Duke Energy
More than Just an Oil Slick

Equities

Americas
Electric Utilities

12-month rating	**Neutral** *Prior: Buy*
12m price target	**US$90.00**
Price	**US$84.05**
RIC: DUK.N **BBG:** DUK US	

Trading data and key metrics

52-wk range	US$86.83-67.13
Market cap.	US$59.3bn
Shares o/s	706m (COM)
Free float	97%
Avg. daily volume ('000)	941
Avg. daily value (m)	US$75.9
Common s/h equity (12/14E)	US$41.5bn
P/BV (12/14E)	1.4x
Net debt / EBITDA (12/14E)	4.3x

EPS (UBS, diluted) (US$)

	12/14E			
	From	To	% ch	Cons.
Q1E	1.17	1.17	0.00	1.17
Q2E	1.11	1.11	0.00	1.11
Q3E	1.40	1.40	0.22	1.40
Q4E	0.87	0.86	-0.52	0.88
12/14E	4.55	4.55	-0.03	4.58
12/15E	4.81	4.70	-2.17	4.76
12/16E	5.05	4.97	-1.55	4.97

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Some wariness on large-cap utes, international exposure; D/G to Neutral
We are reducing our estimates and downgrading to Neutral with DUK recently hitting 52-week highs, utilities outperforming the S&P 500 by 14% in 2014, and DUK having outperformed the XLU utilities ETF by 6% since the summer. We continue to be concerned that fund rotation out of utilities in 2015 after such strong performance will hit the slower growing large cap names harder than more nimble small/mid-cap utilities (see our 12/19 note " The 'SMID Bid'.) We are reducing EPS estimates $0.08 to reflect lower results from Saudi subsidiary NMC as a result of its correlation to falling Brent crude, and see Duke near low end of anticipated '15 guidance range of $4.70-4.85.

Still plenty of opportunities to invest, but hard to budge that 4%-6% needle
Over the long run, the company has many options to invest large sums of repatriated cash, including the NCEMPA purchase (could yet close earlier than expected by YE2015), the Atlantic Coast Pipeline project, T&D infrastructure in Indiana, regulated solar in NC, CCGT in FL with much of this yet to be reflected in formal capex guidance (expected in February). That said, all of this simply keeps mgmt in its stated 4-6% EPS guidance range, offsetting broader considerations. We expect an increase in expected coal ash remediation capex (among other revisions) in February in conjunction with its Analyst Day. Nevertheless, with a $59B mkt cap ship to steer (largest in the sector), we see DUK as defining the utility 'average' in this range than exceeding peers.

Midwest Gen sale likely to close January: Buyback coming?
We expect the Midwest Gen sale to close within days of FERC approval, probably in January. Management intends to reveal its use of cash proceeds soon thereafter, with an eye toward avoiding dilution by holding cash too long. We believe the most likely use of cash is to pay for the NCEMPA acquisition at yearend. In our opinion, a yearlong lag argues for stock repurchases and debt reduction in interim, esp. with oil pressures.

Valuation: Maintain $90 PT on higher multiple even as ests come down
We are rolling forward to a 2017E ute peer P/E mult and maintaining our $90 PT on a higher mult even as we reduce our ests $0.08. We value the company on a SOP basis.

Highlights (US$m)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Revenues	14,529	19,624	24,598	25,055	25,276	26,064	26,822	27,447
EBIT (UBS)	3,693	5,026	5,885	6,454	6,769	7,164	7,437	7,676
Net earnings (UBS)	1,945	2,480	3,067	3,216	3,315	3,504	3,644	3,788
EPS (UBS, diluted) (US$)	4.38	4.32	4.35	4.55	4.70	4.97	5.17	5.37
DPS (US$)	2.97	3.03	3.09	3.16	3.24	3.32	3.42	3.54
Net (debt) / cash	(18,617)	(38,875)	(39,594)	(40,500)	(40,762)	(40,731)	(40,357)	(39,741)

Profitability/valuation	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
EBIT margin %	25.4	25.6	23.9	25.8	26.8	27.5	27.7	28.0
ROIC (EBIT) %	11.7	10.8	9.5	10.2	10.5	10.9	11.2	11.4
EV/EBITDA (core) x	7.7	9.0	10.1	10.5	10.2	9.7	7.6	7.3
P/E (UBS, diluted) x	13.0	14.9	16.0	18.5	17.9	16.9	16.3	15.6
Equity FCF (UBS) yield %	(4.9)	(3.2)	0.4	2.2	3.4	4.0	4.7	5.2
Net dividend yield %	5.2	4.7	4.5	3.8	3.9	4.0	4.1	4.2

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$84.05 on 02 Jan 2015 19:38 EST

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Investment Thesis

Duke Energy

12-month rating **Neutral**

12m price target **US$90.00**

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 $16B-$20B of growth investment from 2014-2018. The sale of merchant gen is now progressing with a closing expected in 1Q15. The portfolio has a 12/31/13 book value of approx. $3.5B but after 1Q14 writedowns will be about $1B-$2B, from which the announced agreement is for $2.8B. The International segment is undergoing a "strategic review" for optimum growth and cash flow. Our price target is derived by applying a 10% premium to the peer P/E multiple to 2017E.

Upside scenario

Our upside case rests on execution of management's regulated capital spending plan plus additional projects not in the plan. 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 $93 per share.

Downside scenario

However, any major problem with the international segment, including unhedged FX rates 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 would also drive downside and the removal of the 10% premium to below $80 per share.

Upcoming catalysts

1Q15	Expect closing of sale of Midwest Gen
1Q15	Strategic review of International concludes

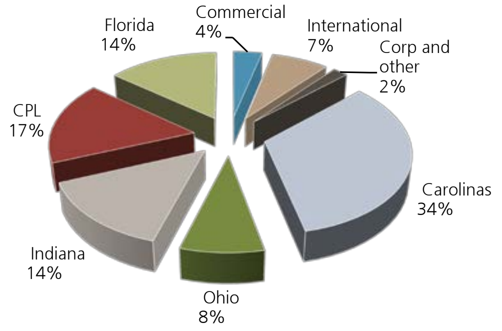
Business description

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

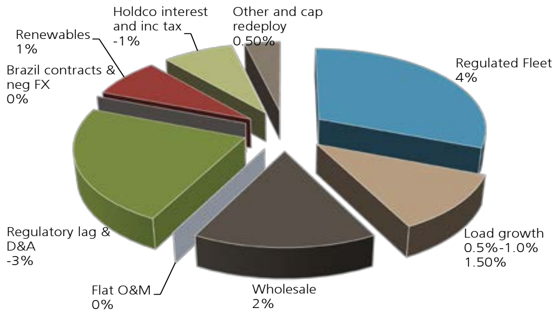
The electric utility industry is projected to experience weak or negative electric demand growth in coming years as a tepid economy and energy efficiency dampen demand. In the unregulated merchant power space, we see limited potential for a meaningful recovery from currently low power prices due to limited 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, 2016E (%)



Source: Company filings, UBS estimates

Sources of 4-6% EPS growth through 2016E



Source: Company filings, UBS estimates

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With Duke having outperformed utility peers by 6% since June, it now trades in-line with the 2017E average peer P/E multiple of 15.9x and we are downgrading from Buy to Neutral ahead of what we believe could be a period of in-line performance vs large-cap peers as funds begin to rotate out of the sector in early 2015, disproportionately weighing on XLU-exposed large-cap equities such as Duke. We have attributed the rebound since June to broader sector rotation between regulated utilities and the more power-oriented names, emphasizing that improvement around both coal ash (following Dan Rivers spill in early 2014) and its Edwardsport coal IGCC plant in Indiana have likely contributed to this 2H outperformance.

A few good catalysts still ahead: While our downgrade comes ahead of still constructive news in January (around close of Duke's pending merchant sale to Dynegy) and associated likely share repurchase/debt paydown at close, as well as capex revisions in February, we think much of this news is 'known'. While a nominal share repurchase announcement may be perceived constructively, we see wider use of cash across both this sale as well as International review as a headwind to investors. In turn, we see the potential acceleration of its NCEMPA regulated portfolio acquisition approval to YE15 (vs. previous '16 expectations) as among several potential 'levers' employed by mgmt to assuage dilution concerns (worth $1.2 Bn – and ~$600 Mn in equity to be funded for deal).

Upward capex revisions coming in February: Chief among the catalysts remains its 4Q earnings call – which will serve as a mini-'Analyst Day', providing a slew of corporate updates, including its formally updated spending plan (reflecting much of the spending *announced* throughout 2H14 for Duke). Items to be formally reflected into its last update (from Feb '13) include revised coal ash plan, an interstate pipeline to NC (in coming weeks), and efforts on utility-scale solar (300 MW RFP in NC).

But fewer international options exist: We see the pullback in F/X as reducing its strategic options around its international portfolio review. While not just reducing nominal EPS contribution, the degraded FX rate also has the secondary effect of reducing the attractiveness of potential alternatives to repatriation, such as expansion and/or M&A. Look for an announcement either way with 4Q results.

And 2015 estimates could be a tad too high as well: and that's likely the chief impediment to shares from here, seeing investors as concerned around a wholesale re-rating of estimates down on the back of the Brent story. We see '15 guidance

And broader use of cash (with dilution concerns) could well linger through 1H15: With mgmt looking to bring back cash from abroad at the same time as selling its Midwest Genco, we see continued pressure on mgmt to act ($2.8 Bn sale price and $1.6 Bn offshare cash position, the bulk of which is USD). While a small share buyback could do well for near-term expectations in January (upon close of Midwest sale), use of cash to paydown debt could temper any real upside.

More broadly, SMIDs poised to do better than large caps in 2015: As a last point on large-cap stories, we emphasize that while a major constituent to the UTY, we see the recent rally in 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).

Bottom line – While DUK's improving story remains differentiated vs. other large-cap regulated utilities, with an overall *improving* story with *greater clarity* on future growth, we see most of the good news already baked into the stock price, with the company unlikely to ever materially increase its long-term 4%-6% earnings growth rate forecast.

National Methanol (NMC) taking a hit on lower oil pricing

DUK's National Methanol subsidiary's results are correlated to plunging Brent crude prices at a rate of about $0.02 EPS for every $10/bbl move. It is our understanding that management's guidance is likely aligned with the ~$100/bbl oil price prevailing at the time of its Analyst Day, implying about ~$0.08 downside should the current global oil slump persist (note that DUK does not sell oil – this is just a correlation); we caution that contango in the oil futures curve offsets the near-term rolloff of upwards of $45-50/bbl. In 2013, NMC produced 27% of net income from the International segment (vs 54% from Brazil), translating to just over ~$100 Mn (~$0.15). We estimate the segment is likely to contribute closer to ~$0.05 in 2015.

DUK currently owns 25% of NMC, with the Saudi Basic Industries Corporation (SABIC) holding 50%, and Celanese - 25%. DUK's share of NMC distributions is expected to decline to 17.5% in mid-2016 as a new 50-Kton polyacetal facility finished construction (DUK's share of earnings is expected to decline 25%-30%). The reduction is the result of a 2010 agreement with the Saudis to extend the JV through 2032.

Figure 1: Crude Oil (IPE Brent), $/Bbl – about a $0.10/share headwind on $50/bbl YoY decline

Source: FactSet

2015 Guidance likely to be in-line with previous long-term forecasts – for now

We see '15 presently towards the bottom end of its range.

We think that 2015 guidance (to be initiated in February) is likely to be closely in-line with prior long-term guidance from management despite the potential trouble at NMC. That is, "4%-6% off the midpoint of original 2013 guidance of $4.20-$4.45". **For 2015 that would be $4.68-$4.86. Rounding that off to the nearest nickel and using the same $0.15 gap used in 2014 would be $4.70-$4.85 with a midpoint of $4.77 vs UBSe $4.71 and consensus $4.77.** Our estimate is substantially lower than our previous $4.81 but we've taken it down mostly for lower NMC results as a result of the global oil slump. Nevertheless, we don't think that the company will opt to incorporate lower oil into its official forecast quite yet – leaving our estimate at the likely low-end of guidance.

Are buybacks a possibility? Yes, but organic uses are chief focus

Every penny counts: putting forth 4-6% near-term buybacks to keep the range intact

No equity issuances are currently planned through 2016 despite a $38B capex plan through 2018 that is likely to rise in February (see below). $2.8B of pretax proceeds are expected from the sale of Midwest Genco assets this year, and another $1.6B of pretax cash (mostly $US) is likely to be repatriated from Brazil as well. Management is also keen to repatriate an ongoing $300M-$400M of cash generation from its International segment. DUK's FFO/Debt stands at a healthy 19% for 2014 (target is 17%) and Debt/Cap is 49%, although holdco debt is ~30% of total debt, including $1B that was just issued in April 2014. Management has indicated a preference to reduce debt with asset sale and repatriation proceeds this year. As of Sept 30, total available liquidity was $4.9B out of $6.0B of facilities.

Management is concerned that a significant delay in redeployment of sale and repatriation proceeds could lead to dilution from these decisions. The nearest-term opportunity for redeployment is likely to be the $1.2B acquisition of the North Carolina Eastern Municipal Power Agency's (NCEMPA) minority ownership in jointly-owned plants (see below for details). The deal is now expected to close almost a year earlier than expected around yearend 2015. In our opinion, the most likely combination of actions is debt reduction in 2015 followed by the NCEMPA purchase and other investment. However, any significant delays in the closing of NCEMPA might lead to a decision to repurchase stock to mitigate dilution – with a $1B buyback creating $0.08 accretion on its own vs the loss of Commercial Power earnings, which were $0.18 in 2014 and $0.02 in 2013.

The Ohio game plan in January

Following the sale of its portfolio for $2.8 Bn in August, we look for management to act swiftly upon expected FERC approval in January. We understand the deal could close within days of receiving approval, with Duke likely announcing a joint share repurchase and HoldCo debt paydown strategy at the time of close in order to minimize dilution impact from its sale; recall that 2015 is the 'highest' year of contributions from the Midwest portfolio, making the timing of any use of proceeds as particularly important for 2015 commitments around making the deal break in the current year (we have yet to bake in an impact in our estimates).

The question remains whether investors will see a buyback as a positive – or ponder more broadly about use of cash flow in a wider sense?

Figure 2: Ohio Genco Dilution assuming *just* debt paydown – how much repo?

Duke Merchant Sale: Debt Paydown	2015	2016	2017	2018
Asset Sale Proceeds $Mn (~$2.6Bn BV)	2,800			
Less: Tax on Sale and Trans Costs	105			
After-Tax Sales Proceeds	2,695			
Interest Expense Avoided (@ 4.5%)	121	121	121	121
After-Tax	42	42	42	42
Net Income Accretion	79	79	79	79
Shares Outstanding	706	706	706	706
EPS Uplift from Interest Paydown	$0.11	$0.11	$0.11	$0.11
Duke Energy Ohio EPS Contribution	$0.24	$0.14	$0.13	$0.19
Accretion/(Dilution)	**-$0.13**	**-$0.02**	**-$0.02**	**-$0.08**

Source: Company reports and UBS estimates

Estimates and Valuation; Downgrade to Neutral ahead of probably large-cap pullback

We've reduced our 2016 and 2017 estimates $0.08, chiefly to reflect lower results from National Methanol. We also embed a higher tax rate for this year but maintain our 2015E-2018E tax rate. Our estimates remain at the low end of 2014 guidance and are now materially below consensus for 2015-2018 as well. Our unchanged price target of $90 remains based off a 10% premium to the 2016E average regulated utility multiple. We are however *rolling forward* our PT ahead to a 2017 P/E peer multiple, with a higher multiple offsetting our lower estimates to keep our PT at $90.

Figure 3: Revised UBS Estimates, 2013-2018E

DUK EPS	2013A	2014E	2015E	2016E	2017E	2018E
UBSe	$4.35	$4.55	$4.71	$4.97	$5.17	$5.38
Prior UBSe	$4.35	$4.55	$4.81	$5.05	$5.25	$5.47
Consensus	$4.35	$4.58	$4.77	$4.99	$5.25	$5.60
Guidance		$4.50-$4.65				
		Grow EPS 4%-6% through 2016 off 2013 guidance $4.33				

Source: UBS estimates, FactSet, and Company Filings;

Figure 4: DUK P/E Valuation, 2017E

Price Target Valuation		
EPS	$5.17	2017E
x	15.9x	Group Avg Multiple
x	10.0%	Premium
PT	**$90.47**	

Source: UBS Estimates

Relative Performance vs. Peers

We include a chart below of recent DUK performance vs. the XLU peer group, with the stock recovering from its 1H issues over coal ash. The stock was just about flat vs. the group in 2014

Figure 5: Duke vs. Utility Peers in 2H14

Source: FactSet

Brazilian Real provides further pressures, but at least mgmt anticipated in budgeting for 2015 and 2016

FX erosion puts pressure on mgmt plan to repatriate annual cash flow of $300M-$400M. It also likely limits strategic alternatives such as M&A and/or expansion

Mgmts plan had contemplated 8% YoY inflation, but had investors?

Duke Energy's primary foreign currency rate exposure is to the Brazilian Real, with the company reporting the International business deriving 54% of net income in 2013 from Brazil and our estimate of 44% of EBIT in 2014. Duke does not hedge its F/X exposure, although most of its reported $1.6B offshore cash balance is denominated in $US, with the exception of a small amount that is intended for working capital. Furthermore, the company's international operations also have $1B of debt denominated in foreign currency, which does act as a natural "hedge" of sorts. Despite the lack of EPS impact, we believe the degrading FX situation puts pressure on management's plan to repatriate annual cash generation there of $300M-$400M. It also likely limits strategic alternatives such as M&A and/or expansion.

3Q14 transcript: "*expect lower results in Latin America, principally driven by the impacts of drought conditions in Brazil and unfavorable foreign currency exchange rates.*"

Company guidance and its long-term earnings growth rate projection of 4%-6% incorporate both the impact of foreign-denominated debt as well as a degrading BRL F/X exposure of BRL 2.45 in 2014, 2.65 in 2015, and 2.85 in 2016. Management's sensitivity guidance is $0.03 EPS per 10% move in the exchange rate. <u>We estimate around penny or less of EPS impact vs guided rates of 2.45, 2.75, and 2.90, respectively, although a -$0.02-0.04 EPS headwind on a YoY basis (tough already for a business seeing limited growth otherwise already).</u>

An offset to the F/X sensitivity below remains a $1 Bn in locally-denominated currency, where the ability to reprice debt upon majority remains a modest offsetting factor (~$0.004 even when assuming an 8% YoY Change in F/X).

Figure 6: DUK Currency Sensitivities vs. Previous Guidance -> Mgmt embedded 8% annual F/X devaluation in projections

	2014E	2015E	2016E
BRL F/X Assumption - UBSe - Guidance and Previous Assumption	2.45	2.65	2.85
BRL F/X Assumption - UBSe - Present	2.45	2.75	2.90
F/X Growth Rate			
Brazil % of International segment income	44%	44%	44%
Delta - EBIT - International Segment	**$0**	**($10)**	**($5)**
Post Tax Impact	**$0**	**($6)**	**($3)**
Shares Outstanding	706	706	706
EPS Impact	**$0.00**	**($0.01)**	**($0.00)**

Source: Company reports

International strategic review – don't necessarily expect a sale

We suspect a partnership deal in Brazil would be upside on its International Review….

Baseline assumption remains simply a tax-efficient repatriation

We increasingly emphasize Street expectations for a sale of the International business are likely misdirected, with a variety of other potentials clearly before management. We emphasize a direct sale of the business would appear dilutive given depressed regional multiples in the Americas (generally in the ~6x EBITDA range), and with management committed to making any transaction accretive, this would appear a tough hurdle to cross.

Focus is on driving EPS growth from the segment rather than need to divest

We see a successful deal in partnering with another IPP as the most attractive avenue for Duke – seeing upside to shareholder expectations if capable in posting such an outcome. That said, we read mgmt's commentary, particularly following the continued pressure on IPP outlook in Brazil coupled with F/X pressures as limiting the ability for any such deal to prove accretive (the baseline assumption with which mgmt continues to operate). Timing on any such deal remains accretive.

What's the purpose of the strategic review?

The purpose appears first and foremost is to solve the segment's relatively flat EPS profile through the forecast period. Part of the problem is the $1.7B of offshore cash there, some of which is needed to cover collateral requirements. Political uncertainty around the drought isn't helping d espite the improvement in power forwards in South America. We suspect management will not suffice with any outcome that does not deliver a corresponding 4-6% EPS trajectory from the business, although this could yet be as basic as putting the cash to work should

Could a deal with AES Tiete work? We think there's good logic.

Bringing the foreign assets back to their original portfolio?

Putting (more) cash to work in LatAm would actually be *accretive* under most scenarios

Among these, we emphasize the opportunity to pursue a transformative merger of the international business appears the most interesting, with synergy opportunities from bringing the business to scale. In particular, we emphasize its regional peer, AES Tiete, could yet fit nicely as a re-combining of the two asset bases (previously housed under the same parent company in a prior life). With total EPS of ~$0.23 from the Brazilian segment in 2013, we see the opportunity to add ~$0.03 from conservative synergy expectations, and most importantly enable Duke to monetize its position via a public equity listing (via a share-for-share transaction). We suspect even if AES Tiete is not the partner, Duke's bias remains to take shares with a regional partner in the Americas to gain the liquidity to gradually sell down the business.

Tax structuring remains the missing piece – fallback announcement?

Exploring ways to bring back the trapped cash

We emphasize the key to any transaction would be resolving off-share tax considerations, enabling the company to repatriate the $1.7Bn (at least over time). We think the structure of any sale could prove crucial to effecting the appropriate tax basis. We see a potential in which a basic repatriation of off-shore cash of a significant chunk could occur (rather than a broader asset sale), potentially a slightly disappointment vs. investor expectations following a year-long process from management to optimize this segment.

A novel thought: does lower oil this NMC a more likely sale?

Potentially. Duke has reiterated time and again it does not see the portfolio as a likely sale candidate, seeing the cash flow profile of this asset as particularly appealing. With the pullback in oil prices, the question remains whether the sale would still be dilutive to overall earnings? We estimate not, although without a visible sense on transaction multiples on such a business amidst wider negativity on the energy complex, it's hard to say. *Net-net, we see the International review potentially expanding to even NMC should mgmt's view around oil prices hold – and lower ROE and cash flow distributions on the assets prevail. That said, this is the 'bottom' of the list for any international sale candidate.*

Increased capex forecast likely in February

Among other annual capex updates, management intends to increase its capex forecast for coal ash remediation in February in conjunction with its 4Q earnings call/Analyst Day. As a result of the passage of the North Carolina Coal Ash Management Act of 2014, DUK recorded two AROs totalling $3.4B on its balance sheet, including one for operating plants in PP&E and another for retired assets in the Regulatory Asset section. This figure compares to our baseline investment opportunity assumption of $2.0-$2.5B remediation that includes dry bottom ash handling & fly ash reliability improvements as well as moving three sites (Dan River, Riverbend, and Sutton) to new, lined structural fills or landfills while continuing the Asheville structural fill and converting remaining units to dry fly ash.

We caution that the ARO is neither finalized nor differentiated between capital opportunities and operating expenses. Under the legislation, the NC PUC will determine both the extent of the spending and remediation as well as the level of and method of recovery.

For the remaining 10 sites not specifically mentioned in the legislation, basins are also to be categorized into High, Intermediate, and Low risk by Department of Environmental and Natural Resources (DENR) by the end of 2015, with each closed by the end of 2019, 2024, and 2029, respectively. High and Intermediate risk may not be capped in place but instead must be de-watered, excavated and relocated to lined landfills or recycled toward a beneficial use such as concrete production or roadway construction. Depending on what final plan is accepted, the total cost could increase to as high as $7B-$10B.

Regarding the final EPA regulations on Coal Combustion Residuals (CCR), we do not think costs incurred under the more stringent NC state legislation would increase under the federal rules.

Capital or expense treatment?

How is this investment to be treated? We think the bulk of the spend will be treated as a capital investment (i.e.- eligible for ratebase treatment), rather than O&M or simply a decommissioning liability. Today, much of the recovery for future coal ash liabilities is accounted for under 'Cost of Removal' accounting as a D&A line item (at least for Progress' current ratemaking purposes).While some legislative proposals have suggested some spend could be disallowed, <u>we believe the spend entailed in remediating ponds is largely as a result of a shift in policy</u> towards a more stringent standard, rather than a failure to address current standards (notwithstanding the failure of the pipe at Dan River).

Our bias is to believe this will be treated as capital rather than O&M spending.

Further Considerations

Grand jury probe into Dan River a lingering risk

A federal grand jury investigation into the Dan River spill remains a lingering risk (although management has already indicated modest impact to clean up already, with insurance addressing the balance). Given documented concerns around the adequacy of the integrity of this pipe dating back some time, we see the potential for further costs arising from the spill. The timeline for the investigation remains unclear, but the company and other agencies have been subpoenaed.

What about rate recovery? No rate cases for foreseeable future

Despite the added spend from coal ash, we think timing of any further cases in the Carolinas will be predicated primarily on reflecting the forthcoming Lee CCGT, with completion in November 2017. We believe much of the spend under any gas pipeline or solar needs will likely have rate recovery mechanisms reflected in any construct approved.

Where the current official capex plan stands:

In February 2014, DUK outlined a total $38B capital budget from 2014-2018, which included $4B of "discretionary" budget (unspecified projects). So far, $1.2B of this discretionary spend (30%) has been applied toward the purchase of the North Carolina Eastern Municipal Power Agency's (NCEMPA) minority ownership in ~700 MW of existing Duke Energy progress nuclear and scrubbed coal plants, including the Harris Nuclear Plant, Brunswick Nuclear Plant, Roxboro Steam Plant Unit 4 and the Mayo Plant. The deal includes a 30-year full-requirements load serving contract and is required to close by yearend 2016 after approvals from FERC, DoJ, NRC, and Carolina regulators. <u>We see the potential for the timing of this acquisition to be accelerated, aiding in the company's deployment of cash, and driving up 2016 EPS.</u>

Projects within the budget but yet to be finalized and priced out include the NC pipeline and additional commercial renewable projects.

NCEMPA timing is a key lever for cash flow deployment

The key question into the annual capex update in February (and long-term EPS guidance expectations) remains to what extent the company will revise its overall budget higher – or if this 'discretionary' budget. Moreover, the question will be to what extent management 'rolls forward' this budget to 2015-19 (with a correspondingly large white space).

<u>New Generation ($6B-$8B)</u>: Total spending on new generation projects is currently projected at $6B-$8B from 2014-1018, with $6.1B of projects specified thus far (including ~$2B of renewables and the $1.2B purchase from NCEMPA). Additional commercial renewable projects are possible as part of the remaining

$2.8B discretionary budget. We believe renewables are also a good candidate for reinvestment of repatriated cash from the International segment as well (beyond the discretionary budget).

Beyond this disclosed capex, management stated it continues to forecast ~300 MW/yr of demand growth across its Carolinas service territory. This would suggest a need for a further CCGT every couple years (the driver to the top end of the range through the forecast period).

Infrastructure ($7B-$9B): Management has guided to $7B-$9B of spending here, with $5.5B previously identified for grid modernization, new customer additions, and commercial transmission projects. Another ~$1.9B applies to Duke's 40% stake in the $4.5B-$5B Atlantic Coast Pipeline project, with approximately $900M remaining in the "discretionary budget" category. The next step for the Atlantic Coast Pipeline project in partnership with Dominion is to file the FERC application in summer or fall of 2015. Construction would begin in summer or fall of 2016 after receipt of a CPCN, with the pipe in service in Nov 2018. In considering possible future ratebase growth beyond the current plan, eventually generation construction in Indiana, such as a CCGT in 2020+, is likely to follow the current transmission build under SB 560 (supportive of 4%-6%).

Compliance & Other ($3B): Guidance for this group is ~$3B in total, including previously identified amounts for EPA compliance ($1.9B) and NRC Fukushima-related safety compliance ($1.3B).

Figure 7: Growth Capital Expenditures, 2014E-2018E

Growth Capital Expenditures 2014E - 2018E ($M)	
New Generation growth	
Florida CC/CT	$1,850
Other Florida	$225
Lee CCGT in SC	$600
Regulated Solar	$1,000
Commercial Renewable	$1,200
Commercial Renewable (discretionary) *	NA
NCEMPA purchase *	$1,200
Total specified projects	$6,075
Category Guidance	$6B-$8B
Infrastructure growth	
Grid Modernization/T&D/SB560	$2,375
SB560 Indiana T&D	*~$1.5B-$2.0B over 7 yrs*
New Customer Connections	$2,400
Commercial Transmission	$700
Atlantic Coast Pipeline (40% stake) *	$1,900
Total specified projects	$7,375
Category Guidance	$7B-$9B
Compliance growth	
EPA regs	$1,900
NRC Fukushima regs	$1,300
Total specified projects	$3,200
Category Guidance	~$3B
Other growth	
Major Nuclear Upgrades	$1,300
Other	$1,100
Total specified projects	$2,400
Total specified growth projects	$19,050
Remaining Discretionary Growth Budget *	$900
Growth investment guidance 2014-2018	$16B-$20B
* Draws from $4B "Discretionary Growth" budget	

Source: Company filings, UBS Estimates

Figure 8: Non-Growth Capital Expenditures, 2014E-2018E

Non-Growth Capital Expenditures 2014E - 2018E ($M)	
Non-growth CAPEX	
Nuclear Fuel	$2,700
Regulated Maintenance	$14,975
Midwest Gen	$125
International	$300
Total specified projects	$18,100
Total Growth & Non-Growth	$38,050
Total 2014-2018 CAPEX Guidance	$34B-$38B
Environmental 2014-2023	
Air (25%), Water (25%), Waste (50%)	$4.5B-$5.5B
Baseline NC ash basin	$500
Ultimate ash cost range	$1.0B-$10.0B

Source: Company filings, UBS Estimates

Resolution around coal is constructive – and upside to capex budget

We reiterate our view on shares reaching an 'inflection' point

Separate from the growth categories above, the company has also projected $4.5B-$5.5B of environmental spending over the next 10 years through 2023. This is separated into three buckets; 25% air pollution controls, 25% water, and 50% waste management, including coal ash ponds and conversion. This amount includes a $500M placeholder for baseline NC coal ash remediation, including excavation of coal ash at Dan River, Riverbend and Sutton to a new, lined landfill or structural fill solution. However, as discussed above, the $3.5B ARO more recently recorded is a better indication of where management believe required investment will land. As a range of possibilities, there is potential for this bill to inflate by $1.0B-$1.5B for a "hybrid cap in place" at 10 remaining sites to $7B-$10B for an "all-dry systems" solution. DUK's baseline assumption is a $2.0B-$2.5B plan that includes dry bottom ash handling & fly ash reliability improvements as well as moving three sites to new, lined structural fills or landfills while continuing the Asheville structural fill and converting remaining units to dry fly ash.

We *don't* see the latest release of the CCR (Coal Combustion Residual) regulations by Federal EPA as having a meaningful impact vs. its current plans. Having already inspected its sites following the Dan River spill earlier this year, we don't necessarily expect any significant revisions around its views on structural integrity – and need to spend to meet tighter federal standards. Rather, we continue to await the corresponding effluent guidelines (which have a more material impact – as this would require retrofits of existing plants).

But what are the relevant implications from federal coal ash regs on Duke?

We see risks around state-federal coordination in the final CCR regulations as particular noteworthy, raising risks around potential for citizen suits against more of Duke's assets. We suspect the 'next round' of coal ash battles will largely migrate by 2016 to specific sites as groups take companies to task on discrete compliance items, away from a more holistic approach across states, etc

Duke still evaluating possible purchase of 600-MW Osprey CCGT from Calpine

Developments are slow going, but the interim contract was already approved and in place

In Florida, the company has $1.85B of new CCGTs and peakers to be in service by 2018, including the 1,640-MW Citrus CCGT, the 220 MW uprate at Hines, and a decision to make between Calpine's Osprey plant or 320 MW of CTs at Suwannee. The decision between Osprey and Suwannee is expected to fall mostly on final cost to the customer, with Osprey's lower heat rate offset with higher transmission build requirements. We see an acquisition as largely a win-win for both Calpine and Duke, putting to rest broader scrutiny of new resource needs by FL.

Still waiting on a deal

While a deal has yet to be formally inked, regulatory filings indicate Calpine lowered its offer price for the plant following recent media scrutiny of DUK's plan to build new peakers instead of contracting for the relatively new (2004), existing plant. (Docket 140111). In May 2014, the plant's current PPA expired and we estimate a new PPA (likely which took effect this fall), likely in the ~$3/kW-month range, backing into a limited (~$10 Mn/yr) EBITDA contribution. In turn, we suspect an eventual asset sale at PPA termination of ~$300/kW (or ~$200Mn) a discount vs. the implied $449/kW for the latest southeast portfolio sold by Calpine, but necessary to make the economics , and while we see upside to our initial estimate, we see an implied EV/EBITDA into the teens.

Florida concerns put to rest as well. Following November's election results, we see the *defeat* of Charlie Crist as governor as a *positive datapoint* for the state's overall utility paradigm (and for Duke as well), following a more challenged period in 2009 under his last stint as Governor. We see timing of any resolution in Florida as less pertinent following

Renewables: Gaining More Clarity in 2015

Solar in the Carolinas coming too

We see Duke's solar efforts as fitting into a broader strategic positioning to capture the solar opportunity via ratebase in its service territory

Regarding solar, with the 300 MW RFP in North Carolina complete ($500M, half PPAs and half ratebase), the hook-up queue should clear, but there is the possibility of another RFP to meet the 12.5% renewable portfolio standard by 2020. In South Carolina, new legislation allows the utility to participate in distributed solar, with a potential 150 MW investment for DEC and DEP by 2021. Staff there is working toward a settlement to move forward with a solar goal of 3% of peak load (both distributed and utility-scale).About 1/3 would be ratebased. There are no tax credits in the state and there is no RPS either. In Florida, DUK intends to follow FP&L's lead on any possibility of adding distributed solar to ratebase, being especially cautious given DEP's higher rates as a result of nuclear costs. The company is not active in pushing for any legislation in this regard.

<u>Staying vigilant on the net metering theme too:</u> We suspect headlines in 2015 to drive some modest focus on solar net metering concerns around rooftop programs, particularly in NC and SC. We don't see this issue as relevant in FL for the time being, seeing an eventual opportunity to put in place some modest capex.

DUK acquires 3 solar projects adding to 128MW; signed PPAs for another 150MWs spread over 5 projects

Duke announced plans to acquire and build three solar projects totalling 128MW in Bladen, Duplin and Wilson counties, North Carolina. They also signed PPAs for five other new solar projects totalling 150MW in the state. The company has allocated $500mn for all eight of these projects. Duke currently has a 300MW RFP in North Carolina and is able to invest in up to 150MW of projects in South Carolina by 2021 through the current legislation.

Sharing with YieldCo's? We see large-cap efforts as aimed at eventual exit

We see yieldco's as good complements

We see Duke's latest efforts in solar (alongside Dominion and Southern) as all geared towards extracting EPS benefits in the current year from recognition of ITC tax credits – and subsequently monetizing the assets in 5-years (following the expiration of tax recapture windows associated with taking the ITC as well as MACRS depreciation cash tax impacts). We emphasize solar assets tend to generate quite limiting EPS beyond their initial year, suggesting limited value to the overall story seeing utilities trade very narrowly on a P/E basis.

<u>*But how does this play out today?*</u> We see an opportunity for Duke among other large-cap utilities to partner with YieldCo's to effectively 'commit' their assets in eventual ROFO deals down to YieldCo structures. While we're not counting on such a deal to be necessarily announced this year – we suspect each large-cap company to begin articulating similar strategies in this vein. Recall that Pattern Energy, PEGI, signed a services agreement with Duke earlier this year.

Expanding its contracted wind efforts: More wind in Texas too?

Ramping up wind side too

Earlier this year, Duke had also announced its plans to build and operate a 110MW wind farm in Texas at the Los Vientos wind farm. The new capacity will be sold under a 25-year PPA to Garland Power & Light and other local municipalities. Upon expected completion in 2H15, Duke will have 912MW of capacity at its Los Vientos I-V projects in Texas and over a 2.1GW wind portfolio.

We continue to expect DUK's management to continue to push forward on ~2bn renewables investments at its utilities in both NC and SC in the 2014-18 period – split between Commercial Renewables (previously disclosed to be $1.2bn of the investment) and regulated solar (we estimate at $1bn based on previous disclosures).

Lingering Risks?

Some more uncertainty at Edwardsport

Duke could face recoverability issues around Edwardsport financing costs related to project delays.

In September, the Indiana Court of Appeals ruled that the Indiana Utility Regulatory Commission (IURC) must reconsider its 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. The rate increase had been authorized as part of the rider that allows costs related to the IGCC plant to be reflected in Duke's rate base outside of a base rate case. Previously we had highlighted the risks associated with underperformance from Edwardsport this winter; however, it appears that the unit has run with far fewer issues lately and is meeting management's expectations.

This ruling does not say that the IURC must reverse its rate-increase decision, but only that it should review and reconsider it. Nonetheless, it does throw in an element of further uncertainty and raises the perception of recovery related risk. The ruling may also translate into a deeper scrutiny during review of Duke's IGCC 12 and 13 rider dockets (which are combined to a single docket with) for which hearings are scheduled for February with a final order expected in 1H15. DUK also filed IGCC 14 on Dec 23 for costs through Sept 2014.

Conversion of post-in-service O&M to capitalized cost may trigger additional writedowns

The IURC had earlier shifted its review of the plant's in-service declaration and subsequent use of power (to power the gasifier) when output was zero ("net negative generation") into the combined IGCC 12/13 docket, rather than review this as a sub-docket of the fuel adjustment clause FAC-99. Previously we earlier highlighted that an important consequence of such a move had been that the review of net negative generation would include the costlier winter months within a full-year timeframe. Rather than risks around capital cost recovery, the focus has rather been on recovery of O&M and purchased power since the June 2013 in-service declaration. One argument being advanced by challengers is that purchased power for the plant appears much larger than the usual "negative generation" seen in other much smaller plants, such as spinning reserves. The larger scale of costs is 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 rather than deferred for cash recovery as O&M.

The plant's total expected cost is currently $3.55B, for which the company has already written down $900M, with max recovery capped through the IGCC riders to $2.65B. While the current level of capital spending has yet to exceed the company's $3.55B budget (it's very close though). Along with an additional risk of the IURC possibly reversing its April 2013 decision after the Indiana Court of Appeals ruling last week to review (the IURC does indeed also have the option to not change its rate increase decision after review), we note that any conversion of post-in-service O&M to capitalized cost as a result of the IGCC12/13 review in November could trigger additional writedowns.

Duke Energy (DUK.N)

Income statement (US$m)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
Revenues	**14,529**	**19,624**	**24,598**	**25,055**	*1.9*	**25,276**	*0.9*	**26,064**	**26,822**	**27,447**
Gross profit	9,384	12,056	15,414	16,235	*5.3*	16,539	*1.9*	17,252	17,932	18,478
EBITDA (UBS)	**5,499**	**7,315**	**8,693**	**9,428**	*8.5*	**9,768**	*3.6*	**10,293**	**10,769**	**11,103**
Depreciation & amortisation	(1,806)	(2,289)	(2,808)	(2,974)	*5.9*	(2,999)	*0.9*	(3,129)	(3,332)	(3,427)
EBIT (UBS)	**3,693**	**5,026**	**5,885**	**6,454**	*9.7*	**6,769**	*4.9*	**7,164**	**7,437**	**7,676**
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	(859)	(1,242)	(1,546)	(1,656)	*-7.1*	(1,726)	*-4.2*	(1,837)	(1,856)	(1,874)
Exceptionals (incl goodwill)	0	0	0	0	-	0	-	0	0	0
Profit before tax	**2,834**	**3,784**	**4,339**	**4,799**	*10.6*	**5,043**	*5.1*	**5,328**	**5,581**	**5,802**
Tax	(885)	(1,290)	(1,261)	(1,572)	*-24.6*	(1,717)	*-9.2*	(1,812)	(1,927)	(2,003)
Profit after tax	**1,949**	**2,494**	**3,078**	**3,227**	*4.8*	**3,326**	*3.1*	**3,515**	**3,655**	**3,799**
Preference dividends	0	0	0	0	-	0	-	0	0	0
Minorities	(4)	(14)	(11)	(11)	*0.0*	(11)	*0.0*	(11)	(11)	(11)
Extraordinary items	(235)	(715)	(416)	(926)	*-122.4*	0	-	0	0	0
Net earnings (local GAAP)	**1,710**	**1,765**	**2,651**	**2,290**	*-13.6*	**3,315**	*44.8*	**3,504**	**3,644**	**3,788**
Net earnings (UBS)	**1,945**	**2,480**	**3,067**	**3,216**	*4.9*	**3,315**	*3.1*	**3,504**	**3,644**	**3,788**
Tax rate (%)	31.2	34.1	29.1	32.8	*12.7*	34.0	*3.9*	34.0	34.5	34.5

Per share (US$)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
EPS (UBS, diluted)	4.38	4.32	4.35	4.55	*4.7*	4.70	*3.4*	4.97	5.17	5.37
EPS (local GAAP, diluted)	3.85	3.08	3.76	3.24	*-13.8*	4.70	*45.2*	4.97	5.17	5.37
EPS (UBS, basic)	4.38	4.32	4.35	4.55	*4.7*	4.70	*3.4*	4.97	5.17	5.37
Net DPS (US$)	2.97	3.03	3.09	3.16	*2.3*	3.24	*2.5*	3.32	3.42	3.54
Cash EPS (UBS, diluted)[1]	8.44	8.31	8.32	8.76	*5.2*	8.96	*2.3*	9.41	9.89	10.23
Book value per share	51.47	58.07	58.65	58.67	*0.0*	60.33	*2.8*	62.00	63.76	65.62
Average shares (diluted)	444.20	573.92	705.75	707.00	*0.2*	705.00	*-0.3*	705.00	705.00	705.00

Balance sheet (US$m)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
Cash and equivalents	2,110	1,424	1,501	1,186	*-21.0*	1,734	*46.3*	2,203	3,015	4,069
Other current assets	4,770	8,698	9,015	10,746	*19.2*	10,773	*0.2*	11,025	11,269	11,478
Total current assets	**6,880**	**10,122**	**10,516**	**11,932**	*13.5*	**12,507**	*4.8*	**13,228**	**14,284**	**15,547**
Net tangible fixed assets	42,661	68,558	69,490	72,256	*4.0*	74,837	*3.6*	77,288	79,536	81,688
Net intangible fixed assets	3,849	16,365	16,340	16,340	*0.0*	16,340	*0.0*	16,340	16,340	16,340
Investments / other assets	9,136	18,811	18,433	18,433	*0.0*	18,433	*0.0*	18,433	18,433	18,433
Total assets	**62,526**	**113,856**	**114,779**	**118,961**	*3.6*	**122,117**	*2.7*	**125,289**	**128,593**	**132,008**
Trade payables & other ST liabilities	3,480	6,174	5,701	7,605	*33.4*	7,548	*-0.8*	7,670	7,802	7,937
Short term debt	2,048	3,855	2,943	3,029	*2.92*	2,901	*-4.23*	2,901	2,901	2,901
Total current liabilities	**5,528**	**10,029**	**8,644**	**10,634**	*23.0*	**10,449**	*-1.7*	**10,571**	**10,703**	**10,838**
Long term debt	18,679	36,351	38,152	38,657	*1.3*	39,595	*2.4*	40,033	40,471	40,909
Other long term liabilities	15,454	26,442	26,575	28,189	*6.1*	29,544	*4.8*	30,977	32,465	34,001
Preferred shares	0	93	0	0	-	0	-	0	0	0
Total liabilities (incl pref shares)	**39,661**	**72,915**	**73,371**	**77,480**	*5.6*	**79,587**	*2.7*	**81,582**	**83,639**	**85,748**
Common s/h equity	22,865	40,941	41,408	41,481	*0.2*	42,530	*2.5*	43,707	44,954	46,260
Minority interests	0	0	0	0	-	0	-	0	0	0
Total liabilities & equity	**62,526**	**113,856**	**114,779**	**118,961**	*3.6*	**122,117**	*2.7*	**125,289**	**128,593**	**132,008**

Cash flow (US$m)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
Net income (before pref divs)	1,710	1,765	2,651	2,290	*-13.6*	3,315	*44.8*	3,504	3,644	3,788
Depreciation & amortisation	1,806	2,289	2,808	2,974	*5.9*	2,999	*0.9*	3,129	3,332	3,427
Net change in working capital	(294)	(63)	(921)	173	-	(84)	-	(129)	(113)	(73)
Other operating	(90)	330	1,200	1,614	*34.5*	1,355	*-16.0*	1,433	1,488	1,536
Operating cash flow	**3,132**	**4,321**	**5,738**	**7,051**	*22.9*	**7,586**	*7.6*	**7,937**	**8,351**	**8,678**
Tangible capital expenditure	(4,363)	(5,501)	(5,526)	(5,740)	*-3.9*	(5,580)	*2.8*	(5,580)	(5,580)	(5,580)
Intangible capital expenditure	0	0	0	0	-	0	-	0	0	0
Net (acquisitions) / disposals	(51)	(451)	0	0	-	0	-	0	0	0
Other investing	30	(239)	629	0	-	0	-	0	0	0
Investing cash flow	**(4,384)**	**(6,191)**	**(4,897)**	**(5,740)**	*-17.2*	**(5,580)**	*2.8*	**(5,580)**	**(5,580)**	**(5,580)**
Equity dividends paid	(1,329)	(1,752)	(2,188)	(2,228)	*-1.8*	(2,284)	*-2.5*	(2,341)	(2,411)	(2,496)
Share issues / (buybacks)	67	23	9	0	-	0	-	0	0	0
Other financing	(627)	(773)	(1,137)	(1,113)	*2.07*	(1,139)	*-2.30*	(1,212)	(1,215)	(1,228)
Change in debt & pref shares	2,500	1,950	933	591	*-36.66*	810	*37.06*	438	438	438
Financing cash flow	**611**	**(552)**	**(2,383)**	**(2,750)**	*-15.4*	**(2,613)**	*5.0*	**(3,115)**	**(3,189)**	**(3,285)**
Cash flow inc/(dec) in cash	**(641)**	**(2,422)**	**(1,542)**	**(1,440)**	*6.7*	**(608)**	*57.8*	**(757)**	**(418)**	**(188)**
FX / non cash items	1,081	1,736	1,619	1,124	*-30.6*	1,156	*2.8*	1,226	1,229	1,242
Balance sheet inc/(dec) in cash	**440**	**(686)**	**77**	**(315)**	-	**549**	-	**469**	**812**	**1,054**

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)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
P/E (local GAAP, diluted)	14.8	21.0	18.5	25.9	17.9	16.9	16.3	15.6
P/E (UBS, diluted)	13.0	14.9	16.0	18.5	17.9	16.9	16.3	15.6
P/CEPS	6.7	7.8	8.3	9.6	9.4	8.9	8.5	8.2
Equity FCF (UBS) yield %	(4.9)	(3.2)	0.4	2.2	3.4	4.0	4.7	5.2
Net dividend yield (%)	5.2	4.7	4.5	3.8	3.9	4.0	4.1	4.2
P/BV x	1.1	1.1	1.2	1.4	1.4	1.4	1.3	1.3
EV/revenues (core)	2.9	3.4	3.6	4.0	4.0	3.8	3.0	3.0
EV/EBITDA (core)	7.7	9.0	10.1	10.5	10.2	9.7	7.6	7.3
EV/EBIT (core)	11.5	13.1	15.0	15.4	14.8	14.0	11.0	10.6
EV/OpFCF (core)	11.5	13.1	15.0	15.4	14.8	14.0	11.0	10.6
EV/op. invested capital	1.4	1.4	1.4	1.6	1.6	1.5	1.2	1.2

Enterprise value (US$m)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Market cap.	24,957	37,120	48,931	59,339	59,339	59,339	59,339	59,339
Net debt (cash)	17,579	28,746	39,235	40,047	40,631	40,746	40,544	40,544
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	**42,535**	**65,866**	**88,166**	**99,386**	**99,970**	**100,086**	**99,883**	**99,883**
Non core assets	0	0	0	0	0	0	(18,433)	(18,433)
Core enterprise value	**42,535**	**65,866**	**88,166**	**99,386**	**99,970**	**100,086**	**81,450**	**81,450**

Growth (%)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Revenue	1.8	35.1	25.3	1.9	0.9	3.1	2.9	2.3
EBITDA (UBS)	3.3	33.0	18.8	8.5	3.6	5.4	4.6	3.1
EBIT (UBS)	4.4	36.1	17.1	9.7	4.9	5.8	3.8	3.2
EPS (UBS, diluted)	2.3	-1.3	0.6	4.7	3.4	5.7	4.0	4.0
Net DPS	2.1	1.9	2.0	2.3	2.5	2.5	3.0	3.5

Margins & Profitability (%)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Gross profit margin	64.6	61.4	62.7	64.8	65.4	66.2	66.9	67.3
EBITDA margin	37.8	37.3	35.3	37.6	38.6	39.5	40.2	40.5
EBIT margin	25.4	25.6	23.9	25.8	26.8	27.5	27.7	28.0
Net earnings (UBS) margin	13.4	12.6	12.5	12.8	13.1	13.4	13.6	13.8
ROIC (EBIT)	11.7	10.8	9.5	10.2	10.5	10.9	11.2	11.4
ROIC post tax	8.1	7.1	6.8	6.9	7.0	7.2	7.3	7.5
ROE (UBS)	8.5	7.8	7.4	7.8	7.9	8.1	8.2	8.3

Capital structure & Coverage (x)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Net debt / EBITDA	3.4	5.3	4.6	4.3	4.2	4.0	3.7	3.6
Net debt / total equity %	81.4	95.0	95.6	97.6	95.8	93.2	89.8	85.9
Net debt / (net debt + total equity) %	44.9	48.7	48.9	49.4	48.9	48.2	47.3	46.2
Net debt/EV	43.8	59.0	44.9	40.8	40.8	40.7	49.5	48.8
Capex / depreciation %	NM	NM	196.8	193.0	186.0	178.3	167.5	162.8
Capex / revenue %	NM	28.0	22.5	22.9	22.1	21.4	20.8	20.3
EBIT / net interest	4.3	4.0	3.8	3.9	3.9	3.9	4.0	4.1
Dividend cover (UBS)	1.5	1.4	1.4	1.4	1.5	1.5	1.5	1.5
Div. payout ratio (UBS) %	67.9	70.1	71.1	69.5	68.9	66.8	66.2	65.9

Revenues by division (US$m)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Others	14,529	19,624	24,598	25,055	25,276	26,064	26,822	27,447
Total	**14,529**	**19,624**	**24,598**	**25,055**	**25,276**	**26,064**	**26,822**	**27,447**

EBIT (UBS) by division (US$m)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Others	3,693	5,026	5,885	6,454	6,769	7,164	7,437	7,676
Total	**3,693**	**5,026**	**5,885**	**6,454**	**6,769**	**7,164**	**7,437**	**7,676**

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

Forecast returns

Forecast price appreciation	+7.1%
Forecast dividend yield	3.8%
Forecast stock return	+10.9%
Market return assumption	5.7%
Forecast excess return	+5.2%

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.	47%	37%
Neutral	FSR is between -6% and 6% of the MRA.	42%	32%
Sell	FSR is > 6% below the MRA.	11%	21%
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 31 December 2014.
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, 6, 16]	DUK.N	Buy	N/A	US$84.05	02 Jan 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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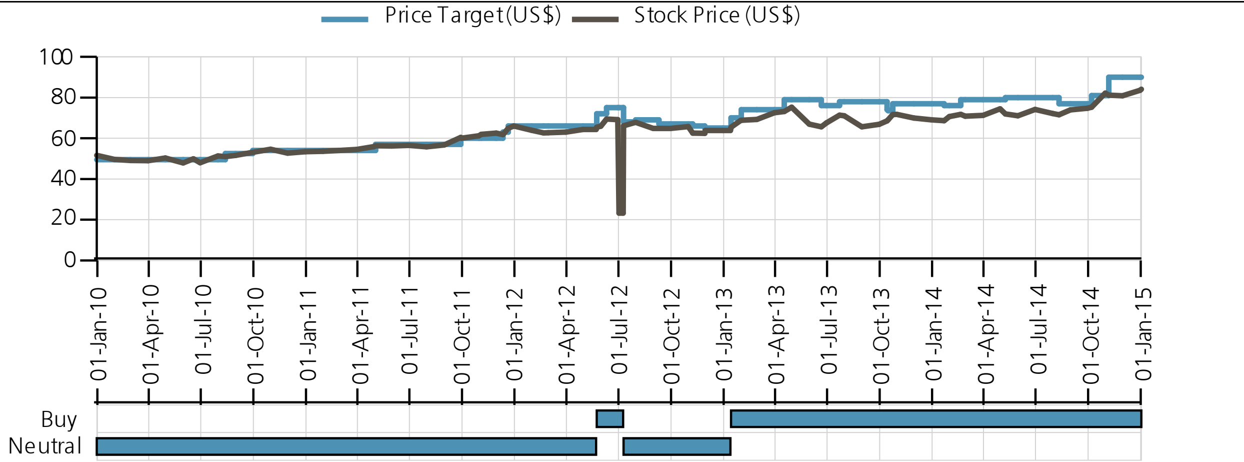
Duke Energy (US$)



Source: UBS; as of 02 Jan 2015

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