

Conference Call Transcript

DUK - Q1 2007 Duke Energy Corporation Earnings Conference Call

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PRESENTATION

Operator

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

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

Sean Trauschke - Duke Energy Corporation - VP IR

Thank you, Cameron. Good morning, and welcome to Duke Energy's first quarter 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 the presentation by providing a general overview of our results and then David will provide more detail and context around our company's results and

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those of each of our businesses. Jim will close with a discussion of our outlook for the remainder of 2007 and beyond. Following those prepared remarks, we will open the lines up to 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 meanings of the 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 and President

Thank you, Sean. Good morning, everyone. And thank you for joining us today. This is an exciting time for all of us at Duke Energy. We have just completed our first quarter as a pure-play electric company, after completing the spinoff of Spectra Energy on January 2. Before we discuss first quarter results, let me first say how pleased I am with the focus and dedication of our team from senior management, to hard-working employees at every level. At every part of our business, we have come together as one company, with one purpose - to create value for our customers, investors and other stakeholders. Our achievements in 2006, as well as our ongoing successes this year reflect that cohesion.

Last year, we moved at an incredible pace. We completed the merger, we derisked the business, sold our marketing and trading, brought Morgan Stanley in as a partner in our real estate business and we completed the spin. This year, we are moving as fast or faster. New plants approved. New legislation passed. New energy efficiency proposal filed. And more to come.

Let's now turn to our first quarter results. In our news release this morning, we reported ongoing diluted earnings per share of \$0.30 for the first quarter of 2007 versus \$0.21 in the prior year's quarter. We beat our internal profit plan for the quarter. The higher numbers reflect the addition of our Midwest power assets, as well as improved results in our International business.

Overall, our first quarter results reflect the strong performance of our core regulated businesses, as well as follow-through on our merger initiatives. We're on track to reach our 2007 employee incentive target of \$1.15 per share on an ongoing diluted basis. Now, I will ask David to give you more detail around the quarter's results. Later on, I will discuss what we see as the significant drivers of our success going forward. David?

David Hauser - Duke Energy Corporation - CFO, Group VP

Thank you, Jim. As Jim told you, Duke Energy reported ongoing diluted earnings per share for the first quarter of 2007 of \$0.30 versus \$0.21 in the first quarter 2006. The \$0.21 excludes the results of the natural gas businesses, which were spun off as Spectra Energy in January 2007 and which are now included in Discontinued Operations.

I realize that given all of the changes in our Company since the close of the first quarter of 2006, it is difficult to understand our ongoing results for 2007 versus 2006. Since we think it is important for you to understand how the business is progressing, we have done a calculation with some simplifying assumptions to make the first quarter of 2007 and the first quarter of 2006 comparable. The largest assumption would be putting Cinergy in the first quarter 2006 numbers. The result of combining Cinergy's and Duke Energy's first quarter results is that 2006 would have been approximately \$0.25 per share, versus \$0.30 per share for 2007 ongoing earnings.

Now, I will begin reviewing our business segment results. I will start with our largest business segment, Franchised Electric and Gas. The segment reported first quarter 2007 EBIT from continuing operations of \$574 million, compared to \$359 million in the prior year quarter. The increase was driven primarily by the addition of the regulated utility operations of Cinergy, increased demand from retail customers, favorable weather conditions and a settlement with the Department of Energy. These increases were partially offset by rate reductions due to the merger and lower bulk power marketing sales.

The addition of Cinergy's regulated operations was the largest driver of the increase in EBIT. The former Cinergy operations contributed \$218 million of EBIT for the quarter. This is net of \$13 million in rate reductions related to merger approval requirements in Ohio, Indiana and Kentucky. I will talk a little more about that later.

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The segment benefited from continued residential and commercial customer growth in our Duke Energy Carolina service territory. The number of customers in the Carolinas has increased by approximately 47,000 or 2% since the first quarter of last year. The segment's results were also positively impacted by increased sales, as favorable weather conditions drove a year-over-year jump in gigawatt hour sales to our Carolina retail customers. Heating degree days for first quarter 2007 were approximately 3% higher than the same period in 2006. The improvement in weather in the Carolinas increased sales by \$22 million.

In addition, a settlement with the DOE resulted in a \$26 million increase in EBIT. You will remember that in early March, we announced that we had reached a settlement resolving Duke Energy's used nuclear fuel litigation against the DOE. Under the settlement, the government agreed to reimburse Duke Energy for previously recorded qualifying storage costs. These additions to EBIT were partially offset by rate reductions in the Carolinas of approximately \$38 million for the quarter. As you know, we agreed to distribute most of the merger savings that we're sharing with our customers within the first 12 months of the merger closing.

For the quarter, the EBIT contribution from bulk power marketing in the Carolinas was \$32 million, net of the impact of sharing of profits from wholesale power sales with industrial customers. Year-over-year bulk power marketing was down \$17 million. The decrease was driven by lower prices in 2007. Regulatory amortization expenses for North Carolina's Clean Air Program were approximately \$56 million for the quarter, compared to approximately \$62 million during the same period in 2006. We expect total expenses to be about \$190 million in 2007, in order to meet the minimum required by the Clean Air legislation.

We were pleased with the operating performance of our regulated generation. For our nuclear operations, the capacity factor during the first quarter was 97.2%. And our fossil/hydro commercial availability index was above target at 93.1%.

Before I move on, I would like to give a brief update on merger-related rate reductions. As I've told you in the past, these reductions will, for the most part, roll off in 2007, allowing for future earnings growth. In 2006, we shared approximately \$132 million, with our customers in all of our jurisdictions. In the first quarter of 2007, we shared \$51 million. We expect to share approximately \$37 million in the second quarter and \$6 million in the third quarter. Except for a very small amount that we will continue to share with our customers in Kentucky, we will have then shipped satisfied our merger savings agreements.

Next, I will review Commercial Power. This segment includes the former CG&E nonregulated generation, acquired when we merged with Cinergy, as well as our Midwest gas-fired plants. For the quarter, Commercial Power had a segment EBIT loss of \$9 million from continuing operations. Despite the loss, EBIT increased approximately \$17 million when compared to a \$26 million segment EBIT loss in the first quarter of 2006.

The increase in Commercial Power's EBIT was driven by the addition of Cinergy's nonregulated generation in the Midwest and reductions in governance costs related to the gas-fired plants in the Midwest. The contribution from Cinergy's nonregulated generation in the Midwest was approximately \$107 million. This was offset by \$53 million of purchase accounting charges associated with the merger, and \$23 million of costs associated with our synfuel facilities. The expense of running the synfuel facilities is included in Commercial Power but of course the tax credit, which is larger than the expense, is in income taxes.

As I promised during our last call, we will begin to provide the effect of mark-to-market treatment as a separate earnings driver. First, let me provide a little background. Most of the output from our generation in Ohio is sold to our native load customers. We economically hedge the remaining output by selling the power forward and buying the associated inputs of coal and emission allowances. Certain transactions that we use to execute this hedging strategy receive mark-to-market treatment under the accounting rules. Consistent with Duke's past practices, we consider any mark-to-market impact as part of ongoing earnings. During the first quarter, Commercial Power's EBIT was negatively impacted by \$26 million of mark-to-market losses on economic hedges. \$8 million of the \$26 will turnaround this year as the transactions settle.

We now think purchase accounting charges will be higher in 2007 than originally expected by an additional \$20 million or so, over our initial expectation of approximately \$90 million. This is due to the sale of some emission allowances, which we thought would occur later. This acceleration reduces future impacts since the amount of purchase accounting, over time, stays the same.

For the first quarter of 2007, Duke Energy International produced segment EBIT from continuing operations of approximately \$94 million, compared to \$86 million in last year's first quarter. This is a 9% increase over the segment's strong first quarter of 2006. International's increase was driven primarily by favorable energy prices in Brazil, and favorable foreign exchange rates, offset somewhat by increased fuel costs in Guatemala. In early February, DEI completed the sale of its 50% ownership interest in two hydroelectric power plants in Bolivia. As a result, Duke Energy no longer owns assets in Bolivia.

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Our Crescent Resources segment's results were down from \$42 million in first quarter 2006, to \$2 million in first quarter 2007. The first quarter 2007 results reflect the impact of Duke Energy's reduced ownership of Crescent. With Duke Energy's effective 50% ownership interest, Crescent's results are reported under the equity method of accounting. Crescent's results were negatively affected by lower developed lot and land sales, and a deduction for interest costs of \$10 million, which did not exist in the prior year quarter's EBIT.

Next, I will review our Other category. As a reminder, Other includes costs associated with corporate governance, and Duke Energy's captive insurance company, Bison Insurance Company Limited. Excluding special items, other was essentially flat, year-over-year. Other's first quarter 2007 ongoing EBIT loss from continuing operations was \$52 million, compared to a loss of \$49 million in the prior year's quarter.

Two special items have been excluded from Other's 2007 ongoing EBIT results. The first was convertible debt charges of \$21 million related to the spinoff of Spectra Energy. These charges represent the distribution of approximately 2 million shares of Spectra Energy common stock to the holders of Duke Energy's convertible notes outstanding. The distribution was in accordance with the terms of the notes. The second special item was \$11 million in charges related to costs to achieve the merger.

Now, I would like to take a few minutes to talk about some other financial items. At the end of the first quarter, we had a net cash balance of \$1.4 billion. \$1.8 billion of cash, cash equivalents and short-term investments, offset by \$400 million of commercial paper outstanding.

Interest expense from continuing operations for the three months ended March 31, 2007, increased \$61 million, compared to the same period in 2006. This increase was due primarily to the addition of Cinergy's debt onto our balance sheet at the time of the merger.

Income tax expense from continuing operations for the first quarter decreased \$3 million compared to the same period in 2006. The decrease was driven by a lower effective tax rate, and offset somewhat by higher pre-tax income in the first quarter of 2007, when compared to the first quarter of 2006. The recognition of synfuel credits and a reduction in the unitary state tax rate in 2007, primarily as a result of the spinoff of Spectra Energy, were the main drivers of the decrease in the effective tax rate from 34.7% to 23.1%.

Finally, there were no share repurchases during the quarter.

In closing, we are pleased with our first quarter performance and believe that it gives us solid footing to achieve our employee incentive earnings per share target of \$1.15. With that, I will turn it back over to Jim.

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

Thank you, David. I want to take a few minutes now to discuss some of the issues that are important to our strategy for this year and beyond. As we have discussed before, our earnings growth plan has three key drivers.

First, steady sales growth of 1.5% in the Carolinas, and 1% in the Midwest. Second, cost reductions and continuous performance improvement initiatives will drive our growth. We are ahead of plan on our merger-related metrics. Of the hundreds of cost saving initiatives we have identified, substantially all of them are either completed or on track for completion. Building on our merger integration success, we have also created a continuous improvement team to focus on further process simplification and efficiencies, particularly in our shared services and corporate center. The third driver for growth is the timely recovery of and on the significant capital investments we have planned, including approximately \$9 billion in regulated CapEx over the next three years. These investments will increase by 25% the rate base of our franchise electric and gas segment by the end of 2009. Today, we are working to put the regulatory mechanisms and legislative framework in place to execute on this build-out.

The primary purpose of these investments is to meet our customers' growing energy requirements and to upgrade our grid. Success in these three areas will help us achieve ongoing earnings growth of 4% to 6% annually through 2009. Today, I would like to focus on the regulatory and legislative initiatives that underpin our investment plans.

So far this year, we have successfully launched, as well as advanced, several major initiatives through the regulatory and legislative processes in our states. Most of them directly support our plan to make major investments in new generation in all of our service areas. First, in late February of this year, the North Carolina state commission gave us approval to build an 800-megawatt coal unit at our Cliffside plant in North Carolina. In its order, the Commission determined that we need 2,100-megawatts of new generation in the Carolinas by the year 2011.

Even with Cliffside, we still need an additional 1,300-megawatts of gas-fired or renewable generation or energy efficiency "save-a-watts". We plan to file a Certificate of Public Convenience and Necessity later this year for permission to build additional gas-fired generation in the state. In its order, the Commission also accepted our commitment to invest 1% of revenues each year in energy efficiency in the Carolinas, subject to appropriate regulatory treatment, and to retire up to 800-megawatts of older less efficient coal-fired capacity.

For every megawatt we save through energy efficiency, we will retire a megawatt of this older higher emitting capacity. As expected, on April 20, a group of environmental intervenors filed a joint motion requesting that the Commission reconsider its approval and we have responded to that motion. We expect the Commission to address this motion later this year.

By May 31, we will also be filing revised cost estimates for the Cliffside plant. We're in the process of revising our air permit application for Cliffside, to include a new pollution control technology that will provide the same or better environmental performance but more reliably and more economically. We expect this to result in only a short delay in the permitting process. Assuming the positive outcomes on these issues, we expect to move forward with our plans to build Cliffside.

Secondly, we expect to file a construction and operating license with the NRC this fall for the Lee Nuclear Station in Cherokee County, South Carolina. Nuclear generation has zero greenhouse gas emissions and is a key part of our plan to reduce the carbon footprint of our portfolio. As announced yesterday, Southern Company has elected not to participate in this project as originally planned.

It is our intent to continue to pursue this project for the benefit of our customers and shareholders. In the fourth quarter, we plan to file a Certificate of Public Convenience and Necessity in South Carolina for the new station. We expect a decision from the Commission in 2008. It would be Duke's fourth nuclear station and would come online in the 2016 time frame.

Third, in April, we filed a Front-End Engineering and Design study, we call it FEED, for our proposed 630-megawatt IGCC plant in Edwardsport, Indiana. The estimated cost of just under \$2 billion is consistent with EPRI's estimated range for a plant of this size and type of technology. Over time, the project will generate approximately \$460 million in federal, state and local tax incentives, including a federal "clean-coal" tax credit of \$133.5 million -- the maximum amount available for the gasification technology. Hearings will begin in June on our application for a certificate to build. And we expect an order from the Indiana commission in the fourth quarter.

Fourth, yesterday, we filed a proposal with the North Carolina commission to implement a new regulatory model for energy efficiency. We consider energy efficiency to be our fifth fuel in meeting customers' energy needs, along with nuclear, advanced coal, natural gas and renewables. The filing provides incentives for Duke Energy to offer new energy efficiency programs, as well as incentives for customers to participate.

This "save-a-watt" proposal would put our energy efficiency programs on an equal footing with our investments in power plants and help us meet growing demand at a lower cost. In formulating this plan, we have been meeting with customers and other stakeholders to identify the most useful and effective ways to improve and expand our company's energy efficiency efforts. While the states we serve have different rules and regulatory structures, we plan to eventually put this proposal in place in all five states.

Fifth, we have also made significant progress in our efforts to obtain assurance of cost recovery, as well as recovery of ongoing financing costs during construction of new generating capacity. South Carolina has just passed a new law, which provides ongoing cost recovery assurance for the construction of new nuclear or coal generation. And allows us to recover our financing costs in rates as we build a new nuclear plant. The legislation also provides for the recovery of certain pollution control expenditures.

In North Carolina, we are working with a diverse group of stakeholders to develop a comprehensive energy bill. Among other things, we are supporting a provision in the proposed bill that would eliminate the financial distress requirement in the current CWIP statute. This change would allow us to apply to the Commission for recovery of ongoing financing costs during the construction of our proposed new nuclear plant without having to demonstrate financial distress.

Meanwhile, the North Carolina commission issued an order stating that it would be appropriate for us to conduct siting, design and licensing work for our proposed nuclear station in South Carolina. And that we may recover these development costs in the future, to the extent that the specific activities and costs are found to be reasonable. The public staff has since asked for reconsideration or clarification of certain aspects of that order. We expect the commission to issue an order in response to this request later this year.

The sixth initiative is one where we are working toward a long-term solution for Ohio's regulatory framework. Last week, our new Governor in Ohio, Ted Strickland, outlined his energy agenda. He is preparing to address, along with the legislature, the need to build new generation, as well

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as whether to adopt a renewable portfolio standard and energy efficiency provisions. He is currently meeting with key stakeholders throughout the state to discuss his plans and solicit their input. He met with the CEOs of Ohio utilities last week.

It is my judgment that Ohio is falling behind other states in developing new generation to meet future growth. Legislation may well be needed to explicitly authorize electric distribution companies to plan, purchase and build new facilities, as well as to encourage development of new technology, alternative energy products and energy efficiency. For example, we need nearly 1,500-megawatts of new generation in Ohio now just to meet current customer demand.

We have not added new generation that is committed to our customers in Ohio, in more than 15 years. As you may remember, we filed last year for an extension of Ohio's rate stabilization plan through 2010. We're currently planning to enter settlement discussions regarding our pending proposal and plan to suggest a five to 10 year extension, rather than the two-year extension we requested initially. We will also seek to structure this long-term commitment to enable us to build or buy generation to meet our projected shortfall in capacity over the extended period.

And finally, on June 1, we will file our first rate review case with the North Carolina commission in 16 years. The Commission requested the rate review as part of its approval of the Duke/Cinergy merger. Our base rates have not changed since 1991, and current prices are currently about 20% below the national average. As this slide shows, the cost of electricity has increased at a lower rate than for most other consumer goods. And Duke's rates compare favorably to other utilities in the Carolinas, in the South Atlantic states and throughout the U.S. As you would expect, we are hopeful that by working closely with our customers and the Public Staff, we can reach a settlement. We would expect the commission's order in late 2007.

As you can see, we have made significant progress on our regulatory and legislative priorities in the last quarter, and over the past year. Our long-term plan is to build or buy some 5,200-megawatts of new capacity by 2016, which is almost 20% of our current regulated generation. At today's construction costs, it can result in projected CapEx of \$10 to \$15 billion for generation over the next nine years.

We're also in a strong financial position. We're meeting our capital budgets and focusing on controlling costs and continuous improvement. Again, as we said earlier, we are on track to reach our 2007 employee incentive target of \$1.15 per share on an ongoing diluted basis. Our dividend yield is competitive. And we're on track to achieve annual ongoing earnings growth of 4% to 6%. Altogether, it is a great value proposition for investors. Now, David and I will take your questions.

QUESTION AND ANSWER

Operator

(OPERATOR INSTRUCTIONS) We will take the first question from Paul Patterson with Glenrock Associates.

Paul Patterson - Glenrock Associates - Analyst

I just wanted to go over the taxes a little bit more. What is the effective tax rate that you guys are expecting now for 2007? Has that changed at all?

David Hauser - Duke Energy Corporation - CFO, Group VP

Yes, it has. And Paul, this is David. It has changed for two reasons. When we told you the number before, we told you a number of 33% for 2007. I would say now, it is looking like 28%. And I think that is for three reasons. I think we will have a bit more synfuel than we believed we'd have at the beginning of the year. We have been able to restructure Brazil, which gives us a tax benefit on the the dividends from Brazil. And we also had the unitary adjustment that I meant -- that I discussed in my script. So, a number of like 28% this year would be a good way to think about it.

Paul Patterson - Glenrock Associates - Analyst

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Okay. So the rate will go up further as we go on further on through the year?

David Hauser - Duke Energy Corporation - CFO, Group VP

Yes, I think that's right.

Paul Patterson - Glenrock Associates - Analyst

And that's because you don't expect synfuels to be the same strength and the unitary, what is it that is driving that?

David Hauser - Duke Energy Corporation - CFO, Group VP

The driver of that is that there was a unitary adjustment associated with deferred income taxes that occurred in the first quarter and that was a little over \$20 million.

Paul Patterson - Glenrock Associates - Analyst

And then the \$53 million in the commercial business, it says \$40 million of that was associated with the emission sales, is that correct?

David Hauser - Duke Energy Corporation - CFO, Group VP

No. The \$53 million is the total purchase accounting adjustment. And it is about -- we've increased our estimates by \$20 million due to the emission allowances for the year.

Paul Patterson - Glenrock Associates - Analyst

Okay. Thank you very much.

Operator

We will take our next question from Jonathan Arnold with Merrill Lynch.

Jonathan Arnold - Merrill Lynch - Analyst

Just picking up on Paul's question. In briefly looking at the numbers, it seems like a 5 point move in the tax rate would be worth somewhere approaching \$0.10 a share on an earnings basis. How -- should we be thinking about it that way? Or are there other pressures offsetting that, that of course you can stick with the statement around the incentive target here?

David Hauser - Duke Energy Corporation - CFO, Group VP

Well, I think that, to the degree the tax rate is impacted by synfuel, you will have expense, as well as then you will have the tax credit, so there are some moving pieces. To the degree the tax rate was affected by the unitary adjustment, which as I said was \$20 million, that doesn't have an offset. So that's the two big pieces that drive it. But synfuel has an expense and a tax credit. And overall, we have told you that synfuel would be \$0.03 this year. That was what was in the \$1.15. And if oil prices today stays exactly where it is, we would expect to do a little better than that but I don't think I am going to predict oil prices.

Jonathan Arnold - Merrill Lynch - Analyst

Could you tell us how much synfuels was in the first quarter?

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David Hauser - Duke Energy Corporation - CFO, Group VP

Yes, it was \$0.01.

Jonathan Arnold - Merrill Lynch - Analyst

Okay. And one follow-up. On the CapEx forecast, you had mentioned, Jim, \$9 billion of regulated spending through 2009.

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

That's correct.

Jonathan Arnold - Merrill Lynch - Analyst

Just looking back to the numbers from January, it was more like I think \$10.3. Can you -- and I don't remember you were that clear at the time about exactly what was in the numbers originally. Can you speak to that change and which lines it has come out of?

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

Well, as it works out, we're both right. The \$9 number is tied to regulated. \$10.3 is total CapEx, which includes other parts of our business.

Jonathan Arnold - Merrill Lynch - Analyst

So no change basically?

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

No change.

Jonathan Arnold - Merrill Lynch - Analyst

Okay. Thank you.

Operator

And we will take our next question from Paul Ridzon with Keybank.

Paul Ridzon - Keybank Capital Mkts - Analyst

Could you review structurally in '08 what is going to happen with regards to rate cuts rolling off and purchase accounting changes?

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

First, Paul, I will address the rate credits. They roll off in '07. So midyear this year, the rate credits roll off. With respect to the other aspect of your question, David?

David Hauser - Duke Energy Corporation - CFO, Group VP

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Yes, the purchase accounting that we would expect for next year, for the year '08, should be something like \$10 million. And keep in mind, that number, the total amount of it over time will not move. But the amount year by year will move some, as we change the business. For example, we told you we sold some emission allowances in the first quarter. So, the current projection would be \$10 million for next year.

Paul Ridzon - Keybank Capital Mkts - Analyst

Versus what is the total for '07?

David Hauser - Duke Energy Corporation - CFO, Group VP

The total for '07, we would expect to be about \$110 million.

Paul Ridzon - Keybank Capital Mkts - Analyst

And just --?

David Hauser - Duke Energy Corporation - CFO, Group VP

Of course, \$53 occurred in the first quarter.

Paul Ridzon - Keybank Capital Mkts - Analyst

And then back to the tax rate, should we think that the \$1.15 is kind of in the bag or are there cost pressures that are offsetting that?

David Hauser - Duke Energy Corporation - CFO, Group VP

Well, we certainly think we will achieve the \$1.15. I don't think I would use the words "in the bag." We have a lot of work to do to continue running the business. But we think we will achieve the \$1.15.

Paul Ridzon - Keybank Capital Mkts - Analyst

Is it incrementally easier with the tax rate?

David Hauser - Duke Energy Corporation - CFO, Group VP

Certainly, that is a positive. Having a lower tax rate is helpful, absolutely.

Paul Ridzon - Keybank Capital Mkts - Analyst

Okay. Thank you very much.

Operator

And we will take our next question from Michael Lapidés with Goldman Sachs.

Michael Lapidés - Goldman Sachs - Analyst

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I have kind of a longer term question. When you think about consolidation of regulated utilities, what is -- with the group trading at pretty high levels just in terms of historical PE multiples, does this make potential M&A or consolidation more difficult or less attractive for larger companies like yourself?

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

My personal view is, is that trading at these levels doesn't make it more difficult. What makes it more difficult is the range of which utilities in this industry are trading. For instance, it is a very narrow band between the lowest PE and the highest PE and it is that narrow band that makes it more difficult to envision greater consolidation.

Michael Lapidès - Goldman Sachs - Analyst

When you think about a multiple of rate base, at what level does kind of -- what is a -- when you think about what a Company can create value with, if they buy another at a certain multiple of rate base, what is kind of the peak level before it becomes uneconomic to do so?

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

That's a tough question. And I'm not sure I have a good answer. And David, I would punt that to you.

David Hauser - Duke Energy Corporation - CFO, Group VP

Thanks. (Laughter) We really don't look at it exactly that way. Because the problem with the multiple of rate base is that that says an amount of goodwill that's going to be there, because you're normally not going to earn on dollars above the rate base. So we look at it as a PE ratio spread between the two companies and then a savings number. And those are the two things that drive a merger.

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

But I would add one point and this is an important point from our perspective. And I appreciate your general questions. But we're very focused on our 4% to 6% growth. We are very focused and it is very doable for us during this period of time. And we're focused on execution and as you've heard me say before, this is the cake. Any type of transaction would be the icing on the cake but our focus is on the cake.

Michael Lapidès - Goldman Sachs - Analyst

Understood. I just wanted to try to get your long-term views of the group in terms of consolidation.

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

I think consolidation, quite frankly, is inevitable in this industry, particularly when you see the increased costs associated with building new coal plants, new nuclear plants, and the need for significant capital investment in this industry to modernize our grid and to prepare to live in a world where there will be constraints on carbon. So I think you are going to continue to see the fundamental forces of this industry drive us to greater consolidation. And quite frankly, we've been on that track for about a decade and a half.

Michael Lapidès - Goldman Sachs - Analyst

Got it. Thank you.

Operator

And we will take our next question from Dan Jenkins with the State of Wisconsin Investment Board.

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Dan Jenkins - State of Wisconsin Investment Board - Analyst

I just had a couple of things. First of all, you mentioned that you have about \$1.4 billion of net cash and \$1.8 billion of total cash. What are -- and do you have any priorities for that going forward as far as dividends or share repurchases or what is the target to spend that money?

David Hauser - Duke Energy Corporation - CFO, Group VP

Dan, two thoughts. First of all, we are in a position where we are reinvesting a lot of money in our business. So our cash flow after reinvesting and after the dividend is negative over the next few years because we're reinvesting so much in the business. So, that will utilize the cash.

The second thing is we do pay a dividend that is over \$1 billion a year, and we intend to continue that and to increase it along with the 75% payout ratio. So we do not have any plan to have a big share buyback associated with that cash or anything like that. We intend to reinvest it in the business.

Dan Jenkins - State of Wisconsin Investment Board - Analyst

Okay. And then I noticed on one of your slides, you had some discussion there on the new source review, the Supreme Court case and so forth, but you didn't really talk about it in your presentation. I was curious, is that included at all in your CapEx budget? And if not, what could that -- how could that potentially impact the CapEx over the next few years?

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

Dan, when the Supreme Court remanded it back to the lower court -- and we have two cases, we have a legacy Cinergy case in the Midwest and a legacy Duke case here in the Southeast. And what this requires us to do is go back to the courts and continue to work through the litigation. We have strong defenses with respect to the NSR allegations, and this would require us to do kind of a -- to basically try these issues either before a judge or jury. I think we will do one before a judge and the other before a jury. I think that is what we're currently contemplating. And it will take us several years, two to three years to work through this. By the time we try the cases, they're appealed again and we go through the long process. So our judgment is, is this will have no impact on our CapEx over the next two to three years.

David Hauser - Duke Energy Corporation - CFO, Group VP

But let me add one thing. We are spending substantially on environmental CapEx to clean up, not associated with this case per se, but we will end up investing \$5 billion in scrubbers and SCR's for the powerplants. And of that, we've spent about \$3.5 so far. So there is substantial CapEx spent and in the plan, not directly tied to NSR but tied to the environmental cleanup.

Dan Jenkins - State of Wisconsin Investment Board - Analyst

Okay. Thank you.

Operator

And we will take our next question from Carl Seligson with [Nyack] Management.

Carl Seligson - Nyack Management - Analyst

Curious about your plan that you filed relative to the save-a-watt situation and what you might expect in terms of actual savings from energy efficiency? You call it the fifth fuel, what is it going to do to your fuel bill? What is it going to do to your sales, et cetera?

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

We have -- this proposal is a very innovative proposal when compared to other plans and programs around the country. Effectively, what we have done is we are asking the Commission to allow us to make investments. And to the extent we create verifiable save-a-watts or a reduction in demand and energy, we're asking to be able to earn off the price of the save-a-watt, in the rate base, in the same way if we were to go out and build a power plant and were generating megawatts.

And so the value proposition here is such that it would incent us the same way we're incented to build power plants, incent us to produce save-a-watts going forward. We believe we can do this at a price discount of about 10% to our avoided costs. So by definition, it would be lower costs to our customers than having built a megawatt to serve that load.

The second point I would make is, is that in the Cliffside order, we have a commitment to the Commission, that the Commission has asked us to honor, that to the extent, for the first 800-megawatts -- or save-a-watts we generate, we use those save-a-watts to reduce or shut down old 50-year-old coal plants that we have in the Carolinas. So our objective over the next three years, as we build the Cliffside plant, is to be able to generate 800 to 1,000 or more save-a-watts, and that will allow us to shut down some of these old plants.

So we are very focused on getting results. We think how this works makes sense. We have talked to the environmental groups, as well as consumer groups about this and we think this approach will allow us to really, scale up and create a lot of save-a-watts in the future, and make it a true viable fifth fuel going forward.

Carl Seligson - Nyack Management - Analyst

The old plants that you contemplate shutting down under this are all at only nominal, if any value, in the rate base at the present time?

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

That's correct.

Carl Seligson - Nyack Management - Analyst

Okay. And presumably, the usage is also at very limited levels, is that also right?

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

It is true. We use those plants, so, they're really critical to removing our reserve margin. And we do use those plants -- we will use them increasingly over the next three to four years until the Cliffside plant comes on in 2011.

Carl Seligson - Nyack Management - Analyst

So shutting down the plant is not the reason why you are building Cliffside?

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

No.

Carl Seligson - Nyack Management - Analyst

Great. Thanks, Jim.

Operator

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And we will take our next question from Steve Fleishman with Catapult Partners.

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

Steve, welcome.

Steve Fleishman - Catapult Partners - Analyst

How are you?

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

I love the name of your new venture.

Steve Fleishman - Catapult Partners - Analyst

Thank you very much. Up and to the right. A question first on this tax rate, since we're on the discussion, what do you think the tax rate would be in '08 when synfuel is kind of all gone and we are at a more clear, normal level?

David Hauser - Duke Energy Corporation - CFO, Group VP

Let me separate one thing out so you just don't consider it. If you ignore the equity component of AFUDC, which of course impacts the tax rate, so if you just set that aside, we would have a tax rate of slightly below 35.5%. And the reason it is going to be below that is because of this Brazil restructuring. So you would look a little below 35%, I expect.

Steve Fleishman - Catapult Partners - Analyst

So a little below 35%?

David Hauser - Duke Energy Corporation - CFO, Group VP

Yes. And you're with me on setting aside the equity component of AFUDC.

Steve Fleishman - Catapult Partners - Analyst

Correct.

David Hauser - Duke Energy Corporation - CFO, Group VP

Okay.

Steve Fleishman - Catapult Partners - Analyst

And then second question, on the -- if you could give any update on the last published numbers you had in North Carolina, on your returns going into this rate filing?

David Hauser - Duke Energy Corporation - CFO, Group VP

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I think it was 11.54% is what we had filed at December 31.

Steve Fleishman - Catapult Partners - Analyst

Okay. That's for '06?

David Hauser - Duke Energy Corporation - CFO, Group VP

Yes.

Steve Fleishman - Catapult Partners - Analyst

Okay.

David Hauser - Duke Energy Corporation - CFO, Group VP

That's 12/31/06 number.

Steve Fleishman - Catapult Partners - Analyst

Okay. And then finally, what have you proposed as part of this to do with your environmental spend? What are those total numbers, et cetera?

David Hauser - Duke Energy Corporation - CFO, Group VP

What have we -- in the upcoming rate filing, is that --?

Steve Fleishman - Catapult Partners - Analyst

Yes, or have you already proposed on how you are going to address the clean smoke stacks?

David Hauser - Duke Energy Corporation - CFO, Group VP

Where we are is we've said we will amortize another \$190 million this year. That will put us at \$1.05 billion, which is 70% of \$1.5 billion, so that was the requirement. We will be making a proposal when we file the rate review that we will be filing the end of May.

Steve Fleishman - Catapult Partners - Analyst

Okay.

David Hauser - Duke Energy Corporation - CFO, Group VP

But we have not said what that is yet.

Steve Fleishman - Catapult Partners - Analyst

Okay. Great. And then maybe, Jim, if you can just touch on your thought on a five to 10-year Ohio plan? Just what is your thinking on the change in strategy there between just kind of extending the current RSP?

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

I think, as we look out, and we look at how the market is evolving, and we look at the level of switching, or the lack of switching that we see; it's crystal clear to us that we need to start planning to have adequate generation to meet that load going forward. We also think that in order to build plants, to buy plants, to really be positioned to meet this load, we need to have a five to 10-year plan. And as we look out, we think that that makes sense for our generation that we have in that region and also allows us to contemplate building another plant in Ohio, going forward.

And so as we think about this, and we look at the legislation that is being considered, and quite frankly the legislation that 's being considered -- and quite frankly, that has been discussed widely is legislation that would grandfather the plants that were deregulated in 2000. And then allow for distribution companies to build and buy new generation and basically add it to the rate base, or recover it over the wires, in the same way you would in a vertically integrated regulated state. So in a sense, I would say that they are contemplating a hybrid approach. I know a number of people have been studying what happened in Virginia.

This five to 10-year plan is contemplated from our standpoint because it is not clear what the timing will be on the legislation and so, as you know, we are on two tracks here. One track is to get the legislation so we can move forward, kind of consistent with this -- what I just said. The second track is to extend the RSP. And our judgment is, extending the RSP more in the five to 10-year range, marries up with where we think the legislation is headed on new builds in the state.

Steve Fleishman - Catapult Partners - Analyst

Okay. Thank you.

Operator

And we will move to our next question which is from Ashar Khan with SAC Capital.

Ashar Khan - SAC Capital - Analyst

How are you guys doing?

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

Doing great.

Ashar Khan - SAC Capital - Analyst

David, could you just help us on this bridge, as we look forward? The forecast for franchise electric and gas, EBIT, if I remember correctly, is \$2,300. We picked up about \$220, approximately, in the first quarter, which puts us on an LTM rate of around over \$2,000. So, we still have to pick up about \$280 million for the remaining three quarters. And I just want to understand what are the drivers in the remaining three quarters which get us to that number?

David Hauser - Duke Energy Corporation - CFO, Group VP

Okay. I'm not sure I'm right on top of your math but let me make a couple of comments. First of all, keep in mind that the give-back associated with the merger drops off. And so that makes future quarters stronger. Secondly, we amortized more than 1/4 of the clean air amortization, so that makes future quarters stronger, especially the fourth quarter. And thirdly, if you look at our spread over the years, our biggest quarter is the third quarter, and so that is where a lot of it would be made up.

Ashar Khan - SAC Capital - Analyst

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And then just follow-up, how much did you amortize in the first quarter on the clean air?

David Hauser - Duke Energy Corporation - CFO, Group VP

\$56 million.

Ashar Khan - SAC Capital - Analyst

\$56 million. Okay. And then the ROE, David, that you mentioned, for the 2006 for North Carolina, that included the effect of the rate give-backs for half of the year. Am I right, in North Carolina, the give backs started like after June? Is that correct? Is that right?

David Hauser - Duke Energy Corporation - CFO, Group VP

No, we adjust out the give backs when we calculate the numbers.

EDITOR'S NOTE - The following updates this answer provided during the Q&A portion of the earnings call. The latest 12 month surveillance report for NC indicated a ROE of 11.54%. This calculation as defined by the NCUC includes all merger related impacts, including costs to achieve, savings and the rate reductions. Some of these items increase the ROE while others decrease the ROE.

Ashar Khan - SAC Capital - Analyst

So that number is a clean number without the give backs.

David Hauser - Duke Energy Corporation - CFO, Group VP

That number is a clean number.

See Editor's Note above

Ashar Khan - SAC Capital - Analyst

I appreciate it. Thank you very much, sir.

Operator

And we will take our next question from Yiktak Fung] with Zimmer Lucas Partners.

Yiktak Fung - Zimmer Lucas Partners - Analyst

Going back to the generation situation in Ohio, is a potential solution for meeting this generation need to rate base DENA assets?

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

I think that is one of the options that we're considering.

Yiktak Fung - Zimmer Lucas Partners - Analyst

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What kind of new legislation would be needed to enable that? Is the currently proposed legislation going to cover a transaction like that?

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

It is going to cover both purchases and builds.

Yiktak Fung - Zimmer Lucas Partners - Analyst

Okay. And if it is going to be purchased in rate base, would this be some sort of fair market price?

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

My judgment, without kind of getting into the negotiation of what the price ought to be, but I would say that our current book value is less than replacement value. And I would say that it would be consistent with what we've done in other transactions in the Midwest, to move it into the regulated utility at book value.

Yiktak Fung - Zimmer Lucas Partners - Analyst

Okay. Thank you very much.

Operator

And our next question will come from Daniele Seitz with Dahlman Rose & Co.

Daniele Seitz - Dahlman Rose & Co. - Analyst

I was wondering, your 4% to 6% growth rate includes all -- you are assuming that all of this CapEx will be rate-based in time?

David Hauser - Duke Energy Corporation - CFO, Group VP

It will either be rate-based or it will be CWIP in rate-base as it is being built. But keep in mind, the 4% to 6% is for the period through '09. The vast majority of what we're talking about, being a coal plant, an IGCC, or a nuclear plant, doesn't actually come in service during that time period. So it really sets us up for the future very, very well, by more than it impacts '07 through '09.

Daniele Seitz - Dahlman Rose & Co. - Analyst

Right. And also, I was wondering, in most jurisdictions, would you be asking for a sort of rider, since obviously regulatory lag could be difficult? Would you -- do you think that there is a possibility for you to get your riders in both the Carolinas and in the Midwest?

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

In the Midwest, and in Indiana, we have that in the law there. And with the IGCC, we anticipate getting construction work in progress during the construction period. Today, and with the passage last week of the legislation in South Carolina, we have the ability to get the equivalent in South Carolina with respect to the nuclear facility that we are proposing. And in Ohio, what we're proposing, and again, this could be either through the legislation or negotiated, we would ask for comparable treatment there.

In North Carolina, if we are successful in eliminating the financial distress requirement that's in the statute, will have the capability to apply to the North Carolina commission and ask for similar treatment. So we are very focused because of the size of these projects, of getting the recovery of

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ongoing financing costs, as we go. We think it is a good thing from our investors' perspective, we think it translates into lower costs for our customers. And it is the right way for us to move, so that we meet the increased requirements of our customers in the future.

Daniele Seitz - Dahlman Rose & Co. - Analyst

Great. Thanks.

Operator

And we will take our next question from William Maze with Ecofin.

William Maze - Ecofin - Analyst

Hi, guys. Sorry about that.

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

No problem.

William Maze - Ecofin - Analyst

Just was hopping back and forth between your call and Spectra Energy. But the -- one thing I--?

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

Where are you having more fun?

William Maze - Ecofin - Analyst

This is more fun.

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

Love the one you're with, right?

William Maze - Ecofin - Analyst

That's right. I just jumped in on the tail end of your discussion of the save-a-watts or megawatts. And just wondering when you anticipate making that filing?

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

We made the filing yesterday.

William Maze - Ecofin - Analyst

Okay. And in order to really put that program in, you need, typically need, anyway, two-way metering and that type of investment. And I'm wondering what your plans are there?

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

Well, what we contemplate in the next three years, we really don't need two-way metering. So we think we can achieve these savings without that. However, you're very -- quite right. To the extent we have two-way metering and we're looking at that in probably several years, and we're doing some pilots in the interim, we think that would enhance our ability to generate and create new save-a-watts if we had two-way metering. But our current plans are built on not having that technology available.

William Maze - Ecofin - Analyst

Okay, great. Okay, thanks a lot, guys.

Operator

That concludes the question-and-answer session today. At this time, Mr. Trauschke, I would like to turn the conference back over to you for any additional or closing remarks.

Sean Trauschke - Duke Energy Corporation - VP IR

Thank you, Cameron. As always, our team will be able to answer any follow-up questions. We want to thank you for joining us today and look forward to speaking with you next quarter.

Operator

Thank you. That does conclude today's conference. We thank you all for your participation. Have a great day.