

## Research Update:

# Duke Energy Corp. And Subsidiaries Ratings Affirmed Following Atlantic Coast Pipeline Exit; Outlook Stable

July 9, 2020

## Rating Action Overview

- Charlotte, N.C.- based Duke Energy Corp. has announced that it will no longer invest in the construction of the Atlantic Coast Pipeline (ACP) project, effectively exiting its joint venture participation.
- Duke Energy expects to take an approximate \$2 billion to \$2.5 billion pre-tax charge to its earnings in 2020.
- We view the cancelation of the ACP project as negative for the company's longer-term cash flow. While we expect that the company will implement various plans to bolster its credit measures, our base case, incorporating these initiatives, assumes that the company will consistently operate with only very minimal financial cushion for its current rating.
- We are affirming our ratings on Duke Energy Corp. and its rated subsidiaries, including Duke's 'A-' long-term issuer credit rating. The outlook is stable.
- The stable outlook reflects our view that Duke's consolidated financial measures will likely remain just above our downgrade threshold with only very minimal cushion at the current rating. Specifically, we expect that Duke will emphasize financial policies that preserve the funds from operations (FFO) to debt ratio at or above 15% for the next three years.

**PRIMARY CREDIT ANALYST**

**Obioma Ugboaja**  
New York  
+ 1 (212) 438 7406  
obioma.ugboaja  
@spglobal.com

**SECONDARY CONTACT**

**Sloan Millman, CFA**  
New York  
+ 1 (212) 438 2146  
sloan.millman  
@spglobal.com

## Rating Action Rationale

**Our decision to maintain the ratings and the stable outlook reflects certain measures that we expect the company will initiate, mitigating the longer-term cash flow loss from the cancelation of the ACP project.** We expect the company to push its previously planned capital spending on ACP out into the outer years in our forecast, decreasing negative discretionary cash flow for 2020 and 2021. In the fourth quarter of 2020, we expect the company to physically settle its \$2.5 billion equity forward transaction and use the proceeds to partially fund its share of leverage drawn on ACP's credit facility. Furthermore, we expect that the company will implement

cost management strategies and effectively manage its rate cases. We view these initiatives as likely sufficient for Duke's financial measures to be maintained at our downgrade threshold, leaving little room for additional setbacks.

**The COVID-19 pandemic presents additional challenges.** Specific risks related to the pandemic include the potential for delayed rate case outcomes, higher bad debt expense, and lower sales volumes. The company is currently in the middle of two key rate cases in North Carolina that were recently delayed due to COVID-19. In addition, roughly 50% of the company's retail electric sales are from commercial and industrial customers (C&I), which we expect will use less electricity over the coming months because of the pandemic. As such, we expect Duke to work constructively with its regulators, including on the use of regulatory deferrals and to implement cost management strategies to mitigate some of the pandemic's effects.

**Our business risk assessment for Duke Energy is unchanged.** This largely reflects the company's effective regulatory risk management, size, and regulatory diversity. Partially offsetting, is the company's exposure to environmental risks associated with its coal-fired generation including on coal ash, and our view of the company's service territories that are prone to hurricanes and localized storms. Other factors we consider in our assessment include the company's track record of delivering safe and reliable services to its customers.

**We expect Duke's FFO to debt to be about 15% through 2022.** In addition to the physical settlement of the \$2.5 billion equity forward transaction in 2020, our base case assumes favorable tax positions in 2020 and 2021, storm costs securitization in 2021, common equity issuance of \$500 million each year through 2022, effective expense management, capital spending of roughly \$10.5 billion on average for 2020 and 2021, and manageable exit costs from ACP. Furthermore, our base case assumes no material reduction in electric sales volumes due to COVID-19, and constructive regulatory outcomes across its key jurisdictions, including in North Carolina and South Carolina. Taken together, we expect FFO to debt at or above 15% through 2022, indicative of minimal cushion at the current rating. We assess the company's financial measures under our medial volatility financial benchmark table.

## Outlook

The stable outlook reflects our view that Duke's consolidated financial measures will likely remain just above our downgrade threshold with only very minimal cushion at the current rating. Specifically, we expect FFO to debt ratio at or above 15% for the next three years. The stable outlook also assumes that the company will continue to implement financial policies that are commensurate with its present level of credit quality, and will effectively manage regulatory and environmental risk across its key regulatory jurisdictions.

## Downside scenario

We could lower our ratings on Duke Energy and its subsidiaries over the next 9 to 12 months if its consolidated financial measures weaken, including FFO to debt weakening to below 15%. This could occur if the company experiences regulatory setbacks in its key regulatory jurisdictions, including in the Carolinas. This could also occur if its efforts to counteract the negative cash flow effects of COVID-19 stall, or if it accelerates its elevated capital spending beyond our base-case expectations. Furthermore, we could lower the ratings if Duke Energy's business risk increases because of more stringent environmental rules related to its coal ash exposure, if we conclude

that the company's regulatory risk management in its key states has weakened, or if the company shifts its strategic focus away from its predominantly lower-risk regulated utility operations.

## Upside scenario

Although unlikely, we could raise our ratings on Duke Energy and its subsidiaries over the next 24 months if its consolidated FFO to debt is consistently above 20%.

## Company Description

Duke Energy, together with its subsidiaries, operates as an energy company through three segments: Electric Utilities and Infrastructure; Gas Utilities and Infrastructure; and Commercial Renewables. The Electric Utilities and Infrastructure segment generates, transmits, distributes, and sells electricity in the Carolinas, Florida, and the Midwest, and uses coal, hydroelectric, natural gas, oil, renewable sources, and nuclear fuel to generate electricity. It also engages in the wholesale of electricity to municipalities, electric cooperative utilities, and other load-serving entities. This segment serves approximately 7.7 million retail electric customers in six states in the Southeast and Midwest regions of the U.S. covering a service territory of approximately 95,000 square miles; and owns approximately 50,880 megawatts (MW) of generation capacity. The Gas Utilities and Infrastructure segment primarily distributes natural gas to residential, commercial, industrial, and power generation natural gas customers. It has approximately 1.6 million customers, including 1.1 million customers located in North Carolina, South Carolina, and Tennessee, as well as 531,000 customers located in southwestern Ohio and northern Kentucky. The Commercial Renewables segment acquires, owns, builds, develops, and operates wind and solar renewable generation projects, including nonregulated renewable energy and energy storage services to utilities, electric cooperatives, municipalities, and commercial and industrial customers. This segment has 21 wind and 100 solar facilities and one battery storage facility with a capacity of 2,991 MW across 19 states.

## Liquidity

As of March 2020, we assess Duke's liquidity as adequate to cover its needs over the next 12 months. We expect the company's liquidity sources to exceed uses by 1.1x or more, and that it will meet our other requirements for such a designation. Duke's liquidity benefits from stable cash flow generation, ample availability under the revolving credit facilities, and manageable debt maturities over the next few years. Importantly, we use maintenance capital spending, recognizing that Duke can reduce capital spending in times of stress. The company's well-established and solid banking relationships, the ability to absorb high-impact, low probability events without the need for refinancing, and a satisfactory standing in credit markets also support our liquidity assessment as adequate. Duke also has revolving credit facilities totaling \$8 billion that backstop its commercial paper program. We rate this commercial paper 'A-2', reflecting our issuer credit rating on the company.

## Principal liquidity sources

- Credit facility of \$8 billion;
- Cash of about \$1.45 billion;

- Cash FFO of about \$9.5 billion; and
- Common equity of about \$2.5 billion.

## Principal liquidity uses

- Debt maturities of close to \$8.1 billion over the next 12 months, including about \$3 billion outstanding under the company's commercial paper;
- Estimated maintenance capital spending of about \$5.6 billion; and
- Dividends close to \$3 billion.

## Environmental, Social, And Governance

Approximately 64% of Duke's total electric generation fleet capacity of almost 51 gigawatts (GW) are fossil fuel-based (24% coal; 45% natural gas), which exposes it to the ongoing cost of operating older units in the face of disruptive technological advances and the potential for changing environmental regulations that may require significant capital investments. In September 2019, Duke Energy announced an updated climate strategy with a new goal of net-zero carbon emissions from electric generation by 2050.

Historically, the company has faced significant environmental, social, and financial repercussions from closing its coal ash ponds in North Carolina, but is mitigating this risk through the state's regulatory framework, which allows coal ash remediation costs to be recovered. But the potential for future regulatory disallowances related to the company's coal ash remediation still poses some risk. In addition, the company's carbon-free nuclear generation portfolio increases its operating risk and exposes it to longer-term nuclear waste storage risks despite the company's long-term track record of achieving safe operational standards of its nuclear fleet.

On the gas side, older assets are susceptible to natural gas leaks, which emit methane. The company also operates its utilities in regions of the U.S. that are prone to frequent hurricanes, which could increase the company's risk exposure because of the severity and frequency of these natural disasters globally.

Overall, we assess Duke's environmental risk as higher than most peers given its environmental exposure, including those related to its coal exposure and hurricanes. Social and governance risk factors are in line with peers. We view Duke's ability to deliver safe and reliable services to customers as a positive social factor but generally in-line with peers. Duke has independent board of directors, who in our view, are capably engaged in risk oversight on behalf of all stakeholders.

## Issue Ratings - Subordination Risk Analysis

### Capital structure

Duke's capital structure consists of approximately \$60 billion of long and short-term debt, including about \$37 billion of debt at its subsidiaries.

## Analytical conclusions

The unsecured debt issued at the Duke Energy level is rated 'BBB+', one notch below the issuer credit rating, as the priority debt at its subsidiaries comprises more than 50% of the company's consolidated capital structure. Our commercial paper rating is 'A-2' based on our long-term issuer credit rating on the company. The junior subordinated notes and preferred stock are rated 'BBB', two notches below our issuer credit rating on the company. We rate these hybrid securities premised on their deferability and subordination.

## Ratings Score Snapshot

Issuer credit rating: A-/Stable/A-2

Business risk: Excellent

- Country risk: Very low
- Industry risk: Very low
- Competitive position: Strong

Financial risk: Significant

- Cash flow/leverage: Significant

Anchor: 'a-'

Modifiers

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: 'a-'

Group credit profile: 'a-'

## Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017

- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | Utilities: Collateral Coverage And Issue Notching Rules For '1+' And '1' Recovery Ratings On Senior Bonds Secured By Utility Real Property, Feb. 14, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Ratings List

### Ratings Affirmed

#### Duke Energy Corp.

#### Piedmont Natural Gas Co. Inc.

#### Duke Energy Progress, LLC

#### Duke Energy Ohio Inc.

#### Duke Energy Kentucky Inc.

#### Duke Energy Indiana Inc.

#### Duke Energy Florida, LLC

#### Duke Energy Carolinas LLC

#### Cinergy Corp.

Issuer Credit Rating	A-/Stable/A-2
----------------------	---------------

#### Florida Progress Corp.

#### Progress Energy Inc.

Issuer Credit Rating	A-/Stable/--
----------------------	--------------

### Issue-Level Ratings Affirmed; Recovery Ratings Unchanged

#### Duke Energy Carolinas LLC

#### Duke Energy Florida, LLC

#### Duke Energy Indiana Inc.

#### Duke Energy Ohio Inc.

#### Duke Energy Progress, LLC

Senior Secured	A
----------------	---

Recovery Rating	1+
-----------------	----

# Issue-Level Ratings Affirmed

<b>Duke Energy Corp.</b>	
Senior Unsecured	BBB+
Junior Subordinated	BBB
Preferred Stock	BBB
Commercial Paper	A-2
<b>Duke Energy Carolinas LLC</b>	
<b>Duke Energy Florida, LLC</b>	
<b>Duke Energy Indiana Inc.</b>	
<b>Duke Energy Kentucky Inc.</b>	
<b>Duke Energy Ohio Inc.</b>	
<b>Piedmont Natural Gas Co. Inc.</b>	
Senior Unsecured	A-
<b>Duke Energy Progress, LLC</b>	
Preferred Stock	BBB
<b>Progress Energy Inc.</b>	
Senior Unsecured	BBB+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

Copyright © 2020 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, [www.standardandpoors.com](http://www.standardandpoors.com) (free of charge), and [www.ratingsdirect.com](http://www.ratingsdirect.com) (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at [www.standardandpoors.com/usratingsfees](http://www.standardandpoors.com/usratingsfees).

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.