Company Overview

Duke's utilities provide regulated electric and gas service to more than 7 million customers in North Carolina, South Carolina, Florida, Ohio, Kentucky and Indiana.

Primary Subsidiaries Include

- Progress Energy
- Duke Energy Carolinas
- Duke Energy Indiana
- Duke Energy Ohio
- Various Affiliates Issuing Tax-Exempt Bonds on behalf of Duke and its subsidiaries.

Parent Credit Ratings

- Moody's: Baa1/Stable
- S&P: A-/Stable
- Fitch: BBB+/Stable

Financial Data

- Debt/Capital: 57%

U.S. Recommended Corporate Bond Sector Weightings

- Financial (30%-45%)
- Utilities (10%-25%)
- Industrial (35%-55%)

U.S. Recommended Bond Ladder

- Short-term (up to 5 years) 30%-40%
- Intermediate-term (6-15 years) 40%-50%
- Long-term (16+ years) 15%-25%

Appropriate for Income

Recommendation

We consider bonds of Duke Energy (and its subsidiaries) to be an appropriate holding for Edward Jones clients who seek Income as an objective within a well-diversified portfolio.

Edward Jones Credit Strength Assessment

Investment Summary

The majority of Duke's earnings are produced by the company's regulated businesses, and the company has a lengthy track record of solid performance. Duke also possesses a leveraged but solid balance sheet, a robust capital-spending program (which leads to an expanding rate base, and thus, future earnings power), and the ability to raise both debt and equity capital to fund its growth. In our view, Duke operates in a number of states that have some of the most constructive regulatory environments, including North Carolina, Florida and Indiana. We believe Duke is a sound corporate credit with the ability to meet its current and future debt obligations.

Bond Strengths

- We believe Duke's business model, which consists primarily of several regulated utilities and International Energy (nonregulated generation), will enable Duke to continue to produce consistent cash flows.
- Duke has a robust capital-spending program that will likely add to the company's asset, or rate, base. A utility is allowed to earn a specified return on its rate base.
- Duke is financed relatively conservatively given the stability of its cash flow, which we view as a positive for bondholders. Major debt-rating agencies have assigned the company's debt investment-grade ratings.
- For utilities, obtaining reasonable allowed returns and raising capital to run the business are key success factors. Duke operates in states that are considered friendly toward utilities, and the company has a lengthy history of raising capital in the debt market.

Bond Weaknesses

- Although a utility earns a return on its rate base, Duke's increased capital spending over the next several years could lead to a higher debt ratio and possibly a weaker financial position.
- Duke has over $50 billion in debt, compared with a recent cash balance of roughly $400 million.
- Duke will probably have to raise additional capital over the next several years, as increasing capital expenditures will likely be higher than cash flows generated by operations.
Recent News and Analysis

2/14/19: Duke Energy posted fourth-quarter operating EPS of $0.84, which was below the $0.89 analyst consensus estimate and down $0.94 from the fourth quarter of 2017. The company provided 2019 EPS guidance in a range of $4.80 to $5.20. The $5.00 midpoint of the guidance exceeds the current $4.95 analyst consensus estimate. This was a decent quarter for Duke overall, in our view. Earnings were down from the fourth quarter of 2017 primarily due to higher depreciation expenses because of the growth the company is pursuing and higher storm-related costs. The company has been seeing solid customer growth, especially in its service territories in the Carolinas and Florida. The company is embarking on a significant capital-spending program in coming years. This spending is expected to lead to growth in earnings as the company ultimately earns a return on the assets added to its utility systems. Duke issued equity earlier this year to help fund these capital-spending plans. We view this favorably because it shows the company’s commitment to maintaining a strong financial position. From a bondholder's perspective, we like the direction in which Duke is moving as it transitions toward becoming a company that earns nearly all of its income from regulated utility operations. These earnings tend to be less volatile and, therefore, are more supportive of continued payment of interest and principal on bonds. Duke’s debt-to-total-capitalization ratio stands at 57%. We see this as a reasonable level for a company that derives nearly all of its earnings from regulated utility operations. We continue to consider bonds of Duke Energy (and its subsidiaries) to be an appropriate holding for Edward Jones clients who seek Income as an objective within a well-diversified portfolio.

Company Outlook

Duke's Business Segments Provide Geographic Diversification

U.S. Franchised Electric and Gas – These consist of the company’s core electric and natural gas utilities in North and South Carolina, Florida, Indiana, Ohio and Kentucky. We expect this regulated core business to continue to generate the majority of earnings. We see Duke’s relatively stable earnings and cash flow being generated mainly by this segment, with growth coming from customer growth and new investments in power plants, transmission and distribution lines, and environmental compliance projects.

Duke Energy International – Duke has reduced its International exposure in recent years by selling its Central and South American power-generation assets. Duke’s primary International asset is now a 25% equity investment in National Methanol Company (Saudi Arabia).

Duke Positioned to Partake in Industry Growth – We expect Duke to grow its rate base significantly over the next several years. With continued investments in environmental projects, maintaining and upgrading transmission and distribution lines, and retrofits of existing power plants, Duke has embarked on several major upgrade projects that will take years to complete and will add to the company’s rate base. Overall, we expect Duke to spend over $10 billion on capital projects in 2018. (Please see Figure 1 for capital spending figures.) In addition to elevated capital spending, we believe Duke’s growth will be aided by reasonable customer growth in its service area and ongoing cost-containment efforts.

Figure 1

Duke Energy Capital Expenditures

Source: Company reports, Edward Jones

Relationships With Regulators – Duke operates regulated utilities in North Carolina, South Carolina, Florida, Indiana, Ohio and Kentucky. Overall, we view the company’s regulatory environment as generally supportive. We view North Carolina, Florida and Indiana as particularly constructive regulatory environments, and we are encouraged that roughly 75% of Duke’s customers are in these three states.

Following the Progress Energy merger, there had been uncertainty regarding Duke’s relationship with the North Carolina Utilities Commission, which was related to the resignation of Bill Johnson, Progress Energy’s CEO, who was picked to lead the combined company, and his replacement by Duke’s CEO Jim Rogers. However, constructive settlements with the North Carolina Public Staff on rate cases at both Duke Energy Carolinas and Duke Energy Progress have eased some of our concern related to this. Overall, we view Duke’s regulatory environment across the states in which it operates electric and gas utilities as quite strong.

Strong Credit Rating Supported by Healthy Cash Flow – Duke’s attractive credit rating enables it to continue to externally finance its capital expenditures by issuing debt. In 2017, Duke generated cash flow from operations of $7 billion. (Please Figure 2.) The company spends a significant amount on capital expenditures, and we expect this to persist for the foreseeable future as it maintains and modernizes its transmission and distribution network and adds generation capacity, especially on the "clean energy" front (renewables). Despite this ongoing investment, Duke has produced sufficient cash flows to pay a dividend for over 90 consecutive years.

Figure 2
Moving Toward a More Regulated Business Mix - Duke has made a decision to move its business mix almost entirely to the operation of regulated utilities. Transactions that have contributed to this include the sale of its Midwest generation business, the sale of its Central and South American businesses, and the purchase of Piedmont Natural Gas (which was primarily regulated). While the company has taken on some additional debt in these transactions, we view this move toward a heavier mix of regulated businesses as favorable for bondholders.

Industry Outlook

Our outlook for the electric utility sector is positive overall, with an improved growth outlook relative to the recent past. This improved outlook primarily reflects our expectations for more spending on utility infrastructure after many years of neglect. The need for additional power plants and transmission lines appears great, and we expect this need will continue for many years to come. Some estimates suggest the costs to update and expand the nation's utility infrastructure could be several hundreds of billions of dollars over the next two to three decades.

Additionally, environmental concerns resulting from the issue of global warming are driving increased spending to reduce emissions from existing power plants. Investments in renewable energy (especially wind and solar power), new nuclear plants and modifications to existing coal-fired plants are proving to be quite costly. As utilities spend on infrastructure and environmental needs, they can earn a regulated return on the invested capital. As a result, earnings can grow faster than they otherwise would.

Financial Strength

We believe Duke's financial condition is solid. The company weathered the storm of the most recent recession relatively unscathed, with no material decline in cash flows. Duke finished 2017 with roughly $400 million of cash on its balance sheet and a debt-to-total-capitalization ratio of 57%. We see this as a reasonable level for a company that derives nearly all of its earnings from regulated utility operations. Duke has not experienced any problems raising new debt or rolling over existing debt in the credit markets. We expect continued healthy capital spending to maintain and upgrade current transmission and distribution infrastructure, and to finance retrofits and construction of new power plants. We also expect Duke will continue to increase its dividend to shareholders.

Duke Subsidiary Municipal Bond Offerings – Duke is permitted to offer tax-free municipal bonds through affiliates. It and its subsidiaries have issued several of these bonds. They are not explicitly listed as Duke bonds, but are obligations of the company's operating subsidiaries, may be secured by a pledge of revenues, and are typically rated equal to or slightly higher than Duke's corporate debt by rating agencies.

Edward Jones Credit Strength Assessment

We believe Duke Energy's credit strength assessment is above average. This is due primarily to the relatively stable nature of its earnings stream that comes primarily from regulated utilities that operate in states with favorable regulatory environments.
Required Research Disclosures

The table lists the percent of corporate credits we follow globally in each of the equivalent rating categories. We do not assign a "Buy" rating to any corporate credits. Investment banking services indicate the percentage of those subject companies that have been investment banking clients within the last 12 months.

<table>
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<th>February 14, 2019</th>
<th>BUY</th>
<th>HOLD</th>
<th>SELL</th>
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<tr>
<td>Corporate Credits</td>
<td>0%</td>
<td>85%</td>
<td>15%</td>
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<tr>
<td>Investment Banking</td>
<td>0%</td>
<td>21%</td>
<td>0%</td>
</tr>
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Appropriate for Income – We consider bonds to be an appropriate holding for investors seeking income within a well-diversified portfolio. Our time horizon is 3-5 years.

Appropriate for Aggressive Income – We consider bonds appropriate only as a small Aggressive Income portion within a well-diversified portfolio. Bonds within this category are riskier, with a higher possibility of loss due to default, than bonds classified as Income. Our time horizon is 3-5 years.

Sell – We recommend investors sell these bonds. We believe these bonds are no longer an appropriate fixed-income holding because, in our opinion, they offer an unattractive risk/reward scenario at current prices. Our time horizon is 3-5 years.

FYI: For informational purposes only; factual, no opinion.

Initiated Coverage (Appropriate for Income) 12/22/10

Analyst Certification

- I certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers; and no part of my compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in the research report. Mike Doyle, CFA

- Analysts receive compensation that is derived from revenues of the firm as a whole which include, but are not limited to, investment banking, sales, and trading revenues.
- Edward Jones trades as principal in the debt securities that are the subject of this research report.

Other Disclosures

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- When investing in issuers incorporated outside your own country of residence, you should consider all other material risks such as currency risk, political risk, liquidity risk and accounting rules differences, which can adversely affect the value of your investment. Please consult your Financial Advisor for more information.
- Edward Jones Credit Strength Assessment: Low – Our opinion is these credits are of low financial quality. We believe these credits are the most likely to default and experience the most financial hardship. Below Average – Our opinion is these credits are of lower-average financial quality. We believe these credits are more likely to default or experience financial hardship than the average. Average – Our opinion is these credits are of average financial quality. We believe these credits have a low probability of default or low chance of experiencing financial hardship. Above Average – Our opinion is these credits are of above-average financial quality. We believe these credits are less likely to default or experience financial hardship than the average. High – Our opinion is these credits are of the highest financial quality. We believe these credits have the lowest probability of default and will experience the least financial hardship.
- Ratings from Standard & Poor's ("S&P"), Moody's and Fitch may be shown for certain securities. S&P requires we inform you: (1) Ratings are NOT recommendations to buy, hold, sell or make any investment decisions and DO NOT address suitability or future performance; (2) S&P DOES NOT guarantee the accuracy, completeness, or availability of any ratings and is NOT responsible for results obtained from the use of any ratings. Certain disclaimers related to its ratings are more specifically stated at http://www.standardandpoors.com/disclaimers.