	FSR is > 6% above the MRA.	49%	33%
Neutral	FSR is between -6% and 6% of the MRA.	40%	26%
Sell	FSR is > 6% below the MRA.	12%	18%
Short-Term Rating	**Definition**	**Coverage[3]**	**IB Services[4]**
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%

Source: UBS. Rating allocations are as of 30 September 2015.
1:Percentage of companies under coverage globally within the 12-month rating category. 2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.
3:Percentage of companies under coverage globally within the Short-Term rating category. 4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

KEY DEFINITIONS: Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months. **Market Return Assumption (MRA)** is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium). **Under Review (UR)** Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation. **Short-Term Ratings** reflect the expected near-term (up to three months) performance of the stock and do not reflect any change in the fundamental view or investment case. **Equity Price Targets** have an investment horizon of 12 months.

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UBS Securities LLC: Julien Dumoulin-Smith; Michael Weinstein; Paul Zimbardo.

Company Disclosures

Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Duke Energy[2, 4, 5, 6a, 6b, 7, 16]	DUK.N	Neutral	N/A	US$67.76	06 Nov 2015
Piedmont Natural Gas Inc[16]	PNY.N	Not Rated	N/A	US$57.65	06 Nov 2015

Source: UBS. All prices as of local market close.
Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

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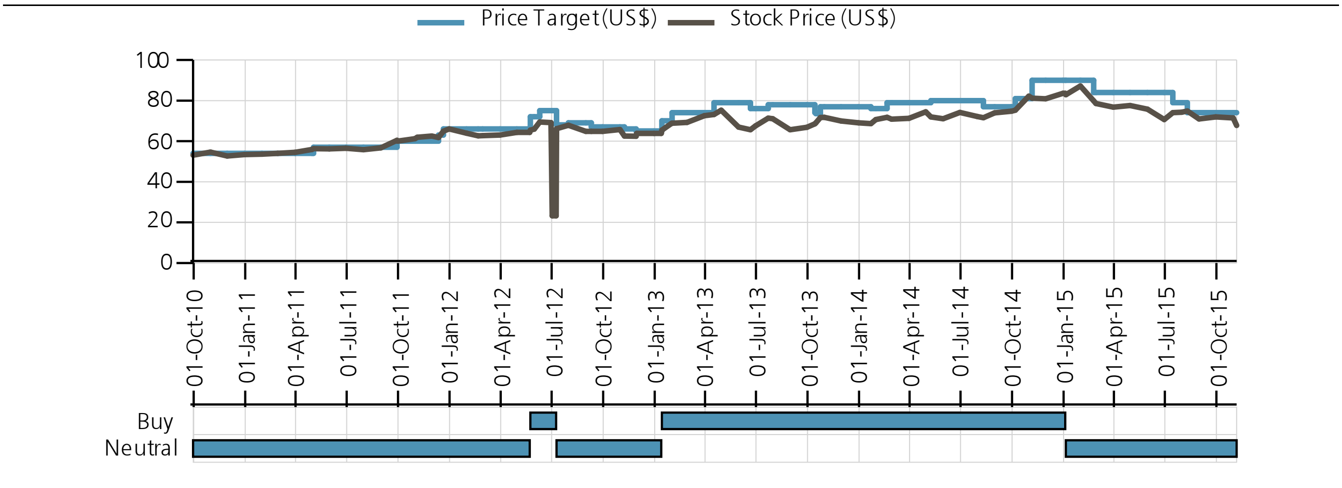
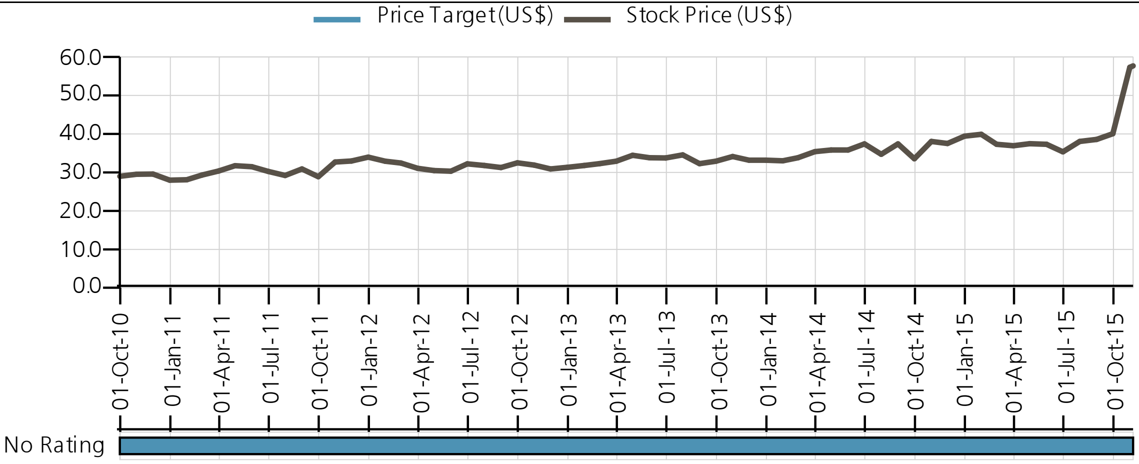
Duke Energy (US$)



Source: UBS; as of 06 Nov 2015

Piedmont Natural Gas Inc (US$)



Source: UBS; as of 06 Nov 2015

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