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Duke Energy Corporation

Cancellation of ACP reduces environmental and construction risks, financial impact is manageable

On July 5, 2020, Duke Energy Corporation (Duke, Baa1 stable) and its partner, Dominion Energy, Inc. (Dominion, Baa2 stable), announced the cancellation of the Atlantic Coast Pipeline (ACP) following ongoing delays and increasing cost and regulatory uncertainty. While the cancellation will result in a substantial write-off for Duke, along with a loss of future cash flow, it also avoids the potential for greater losses if project costs were to continue to escalate, or if construction were to be cancelled at a later date. The cancellation of the natural gas pipeline, and related plans to shift investment to renewables, battery storage and energy efficiency may also speed Duke's transition to net-zero carbon emissions, reducing its carbon transition risk.

ACP was initially announced in 2014 and was intended to increase energy supply and diversity by bringing natural gas east to markets in North Carolina and Virginia. At the time of cancellation this week, the project, which is owned 47% by Duke and 53% by Dominion, had an estimated total completion cost of $8 billion (versus prior estimates of $4.5- $5 billion) and was nearly three and a half years behind schedule. As of March 31, 2020, over $4 billion had been invested, with Duke's 47% share including approximately $1.2 billion of invested capital, and a guarantee of $845 million of ACP's outstanding construction loan. Following the termination, Duke expects to incur earnings charges of $2-2.5 billion before tax. The majority of this will be taken in the second quarter of 2020, the remainder will be recorded later in the year as certain exit related costs are incurred.

Given Duke's size and the scale and diversity of its other operations, the impact to the company's balance sheet and credit metrics is manageable. The reduction in capitalization due to the impairment will cause only a modest increase in the company's consolidated debt to capital ratio. We estimate, on a pro-forma basis as of March 31, 2020, following the charge-off, Duke's ratio would increase by about 100 basis points, to about 59%, versus a covenant maximum of 65%.

Although the ACP construction loan will now be consolidated onto Duke's balance sheet, the company anticipates utilizing the proceeds of its $2.5 billion forward equity sale, which is scheduled to close by year-end 2020, to repay debt balances. Considering this debt reduction, expected near-term reductions in operations and maintenance spending in the range of $350-$450 million undertaken as a result of the coronavirus, along with increased cash flow due to a pull forward of $287 million of alternative minimum tax credits, we expect the company to generate a near-term ratio of cash flow from operations excluding changes in working capital (CFO pre-WC) to debt above 15%.

Given the loss of expected cash flow from ACP, and depending on the outcomes of its pending North Carolina rate cases later this year, along with the continuing impacts of the coronavirus, we believe Duke may evaluate further refinements to its operations and maintenance plans, capital program or funding strategies to maintain ratios of CFO pre-WC to debt comfortably above 15%.

Duke plans to file Integrated Resource Plans in the Carolinas in September 2020 which will include multiple scenarios to support a path to a cleaner energy future. The company's investment plans are focused on delivering customer benefits, supporting grid resiliency and reliability, and helping to rebuild the economy. The absence of a large, costly project such as ACP should provide the company some additional financial flexibility to achieve these plans.

Duke is a large (2019 revenue - $25 billion) holding company for intermediate holding company Progress Energy, Inc., and regulated utilities Duke Energy Carolinas, LLC, Duke Energy Progress, LLC, Duke Energy Florida, LLC, Duke Energy Indiana, LLC, Duke Energy Ohio, Inc., Duke Energy Kentucky, Inc., and Piedmont Natural Gas Company, Inc. as well as commercial renewables and natural gas infrastructure businesses in the US. Duke is headquartered in Charlotte, North Carolina.

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