



Conference Call Transcript

DUK - Q4 2007 Duke Energy Corporation Earnings Conference Call

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PRESENTATION

Operator

Good day everyone, and welcome to the Duke Energy fourth quarter and year-end earnings conference call. Today's conference is being recorded.

At this time, for opening remarks I would like to turn the conference over to the Senior Vice President of Investor Relations, Sean Trauschke. Please go ahead sir.

Sean Trauschke - Duke Energy Corporation - SVP, IR

Good morning and welcome to Duke Energy's fourth quarter and year end 2007 earnings review.

Leading our discussion today are Jim Rogers, Chairman, President, and Chief Executive Officer, and David Hauser, Group Executive and Chief Financial Officer. Jim will begin today's presentation by providing a general overview of our results, and a discussion of our outlook for 2008. Then David will provide more detail and context around our 2007 results for each of our businesses, as well as more detail and context around our 2008 plan. Jim will close with an update of our regulatory initiatives and our areas of focus for 2008. Following those prepared remarks, we will open the lines up for your questions.

Before we begin, let me take a moment to remind you that some of the things we will discuss today concern future Company performance, and include forward-looking statements within the meaning of Securities laws. Actual results may materially differ from those discussed in these forward-looking statements, and you should refer to the additional information contained in Duke Energy's 2006 Form 10-K filed with the SEC, and our other SEC filings, concerning factors that could cause those results to be different than contemplated in today's discussion.

In addition, today's discussion includes certain non-GAAP financial measures as defined under SEC Regulation G. A reconciliation of those measures to the most directly comparable GAAP measures is available on our Investor Relations website at www.duke-energy.com.

With that, I will turn the call over to Jim.

Jim Rogers - Duke Energy Corporation - Chairman, CEO, President

Thank you, Sean. Good morning everyone, and thank you for joining us today. Most importantly, thanks again for your interest and investment in Duke Energy.

We had a very strong fourth quarter and a strong year. As we said in our news release this morning, we reported ongoing diluted earnings per share of \$0.27 for the fourth quarter of 2007, versus \$0.23 in the fourth quarter last year. Ongoing diluted earnings per share for the full year 2007 were \$1.25, compared to \$0.99 for 2006. These 2006 results exclude the natural gas businesses, which were spun off as Spectra Energy in January 2007, and which are now included in discontinued ops.

Our fourth quarter results reflected an improvement of approximately 37% in combined ongoing segment EBIT from our three largest business units. Of course, we are pleased with our fourth quarter financial results. We are also very pleased with the superior performance of our people and our assets. Equally important, we have resolved many of the regulatory and legislative issues that were both on our minds as well as yours last year.

In our news release this morning, we announced our 2008 employee incentive earnings target of \$1.27 per share on an ongoing diluted basis. As you will recall during our Analyst Conference last September, we committed to a compound annual growth rate of 5 to 7% in ongoing diluted EPS through 2012 from the base of our 2007 employee incentive target of \$1.15.

We have come out of the gate strong in '07, nearly 9% above target. But you should remember that due to the timing of our construction and capital investments, growth will likely be lumpy over the next several years. Off the \$1.15, we believe we will be at the high end of the 5 to 7% range. If you come off the \$1.25, we believe we will be on the low end of that range. Regardless of the 2007 base, we still believe that through 2012, we can achieve a compound annual growth rate of 5 to 7% in ongoing diluted EPS.

Our earnings growth will be driven by the following three factors. Capital reinvestment, growth in our customer sales base, and execution on our regulatory and legislative initiatives. David will share more details on the assumptions we have used to arrive at our 2008 earnings target, but first I will discuss our segment EBIT expectations for 2008.

We expect the Company's total ongoing segment EBIT to be more than 3.2 billion in 2008 before other net expenses. Again, our regulated businesses will be the largest contributor to ongoing EBIT. We expect an ongoing EBIT contribution of approximately 2.4 billion from U.S. Franchised Electric & Gas.

Our Commercial Power segment is expected to contribute approximately \$385 million in ongoing segment EBIT. Most of the Commercial Power ongoing segment EBIT comes from serving retail electric customers in Ohio. This number also reflects the continuing improved performance of our Midwest gas plants. Our international operations are expected to contribute \$380 million in ongoing segment EBIT, and our ownership interest in Crescent Resources is expected to deliver \$75 million in ongoing equity earnings in '08.

With that, I will turn it over to David.

David Hauser - Duke Energy Corporation - Group Executive, CFO

Thank you, Jim. I will begin with a review of our 2007 business segment results. U.S. Franchised Electric & Gas, our largest business segment, reported fourth quarter 2007 EBIT from continuing operations of \$519 million, an increase of \$96 million from last year's fourth quarter.

The quarter-over-quarter improvement in segment EBIT was primarily driven by the completion earlier in 2007 of merger-related rate reductions, lower Clean Air amortization, retail rate increases in the Midwest, favorable weather, and increased wholesale volumes. In the fourth quarter of 2006, we recorded Clean Air amortization for North Carolina's Clean Air Program of \$38 million. We met our amortization obligation under the Clean Air Legislation in the third quarter of 2007, and did not incur any regulatory amortization expense in the fourth quarter of 2007. As we have discussed in the last few calls, the merger-related rate reductions ended in the second quarter of 2007, except for a small amount that we will continue to share with our customers in Kentucky over the next five years.

Weather contributed to the quarter-over-quarter increase in the segment's ongoing EBIT. For the full year, the EBIT contribution from weather was about \$100 million above normal. Keep in mind, this was offset by higher employee incentives, and increased O&M costs, due to plant maintenance. Long-term contracts that took effect in early 2007, drove the increase in wholesale volumes, primarily in Indiana.

In addition to incentives and plant O&M costs, the segment's ongoing EBIT was also partially offset by a charge associated with the write-off of a portion of Duke Energy Carolina's GridSouth development costs, in accordance with the recent North Carolina Utilities Commission rate order.

Our regulated customer base continued to grow. Approximately 44,000 customers were added in the Carolinas since the fourth quarter of 2006, a 2% increase. Approximately 15,000 customers were added in the Midwest in that same time period, a 1% increase.

While we continue to add customers for all of U.S. Franchised Electric & Gas, we are affected by general market conditions, including the general decline in the textile industry, as well as softening in some other industries. For the quarter the EBIT contribution from bulk power marketing was approximately \$32 million, net of the impact of sharing of profits with industrial customers.

Next I will review Commercial Power. Ongoing EBIT for this segment increased approximately \$57 million from the fourth quarter of 2006. The segment's improved EBIT was driven by lower purchase accounting expense, the favorable timing of recoveries of fuel and purchase power costs, and improved mark-to-market results, from economic hedges due to increasing coal prices.

The quarter's positive drivers were partially offset by higher expenses from increased plant maintenance. Increased generation and higher capacity revenues continued to improve the results of our Midwest gas-fired assets. For the year, these assets lost \$14 million. As we have told you in the past, we now expect these assets will reach their breakeven point by 2009 on an ongoing EBIT basis.

One additional item, we pledged approximately 2,700 megawatts in the recent PJM 2011/2012 auction, at a price of \$174 per megawatt day. This price is 70% higher than the auction results in October. Finally, for the fourth quarter, Commercial Power's EBIT included \$13 million of mark-to-market net gain on economic hedges. I will remind you that we consider any mark-to-market impact as part of ongoing earnings.

Now let's turn to our international business. For the fourth quarter of 2007, Duke Energy International reported ongoing segment EBIT of approximately \$105 million, an increase of \$25 million over last year's fourth quarter. DEI's improved results for the quarter were driven mostly by higher margins at National Methanol, partially offset by less favorable hydrology in Argentina. We continue to be pleased with the overall contribution of International, particularly Brazil and Peru.

Next is Crescent Resources. Ongoing results for this segment were \$32 million in the fourth quarter of 2007. That is a \$15 million increase over the ongoing results for the fourth quarter of 2006. The higher current year results were due to increased legacy land sales, and a gain on the sale of the Piedmont Town Center in Charlotte, North Carolina. These increased results were partially offset by impairment losses of about \$32 million on some residential developments. I want to make it clear that these impairment charges are related to a few individual Crescent developments, and not our overall investment in Crescent. The overall fair value of our Crescent investment continues to exceed its carrying amount.

Next I will review our Other category. Other primarily includes costs associated with corporate governance, and Duke Energy's captive insurance company. The fourth quarter 2007 ongoing results for Other were relatively flat, when compared to the same quarter in 2006. Other's ongoing net expense from continuing operations was \$92 million, compared to \$86 million in the prior year's quarter.

Now I will focus on a few important non-operating items on a year-over-year basis. We ended 2007 with a net cash balance of approximately \$400 million, about \$1.1 billion of cash, cash equivalents, and short-term investments, offset by about \$700 million of short-term commercial paper outstanding. Interest expense was \$685 million for 2007, compared to \$632 million in 2006. The increase is primarily due to the inclusion of a full year of interest expense in 2007, associated with debt of the former Cinergy companies, compared to only nine months in 2006.

The effective tax rate was approximately 32%, compared to approximately 29% in 2006. This is higher than what we have been telling you, because the 2007 tax rate is absent synfuel credits, which expired in 2007, and are now included in discontinued operations. For the full year 2007, our synfuel operations contributed about \$0.02 to net income. The higher tax rate in 2007 was primarily due to the previous year's favorable tax items, including settlements, tax benefits related to the impairment of the investment in Bolivia, and the reversal of previously recognized taxes related to dividends on foreign operations.

With that let's turn to our 2008 expectations. This slide provides the ongoing earnings per share assumptions used to set our 2008 employee incentive target of \$1.27. As always, our plan is based on normal weather. The 2008 incentive target incorporates the rate adjustments resulting from the recent rate proceeding in North Carolina. The target also assumes lower net purchase accounting charges.

We have assumed an effective tax rate of 33% for 2008. You should note that this tax rate is absent synfuel credits which expired in 2007. We expect interest expense to be approximately \$700 million, as I mentioned at the beginning of 2008, our cash, cash equivalent and short-term investment balance was approximately \$1.1 billion. Our plan reflects a quarterly dividend increase of \$0.01 per share beginning in the third quarter of 2008. Of course, this is subject to Board approval.

Now let's take a quick look at our projected CapEx spending in 2008. We plan to spend approximately \$5.1 billion this year. This represents a slight increase from what we showed you in September. The primary drivers for the change are timing associated with the gas plant and nuclear development costs of \$40 million. Over 75% of these dollars will be spent on our regulated businesses. It includes new generation resources to meet our growing demand, environmental expenditures to meet federal, state, and local pollution control requirements, and maintenance and new customer additions.

Most of the CapEx in our commercial businesses will be spent completing the wind projects we acquired last year, and expanding our International segment. We continue to use a measured approach when we assess international investment opportunities, and any investments will be made with offshore cash.

Let me conclude by giving you a quick walk-through of our projected 2008 cash flows. Based on our \$1.27 per share target, we expect total sources of cash to be about \$3.4 billion. Total uses of cash are estimated to be \$6.5 billion. This total includes approximately \$5.1 billion in CapEx for expansion, environmental, maintenance, and other.

The primary uses of cash are mostly the capital expenditures and investments that I just outlined, along with the dividend payments of approximately \$1.2 billion. The total dividend payments include the projected quarterly dividend increase of \$0.01 per share beginning in the third quarter of 2008. So we expect our cash outflows to exceed our cash inflows by about \$3.1 billion. This of course, the driven by our reinvestment in the businesses.

Our strong investment grade balance sheet will provide us with significant flexibility in achieving our CapEx plans. We do not need to issue equity to fund our CapEx program. And while we started the year with \$400 million in net cash, we still anticipate tapping the debt capital markets in 2008. In fact, we already have done so. Duke Energy Carolinas raised \$900 million in a two-part first mortgage bond sale last month. We will be posting our financing plans on our website next week.

With that, I will turn it over to Jim for closing remarks.

Jim Rogers - Duke Energy Corporation - Chairman, CEO, President

Thank you, David. As you all can see, 2007 was a good year. I want to take this opportunity to thank our employees for such a productive year! I appreciate their hard work and their commitment to our Company. They made it happen. Some of that productivity was on the regulatory front, and this slide provides a good view of how we have resolved many of the regulatory uncertainties we faced in 2007.

As you saw last week, we received our final air permit for the new Cliffside Unit 6 in North Carolina. A week earlier, we received the final air permit for the new coal gasification plant in Edwardsport, Indiana. We are proceeding with construction of these two plants, a total investment of approximately \$4 billion over the next five years. These projects enable us to continue our long history of providing safe, affordable, reliable electricity to meet our customers' needs and support our state economies.

These advanced coal technologies that we are building will eventually replace nearly 1200 megawatts of older, high-emitting units. These new plants, along with our plans for energy efficiency, renewables, new gas plants, and a new nuclear plant, serve as major steps in our efforts to

reduce our carbon footprint. Internally, as you might expect, we use a more detailed scorecard to measure how we are doing, especially in generation, reliability, safety, and customer service.

Our commitment to continuously improve means we annually set the bar very high. As an example, by every standard our nuclear fleet had an outstanding year, the third best ever. But as you can see, the fleet's capacity factor is just off our stretch target. This is an example of how we push our operations to do better every day, every month, and every year.

We are doing well in providing reliable service, except for gas outages where we've had some work to do. We are tracking well on our safety record, and our residential and large business customer satisfaction continues to improve every year. We focus on the scorecard because we understand the linkage between operational excellence and regulatory success. Keeping our customers satisfied, our rates competitive, and our reliability high, increases the probability that we can achieve favorable regulatory outcomes in the future.

To give you a sense of what we are focusing on this year, I would like to quickly put 2006 and 2007 in perspective. In 2006 we completed the Cinergy merger. We successfully integrated the two companies, and we completed the spin-off of Spectra Energy. Great momentum for '06.

In '07, we sustained that momentum by continuing to harvest the merger savings. We achieved our financial targets, and we removed significant regulatory uncertainty. So the question is how do we continue creating shareholder value in '08 by maintaining this momentum. Our answer is by focusing on three primary areas.

First, advancing our asset modernization strategy. I'm so proud of the efforts of so many Duke Energy employees, who helped us win state regulatory approval to build two of the cleanest coal plants in the nation -- our 630-megawatt IGCC plant in Edwardsport, and our 800-megawatt advanced clean coal plant in Cliffside, North Carolina. These provide great value to our customers, by enabling us to meet growing demands, while simultaneously retiring older, less efficient assets, and shrinking our environmental footprint, an important step in decarbonizing our fleet for the future.

But winning approval to build these assets is only the beginning of our asset modernization strategy. Across our operations in '08, we are carefully evaluating opportunities to deploy capital, whether constructing wind turbines in Duke Energy generation services, new power generation facilities in Duke Energy International, our clean tech infrastructure in Franchised Electric & Gas, and a disciplined manner that provides benefits to our customers, our shareholders, and the environment. You will hear much more about the progress of this strategy as we move through the year.

Second, continuing our proactive regulatory and legislative strategy. As we've said, '07 was productive and a noteworthy year on the regulatory legislative front. From baseload legislation in South Carolina, to regulatory approval of power plants in two different states, to the resolution of our North Carolina rate review, I am pleased with all that we have got done. But '08 will not be a year for resting on our accomplishments.

There is much work to do to enhance customer and shareholder value so you will see us busy on a number of fronts. These initiatives will focus on both creating value, such as securing implementation of our innovative Save-a-watt plan in all of our states, as well as on protecting value, such as working to secure passage of Federal Carbon Legislation, that applies to all sectors of the economy, and is fair to our customers, as well as our investors.

Later today I am traveling to Columbia, South Carolina, to testify before the Public Service Commission, where we have a partial settlement on our Energy Efficiency plan. I am especially pleased that we are receiving broad support for our plans, including from industrial customers and major environmental organizations. With this support, South Carolina could be the first state to approve our Save-a-watt plan in '08. And yesterday three major national energy efficiency organizations announced support for our save-a-watt proposal.

Let me now turn to our third major focus, and that is a continued relentless focus on operations and costs. I am proud of the way our employees kept their eye on the ball this year in running our operations. Particularly in the face of record-setting heat and record-setting drought. Many CEOs in our industry would love to see the kind of operational scorecard I reviewed with you earlier. We are all about improvement, and we have a belief that no matter how good you are, you can always be better.

I have challenged the team to improve in everything we do, and we continue to find ways to control our operating costs. With our focus on modernizing and decarbonizing our asset base, we are committed to keeping our major construction projects, such as Cliffside and Edwardsport, on-budget and on-schedule. We will be very transparent with regulators and other interested parties about our progress.

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Additionally, we face a large number of employee retirements in the near future, and we are working to develop a plan to replace them. As you can see we have a full plate in '08. I look forward to updating you throughout the year.

Putting it all together, we think we have a great value proposition for investors. We continue to make good progress toward achieving our goals, including maintaining a strong financial position. We have a proactive regulatory approach, a 5 to 7% compound annual growth rate in ongoing diluted EPS through '12, annual dividend growth, our current dividend yield is approximately 4.5%, no anticipated equity offerings through '12 excluding internal plans, and a strong balance sheet to provide flexibility.

In closing, I want to take a moment to highlight some changes in our management team. Brew Barron, our Chief Nuclear Officer, will be retiring next month. We really thank Brew for his more than 35 years of service to our Company. Later this month, Dhiaa Jamil, currently our Senior Vice President of Nuclear Support, and who has more than 26 years of nuclear experience with our Company, will succeed Brew as Chief Nuclear Officer. We have long been one of the premier operators of nuclear plants in the U.S., and we have a deep bench of talent in our nuclear operations. Dhiaa is just one example of that talent.

Since our last earnings call in November, Lynn Good became Group Executive and President of our commercial businesses, with her extensive financial and energy experience we know Lynn will do a great job.

I know we have given you a lot of information in a relative short amount of time, we wanted to ensure there was ample time for your questions. David and I are now ready to take them.

QUESTION AND ANSWER

Operator

Thank you. The question-and-answer session today will be conducted electronically. (OPERATOR INSTRUCTIONS) We will take as many questions as time permits. We will hear first from Paul Patterson with Glenrock Associates.

Paul Patterson - Glenrock Associates - Analyst

Good morning, guys. Can you hear me?

Jim Rogers - Duke Energy Corporation - Chairman, CEO, President

I can, Paul, welcome.

Paul Patterson - Glenrock Associates - Analyst

Thank you. Just want to touch base with you on sort of quick questions here. The favorable timing of fuel and power, could you just explain a little bit more about how much that was, and what is causing that, in terms of the timing the and how that impacts earnings?

David Hauser - Duke Energy Corporation - Group Executive, CFO

Basically in the Commercial businesses they are not under FAS-71, so we under collected fuel by about \$40 million in '06, and that was over collected in '07 about \$40 million.

Paul Patterson - Glenrock Associates - Analyst

So about an \$80 million difference?

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David Hauser - *Duke Energy Corporation - Group Executive, CFO*

That is about the swing.

Paul Patterson - *Glenrock Associates - Analyst*

And that is a pretax number?

David Hauser - *Duke Energy Corporation - Group Executive, CFO*

Yes.

Paul Patterson - *Glenrock Associates - Analyst*

Okay, I got you. In terms of the, what was the actual loss on the residential properties? What was the impairment on that?

David Hauser - *Duke Energy Corporation - Group Executive, CFO*

Our share was about \$30 million. Keep in mind we own 49%.

Paul Patterson - *Glenrock Associates - Analyst*

But you guys feel pretty confident that there are no losses going forward, because of the value of your properties, correct?

David Hauser - *Duke Energy Corporation - Group Executive, CFO*

Yes, those were specific projects in Florida that we had to write down, and we are confident that the total portfolio is still very good.

Paul Patterson - *Glenrock Associates - Analyst*

Okay, great. And then finally, with the interest expense, it said in the press release, it looked to me like the majority of that was associated with DEI. I am sorry if I missed this but what is it that DEI did in the quarter, that impacted it, and what currency impact was there in '07? I'm sorry if I missed that as well. I got a few calls, I got confused, I am sorry.

David Hauser - *Duke Energy Corporation - Group Executive, CFO*

We have a piece of debt at Paranapanema that is about \$540 million. That updates regularly, based on inflation in Brazil. And that was the interest impact that we were talking about.

Paul Patterson - *Glenrock Associates - Analyst*

Okay.

David Hauser - *Duke Energy Corporation - Group Executive, CFO*

And then the EBIT number for FX, I think it was \$18 million for the year of EBIT, and \$6 million of net income.

Paul Patterson - *Glenrock Associates - Analyst*

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Great. Thanks a lot.

Jim Rogers - Duke Energy Corporation - Chairman, CEO, President

Paul, thank you.

Operator

Thank you. We will now move on to our next question from Jonathan Arnold with Merrill Lynch.

Jim Rogers - Duke Energy Corporation - Chairman, CEO, President

Welcome, Jonathan.

Jonathan Arnold - Merrill Lynch - Analyst

Thank you, guys. Couple of quick things. I noticed in the forecast for the corporate segment, you have it as a drag of about \$265 million for 2008.

And I think remembering back to when you gave these original post-merger guidance, I think you had been talking about numbers more in the 200 range, and maybe even a little below. So can you help sort of bridge what the difference is, why you now expect that to be higher? Is it costs that were previously in the segments, or something different?

David Hauser - Duke Energy Corporation - Group Executive, CFO

Well, let me give you three numbers. When we came out with our '07 forecast, the number was 215, that we told you for the Other segment. And that is actually where we had a fair amount of our stretch. That number ended up at 235 for the year, and then next year is 265. I think if you think about the 265 in that range is a good run rate going forward. Obviously we had hoped to beat that, but that also has some of the activities associated with energy efficiency, and some of the gas activities really.

Jonathan Arnold - Merrill Lynch - Analyst

So you are saying that you haven't managed to drive down those corporate costs quite as much as you might have hoped a year ago?

David Hauser - Duke Energy Corporation - Group Executive, CFO

I think we have driven them down pretty effectively, in '06 they were 344 million. So we have driven them down a lot, but it looks to me like the run rate is going to be in the 265 range.

Jonathan Arnold - Merrill Lynch - Analyst

Thanks David. One other thing I had was, you gave the 700 million forecast for interest in 2008. Is that net of interest income, or is that the actual interest expense?

David Hauser - Duke Energy Corporation - Group Executive, CFO

That is the gross number. We would expect to have some interest income. The interest income, we have less cash now. The interest income should be 50 million, or a number of that nature.

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Jonathan Arnold - Merrill Lynch - Analyst

Finally, on the same subject, how much capitalized interest is there within that forecast, is it more or less?

David Hauser - Duke Energy Corporation - Group Executive, CFO

Well to tell you the truth, Jonathan, I don't have that number. We can get that number, but if you look at our expenditures, the biggest expenditures would be on Cliffside and on the IGCC, and the ADC rate in the Carolinas is 8.7%. But we can get you the number of how much is capitalized interest.

Jonathan Arnold - Merrill Lynch - Analyst

Okay. Thank you. If I could just squeeze one last thing in, you mentioned mark to market in Commercial Power. Not sure if you mentioned this in response to Paul's question, but how much was that in the quarter, and maybe the year?

David Hauser - Duke Energy Corporation - Group Executive, CFO

It is 13 million positive. So the driver of that is that coal went up, so it has a positive mark to market. Power went up also, which has a negative mark to market, but the gains on the coal were bigger than the losses on the power.

Jonathan Arnold - Merrill Lynch - Analyst

That was a quarterly number, is it?

David Hauser - Duke Energy Corporation - Group Executive, CFO

13 million is the year number.

Jonathan Arnold - Merrill Lynch - Analyst

Okay.

David Hauser - Duke Energy Corporation - Group Executive, CFO

Actually, it is the same number, the year and the quarter.

Jonathan Arnold - Merrill Lynch - Analyst

Okay, thank you very much, guys.

Jim Rogers - Duke Energy Corporation - Chairman, CEO, President

Jonathan, thank you.

Operator

We will move on to our next questioner with Ashar Kahn with SAC Capital.

Ashar Khan - SAC Capital - Analyst

I just want to go through Commercial Power, how to bridge between '07 and '08. David if I am right, Commercial Power is being reported without synfuel, right? Because that is how the earnings are being shown. So now the '07 reported number has no cost of synfuel operations, if I am correct?

David Hauser - Duke Energy Corporation - Group Executive, CFO

You are correct.

Ashar Khan - SAC Capital - Analyst

Okay. Then if you can bridge me through '07 going to '08, especially with what Midwest assets did in '07, and what you are projecting them to do with '08, and I think there is a purchase accounting adjustment as well. If you could help I would appreciate it.

David Hauser - Duke Energy Corporation - Group Executive, CFO

Okay, let's walk through a few numbers. So 2007 was 278 million. But we talked earlier about the fuel over collection of 40 million. That is from the '06 time period. So that is in the 278.

And we had a positive mark to market of 13. So if you take those two items out, that wouldn't repeat in '08, you would have 225 million as a starting point. Purchase accounting is going to improve 105 million next year. So you add 105 to that 225, and you are at 330.

And the balance of 55 is improvement in the business. And that is improvement in three areas. One is in the gas plants that you mentioned. One is in Duke Energy generation services, as the wind facilities begin to come on, and the final one is improvement in sales and margins associated with the Commercial business.

Ashar Khan - SAC Capital - Analyst

That was very helpful. Then, David, why are we expecting flat growth in the International business, '07 to '08?

David Hauser - Duke Energy Corporation - Group Executive, CFO

I think the big strength of the International business this year was in two areas that we have assumed aren't as strong next year. One is in Peru, which had some transmission constraints that ended up very positive for us. And second one is in National Methanol, and we have assumed a bit lower prices from methanol next year.

Ashar Khan - SAC Capital - Analyst

But then we are investing in the International business. Could you just mention about that, and how those investments turn into profitability or earnings going forward?

David Hauser - Duke Energy Corporation - Group Executive, CFO

Built into the numbers we have given you for International, we do have some growth, and that is associated with the hydro plants we are building in Brazil, but the detriment in Peru, and the reduction in National Methanol, more than offset that and kept it flat basically.

Ashar Khan - SAC Capital - Analyst

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And if I can end up, this is from memory, you had mentioned in your September analyst meeting, that from a base of I guess the Commercial Power and the Duke international, the '08 base, and then you expected a 10% growth rate in EBIT going forward. So that still stands true today, right, if so we can take the 380 and the 385, which is something like 765, and expect a 10% growth rate in that EBIT going forward on an annual basis?

David Hauser - *Duke Energy Corporation - Group Executive, CFO*

That is what we talked about through '12, but that will be lumpy also.

Ashar Khan - *SAC Capital - Analyst*

Could you just mention of the lumpiness?

David Hauser - *Duke Energy Corporation - Group Executive, CFO*

Well, that growth rate has presumptions of investments that we make, both in wind farms and in international, and the exact timing of those, depends on when we can find the right opportunities.

Ashar Khan - *SAC Capital - Analyst*

Okay.

David Hauser - *Duke Energy Corporation - Group Executive, CFO*

The underlying business should grow pretty smoothly, it is the new deals that you have to find.

Ashar Khan - *SAC Capital - Analyst*

Yes, but you are on track for those new deals, as we are investing today, correct?

David Hauser - *Duke Energy Corporation - Group Executive, CFO*

Yes. We are making investments today, both in the wind, and in the hydro in Brazil.

Ashar Khan - *SAC Capital - Analyst*

Okay. I appreciate it.

David Hauser - *Duke Energy Corporation - Group Executive, CFO*

Okay.

Jim Rogers - *Duke Energy Corporation - Chairman, CEO, President*

Ashar, thank you very much.

Operator

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We will now hear from Lasan Johong with RBC Capital.

Lasan Johong - RBC Capital Markets - Analyst

Good morning.

Jim Rogers - Duke Energy Corporation - Chairman, CEO, President

Welcome.

Lasan Johong - RBC Capital Markets - Analyst

Thank you. Yesterday there was an article in the Wall Street Journal that said three major banks are going stop funding new coal fire projects. This seems to be a trend in the whole power sector.

Could you comment on the effects on Cliffside financing potential, and second, if you are confident that any kind of carbon costs levied by the Federal Government would be appropriately recoverable by Duke, and basically are you sure you can pursue a new facility without Yucca Mountain, completely authorized to collect nuclear waste?

Jim Rogers - Duke Energy Corporation - Chairman, CEO, President

Those are three really good questions, and you think it would take the rest of our time for me to do justice to them. They are such good questions. But first, with respect to the three banks, the bottom line is, our power plants will be basically funded on our balance sheet. We will be raising, as we raise debt in the future to fund this, it will be for the entire operations. We won't be specifically funding either one of these two plants.

Most importantly is the coal gasification facility in Indiana. Really is a plant that gives us the capability to be able to capture carbon, to the extent we can do carbon capture sequestration at that facility, and of course, our Cliffside plant has the capability to be ready for any new technologies that may come along, with respect to carbon capture. So we think the bank's position on this, as we understand it, we don't think it will have any impact on our funding of our capital program going forward.

With respect to carbon legislation, it is clear that we are on-track to get carbon legislation in this country, I believe in '09 or '10. It looks like it will be a nationwide cap in trade system. There is a lot of debate with respect to the allocation of allowances, and that is really critical from our standpoint, in terms of impact on our customers. But in every jurisdiction we do business today, we have the ability to recover the cost of compliance with Federal environmental law.

In fact, we have just come out of a \$5 billion cap spend, where basically on that capital program, we weren't nicked a nickel by any of the regulators with respect to those expenditures, and all of them was to reduce SOx, NOx, and mercury from our existing plant. So we are confident that we will be able to recover these costs going forward. We believe that we are really standing in the shoes of our customers, as we debate these issues in Washington, to try to minimize the impact on our customers and on the communities we serve, and our communities have long been reliant upon coal to supply electricity.

With respect to your third question on nuclear, we filed in December our construction operating license application with the NRC for our Lee plant. We believe that under the existing law even though Yucca Mountain has not been resolved, that the NRC will be able to grant us a license, a construction operating license to go forward. We do believe that the Yucca Mountain issue, or the spent fuel issue feeds to get resolved, and we are working hard to get resolution of that issue.

Lasan Johong - RBC Capital Markets - Analyst

How many years of storage do you have planned for your new nuclear plant, should you come out and not be ready in time?

Jim Rogers - Duke Energy Corporation - Chairman, CEO, President

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We have adequate storage at all of our existing sites to continue to operate them through the terms of their licenses.

Lasan Johong - RBC Capital Markets - Analyst

Fantastic. Thank you.

Jim Rogers - Duke Energy Corporation - Chairman, CEO, President

Thank you.

Operator

All right. And we will hear next from Paul Ridzon.

Jim Rogers - Duke Energy Corporation - Chairman, CEO, President

Paul, welcome.

Paul Ridzon - Keybank Capital Markets - Analyst

You indicated that the 100 million of weather EBIT benefit was offset by comp, and I guess O&M to meet the higher operating requirements of plants in the heat. What was the split between those two?

David Hauser - Duke Energy Corporation - Group Executive, CFO

The incentive goals were about 45 million over last year. They were about 60 million over the plan. And then maintenance was, I think that was 40 million, does that sound right? I think that is right.

Paul Ridzon - Keybank Capital Markets - Analyst

These are pretax numbers?

David Hauser - Duke Energy Corporation - Group Executive, CFO

50 million of maintenance. Yes, those are both pretax numbers.

Paul Ridzon - Keybank Capital Markets - Analyst

What should the O&M look like directionally versus '07 for '08?

David Hauser - Duke Energy Corporation - Group Executive, CFO

We have run the budgets. The O&M is up very modestly, but that is all reflected in the 2420 of earnings that we provided as the EBIT goal, so we expect the total Franchised Electric to be up \$115 million next year. And that is with normal weather.

Paul Ridzon - Keybank Capital Markets - Analyst

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Thank you.

Jim Rogers - Duke Energy Corporation - Chairman, CEO, President

Thank you very much for your question.

Operator

Now we will go to Brencourt, [Andrew Levi].

Jim Rogers - Duke Energy Corporation - Chairman, CEO, President

Good morning. Welcome.

Andrew Levi - Brencourt Advisors - Analyst

Glad I got a welcome. Jim this question is for you. I guess you were quoted, there is a Reuters story out that Duke has earned the right to do another deal. There are some statements in there about wanting to have a smaller carbon footprint. Can you maybe just go into that?

Jim Rogers - Duke Energy Corporation - Chairman, CEO, President

Sure, I would be delighted to. When I look back at the fact that we gained approval for our merger in 11 months, from five states, that was warp speed. And I put a tick in the box as a success, in terms of getting the requisite regulatory approvals. When I look at how we have integrated these two companies, how we have harvested cost savings, with more work to do, but I can put a tick in the box, that we have been able to achieve our expectations there. And so it would be my judgment that we have earned the right to do another deal. The question is what is the criteria and when.

And if we are fortunate enough to do another deal, and that is just a matter of the timing and the opportunities that may present themselves, but our criteria obviously, as it is for any combination, is going to be accretive to earnings, it has got to create value for our shareholders, it has got to make sense from our customer's standpoint, it has got to allow us to have the size and scale that I believe will be increasingly necessary, as the price tag on nuclear plants and coal plants continue to go up, as we look at the significant capital programs that we have.

So it would be my belief that we are well-positioned. If you look back over the last 15 years, there has been continued consolidation in our industry. I think that is going to continue. I think the fact that we (our industry) had two failed mergers in the recent past, it seems to be a period where it is ebbing.

I do believe that you are going to see additional combinations occur in our industry in the future, and we will start to move into more of, to use the ebb and flow analogy, a little more flow there. But from our standpoint, our primary focus is what I like to say is on the cake. It is on getting that 5 to 7% growth, hammering it out, hammering it out and getting the regulatory initiatives we have resolved as we did last year. It is bringing these two plants in on time, under budget.

That is our primary focus, and that is going to create the value. It will be icing on the cake for us if we are able to find the right strategic partner that will allow us to meet our criteria. One of the criteria you mentioned is a combination maybe with a company that at the end of the day, that the carbon footprint is smaller as a consequence of the combination. That is just one of many criteria, and quite frankly you never find a partner that matches up on everyone. That is just the reality of combinations.

But my point was simply we have earned the right, we are opportunistic, our primary focus is on the blocking and tackling, and to make sure there is no confusion about that. Thank you though, for the question.

Andrew Levi - Brencourt Advisors - Analyst

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Thank you as always.

Operator

Okay. And now we will move on to Michael Lapidès with Goldman Sachs.

Michael Lapidès - Goldman Sachs - Analyst

Hi guys, congratulations on a good quarter and a good year!

Jim Rogers - Duke Energy Corporation - Chairman, CEO, President

Thank you and welcome, Michael.

Michael Lapidès - Goldman Sachs - Analyst

Thank you. A couple of easy questions for you. When you think about the long-term growth rate of the Latin American business on the existing assets, how should we think about that? It is kind of hard for us to model out growth of the acquisitions only because we don't really know what you are going to buy. So on the existing asset base, what do you view as the long-term growth rate?

David Hauser - Duke Energy Corporation - Group Executive, CFO

We haven't really thought about it exactly like that Michael. I think as demand keeps growing in Brazil, the key driver is going to be the new assets that we bring in and the higher prices. I think if you thought about in a way that parallels the growth in Brazil, you should see our underlying growth move with it.

Michael Lapidès - Goldman Sachs - Analyst

Got it. Also on the real estate, on your equity investment in Crescent, can you talk about your outlook for the next year or so, given the overall U.S. real estate market?

David Hauser - Duke Energy Corporation - Group Executive, CFO

We put out, our 49% target is 75 million. Our businesses that are in the Commercial areas, especially in the Charlotte area are doing well. Our businesses that are Palmetto Bluffs down in the Hilton Head area is doing very well. The businesses in Florida are not doing very well. So that is really kind of the split, and so the question is how fast does Florida bounce back.

Michael Lapidès - Goldman Sachs - Analyst

And how much of a percent of total is Florida versus the other two components?

David Hauser - Duke Energy Corporation - Group Executive, CFO

I don't have an exact percentage, but it is much smaller than the Hilton Head area and the Charlotte area.

Michael Lapidès - Goldman Sachs - Analyst

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Got it. Last question. We have seen Appalachian coal prices pretty much shoot through the roof over the last couple of weeks, really the last month or so. Can you talk about whether that has any impact on whatever agreement you and the other companies reach in Ohio going forward in the next few months?

Jim Rogers - Duke Energy Corporation - Chairman, CEO, President

It would be my judgment that this volatility in pricing for coal will not, we are at a delicate part of negotiations today before the Legislature, trying to put in place new legislation that would allow us to operate beyond the end of the rate stabilization period, which ends at the end of '08, but we don't see this volatility in pricing affecting that negotiation at this time.

Michael Lapidès - Goldman Sachs - Analyst

Okay. Thank you, guys. Much appreciated.

David Hauser - Duke Energy Corporation - Group Executive, CFO

See you, Michael.

Michael Lapidès - Goldman Sachs - Analyst

Thank you.

Operator

Okay. We will now move on Steve Fleishman with Catapult Capital Management.

Steve Fleishman - Catapult Capital Management - Analyst

Hi, Jim.

Jim Rogers - Duke Energy Corporation - Chairman, CEO, President

Hi, Steve. Welcome.

Steve Fleishman - Catapult Capital Management - Analyst

Thank you. Couple of questions. First, just a detail one. The discontinued operations for 2007, did you say that was the synfuel?

David Hauser - Duke Energy Corporation - Group Executive, CFO

That is the biggest single thing in there. We moved that to discontinued operations in December.

Steve Fleishman - Catapult Capital Management - Analyst

Okay. Did that basically move all synfuel earnings out for the year?

David Hauser - Duke Energy Corporation - Group Executive, CFO

Yes, so the entire thing has moved out.

Steve Fleishman - Catapult Capital Management - Analyst

Including the tax benefits or not?

David Hauser - Duke Energy Corporation - Group Executive, CFO

That is right, both the expense of operating the plants and the tax benefit is netted in discontinued operations.

Steve Fleishman - Catapult Capital Management - Analyst

Okay. You said that was net positive \$0.02.

David Hauser - Duke Energy Corporation - Group Executive, CFO

That was a positive \$0.02.

Steve Fleishman - Catapult Capital Management - Analyst

Okay. Secondly, on the Cliffside plant, you guys had put out a release prior to the approval by the Department, regarding I guess some of the Democrat gubernatorial candidates coming out against the plant and the approval. Obviously you got the approval now. What happens if one of those candidates becomes Governor? Have they indicated, is it kind of water over the bridge at this point, under the bridge at this point, or --?

Jim Rogers - Duke Energy Corporation - Chairman, CEO, President

Probably under the bridge for one, and over the bridge for the other. Because they won't both be around at the end of the election. But I think their position, when you parse through the position, and we have obviously had conversations with the candidates since then, they were focused more on delay in the issuing of the permit, not whether it should be done or not, is the way I read their press releases.

The bottom line is, is that the permit has been issued, and that ends the conversation, because we have both a certificate saying we need to build the coal plant, and in fact, our State Commissions say it would be imprudent to not build it and build gas in lieu of it. When you see the article in the "New York Times" today on gas pricing, the volatility of rising gas pricing, it kind of reinforces the judgment that was made by the North Carolina Commission on that point. So we have a certificate at hand, we have an air permit in hand that we have accepted, and we will be turning dirt, and starting the construction process now. So we do not think that their position on this will affect us.

Now, if you are looking forward in terms of building additional coal plants in North Carolina, our current view is, is that as we look at our resource plan and given the fact that we have a nuclear plant planned to come on line in the 2018 timeframe, as we look out we don't see the need for another base load coal plant for many years. In fact, I would go so far as to say we don't need another base load coal plant until carbon capture and sequestration technology has been commercialized, which some people say could be as much as 15 years off. So that is my way of saying that this issue will not present itself in the near term again, and what has been done on Cliffside can't be undone at this point.

Steve Fleishman - Catapult Capital Management - Analyst

Okay. Great. And then finally, just on the growth rate comments that you made, Jim, you are basically saying that you are still at a 5 to 7% long-term growth off of that \$1.15, but feel more confident that you might be able to reach the high end of that?

Jim Rogers - Duke Energy Corporation - Chairman, CEO, President

Yes.

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Steve Fleishman - Catapult Capital Management - Analyst

Okay. Thank you.

Jim Rogers - Duke Energy Corporation - Chairman, CEO, President

Thank you very much.

Operator

We will now take our last question from Leslie Rich with Columbia Management.

Leslie Rich - Columbia Management - Analyst

I got in under the wire.

Jim Rogers - Duke Energy Corporation - Chairman, CEO, President

You did Leslie. Welcome.

Leslie Rich - Columbia Management - Analyst

Thank you. As I look at the capital spending required for Cliffside and Edwardsport have your projections changed?

Jim Rogers - Duke Energy Corporation - Chairman, CEO, President

Our projections have not changed, and as you may remember, with Edwardsport, this is a CWIP project, and with respect to Cliffside, it is an AFD, allowance for funds used during construction project, with the ability to get cash CWIP at our next general rate case, which our current plans is probably in 2010.

Leslie Rich - Columbia Management - Analyst

Okay. So the timing and magnitude of the spend is more or less in-line with what you laid out?

Jim Rogers - Duke Energy Corporation - Chairman, CEO, President

That is correct. And actually one of the things we are doing, Leslie, a really good question on your part, with the certificates in hand, our people have gone to work to really tie down the costs of equipment that we will be using, at the same time working to tie down the cost of labor in these projects. We are committed to, on a periodic basis, and it is monthly in the Carolinas, and I don't remember the exact timeline in Indiana, but to go back, in Indiana, it is every six months. To go back to the state Commission and show them what our numbers are, show them how the costs are trending, to keep them fully informed with respect to any cost increases we may experience.

But our #1 objective today is to tie these costs down. The fact that there has been so many coal plants canceled, or plants abandoned, this might take some of the pressure off the skilled labor market in the U.S., but more to come on that, but the goal line is to tie the costs in, lock them down, and bring these things in on-time, under budget.

Leslie Rich - Columbia Management - Analyst

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Okay. And then question for David in terms of cash flow and funding. You show negative free cash flow of \$3.1 billion, and you said \$1.1 billion of that would be funded with cash? Is that what you said?

David Hauser - Duke Energy Corporation - Group Executive, CFO

Well, we have about \$1.1 billion in cash, and so we will use up our cash substantially this year, yes.

Leslie Rich - Columbia Management - Analyst

And so you would issue net debt of \$2 billion?

David Hauser - Duke Energy Corporation - Group Executive, CFO

We actually have about a \$1.5 billion of maturities this year also that we will have to replace. So you would to have add in that.

Leslie Rich - Columbia Management - Analyst

All right. So 3.5 billion of new debt?

David Hauser - Duke Energy Corporation - Group Executive, CFO

That is a good way to think about. We already did \$900 million of that.

Leslie Rich - Columbia Management - Analyst

I am just wondering why your interest expense only goes up by \$15 million. Am I missing something?

David Hauser - Duke Energy Corporation - Group Executive, CFO

I think the big driver is we will be decreasing our use of commercial paper this year. We had a lot of commercial paper last year, where we had sold the commercial paper and then reinvested the money. And I think that probably the difference is associated with that commercial paper. Plus the timing of the debt. A lot of the debt won't be until late in the year.

Leslie Rich - Columbia Management - Analyst

Okay. And then finally, I am sorry if you have said this twice or more, the purchase accounting adjustment of 105 million in Commercial Power in '08, is that what you were referring to when you said coal prices went up, power prices didn't go up as much, or that was a comment about '07?

David Hauser - Duke Energy Corporation - Group Executive, CFO

No, the mark to market question is what I was answering when I talked about coal prices and power prices.

Leslie Rich - Columbia Management - Analyst

So what is happening with the purchase accounting?

David Hauser - Duke Energy Corporation - Group Executive, CFO

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So purchase accounting was about \$110 million this year, and will be about \$5 million, it was 110 million in '07. It will be about \$5 million in '08. That is the \$105 million.

Leslie Rich - *Columbia Management - Analyst*

Great. Thank you.

David Hauser - *Duke Energy Corporation - Group Executive, CFO*

Okay.

Jim Rogers - *Duke Energy Corporation - Chairman, CEO, President*

Leslie, thank you very much.

David Hauser - *Duke Energy Corporation - Group Executive, CFO*

See you, Leslie.

Operator

Okay. And Mr. Trauschke, I will turn the conference back over to you for any closing or additional remarks.

Sean Trauschke - *Duke Energy Corporation - SVP, IR*

Thank you, Wendy. We want to thank you all for joining us today, and as always, our team will be available to answer any follow-up questions you may have. Thank you.

Operator

And that concludes today's conference call. Thank you for your participation. You may now disconnect.