Good day and welcome to the Duke Energy third-quarter earnings call. Today's conference is being recorded.

At this time, I would like to turn the call over to Mr. Mike Callahan. Please go ahead, sir.

Mike Callahan - Duke Energy Corporation - VP of IR

Thank you, Rachel. Good morning, everyone, and thank you for joining Duke Energy's third-quarter 2016 earnings review and business update. Leading our call today is Lynn Good, Chairman, President, and CEO; along with Steve Young, Executive Vice President and Chief Financial Officer.

Today's discussion will include forward-looking information and the use of non-GAAP financial measures. Slide 2 presents the Safe Harbor statement which accompanies our presentation materials. A reconciliation of non-GAAP financial measures can be found on duke-energy.com and in today's materials. Please note, the appendix for today's presentation includes supplemental information and additional disclosures.

As summarized on slide 3, Lynn will cover the key milestones we reached in the quarter as we near the completion of our portfolio transition, and provide a brief overview of our new business segments. She will also discuss our third-quarter financial and operational highlights and provide an update on our growth initiatives.

Steve will then provide an overview of our third-quarter financial results and load growth trends, as well as an update on regulatory activity. He will also provide insight into our expectations for 2017 before closing with our key investor considerations.

With that, I'll turn the call over to Lynn.

Lynn Good - Duke Energy Corporation - Chairman, President and CEO

Good morning, everyone, and thank you for joining us today. We had a strong third quarter at Duke Energy, delivering very solid financial results and demonstrating significant progress in the execution of our business portfolio transition. We closed the Piedmont Natural Gas acquisition, and we also announced the sale of our Latin American assets. This transition of our business portfolio strengthens our franchise of high-quality, stable and growing energy infrastructure businesses.

Starting on slide 4, let me begin with our business portfolio transition. On October 3, we closed the Piedmont Natural Gas acquisition, following approval by the North Carolina Utilities Commission. We're delighted to bring Piedmont's industry-leading expertise into our company as we expand our natural gas platform, supporting our transition to a lower-carbon future and growing investments in important natural gas infrastructure. We have worked with and admired Piedmont for many years, and our post-closing integration efforts are well underway.
In addition, on October 10 we announced agreements with China Three Gorges Corporation and I Squared Capital to sell our Latin American generation assets. China Three Gorges will buy our assets in Brazil for approximately $1.2 billion, including the assumption of debt. We expect to complete the transaction in 2 to 4 months, once we receive required approvals in Brazil and China.

We're making good progress. In fact, this morning the Brazilian Antitrust Agency preliminarily approved the transaction without any objections. This begins a 15-day statutory objection period, and if no objections are filed, the approval will become final.

I Squared Capital will buy our remaining assets in South and Central America in a separate transaction, also valued at approximately $1.2 billion. We expect to close this transaction within the next 3 to 5 months. The proceeds available will be used to reduce Duke Energy Holding Company debt. Steve will discuss additional implications from these transactions in a moment.

Both of these announcements demonstrate our commitment to deliver more predictable growth and earnings and cash flows. I'm proud of our team for the extensive work on these transactions, as well as the continued dedication of our employees at Duke Energy International, who have managed the business very well throughout the process. We look forward to a timely close as we exit our Latin American generation business, and we're pleased to welcome the Piedmont employees to Duke Energy.

Turning to slide 5, consistent with the transition of the portfolio, today we are announcing the realignment of our financial reporting segment structure, beginning with our fourth-quarter results. Prospectively, we will discuss performance for three primary business segments: electric utilities and infrastructure, gas utilities and infrastructure, and commercial renewables.

Electric utilities and infrastructure will be comprised of our regulated electric utilities in the Carolinas, Florida, and the Midwest. This segment will also include our commercial transmission investments.

As previously noted, Frank Yoho will lead our gas utilities and infrastructure business, which will contain Piedmont; our local gas distribution companies in Ohio and Kentucky; and our gas pipeline investments, such as Atlantic Coast Pipeline, Sabal Trail, Constitution, and Piedmont's existing joint venture investments.

With the realignment of our business, commercial renewables will become its own segment.

Meanwhile, Other will continue to include holding company interest expense and our captive insurance results. Other will also begin to include our National Methanol equity investment in the fourth quarter. With the divestiture of the Latin American generation business, the balance of the International segment will be classified as discontinued operations starting in the fourth quarter of 2016. We will continue to report the earnings of this business in adjusted earnings per share until closing.

Turning to slide 6, let me update you on our strong financial results for the quarter. We announced third-quarter 2016 adjusted earnings per share of $1.68, an increase of $0.21 from the prior year. We generated higher adjusted earnings with strong results in our regulated utilities due to warmer summer weather and our continued commitment to cost management and operational excellence.

Based on the strong results through the first three quarters of the year, we are trending toward the high end of our original 2016 adjusted diluted EPS guidance range of $4.50 to $4.70 per share. This excludes costs associated with Hurricane Matthew.

Turning to slide 7, we're continuing to move forward and deliver strong results on our $30 billion growth capital plan. This plan aligns with our vision to invest capital in smarter energy solutions that generate cleaner energy and modernize the grid, creating value for customers and delivering earnings and dividend growth for our shareholders.

Here are a few updates. Site preparation activities are underway in our nearly $1 billion Western Carolinas modernization project, with plant construction anticipated to begin in early 2017. This project allows us to retire our Asheville coal units early, build cleaner natural gas units and install renewable energy on the site. The project is on track to be completed by late 2019.

In September, we worked with the Indiana Office of the Utility Consumer Council to develop a plan to modernize and upgrade the Markland Hydro Station. This multi-year effort will increase the output of the nearly 50-year-old facility, producing low-cost, carbon-free electricity for Indiana residents for years to come. Per the agreement, the approximately $150 million investment and related expenses will be recovered through the recently approved renewable energy rider.

Last week we issued an RFP for 400 megawatts of renewable energy in our Duke Energy Carolinas service territory. This furthers our efforts to provide renewable energy to our customers. Proposed projects must be in operation by December 31, 2018.
Also in North Carolina, we recently filed for a Certificate of Public Convenience and Necessity, or CPCN, for our Duke University combined heat-and-power project. The project will consist of a natural gas fired generator that also provides steam service to the campus, and lowers the University's carbon dioxide emissions by 25%. Combined heat-and-power projects represent an attractive energy solution that could benefit many of our universities and other large industrial customers in the years to come.

Shifting to our natural gas infrastructure investments, we continue to make investments in integrity management programs within our local distribution companies, and advance construction of our pipeline products. Let me briefly update you on Sabal Trail, Atlantic Coast Pipeline, and Constitution.

Construction on the Sabal Trail Pipeline began in August and the project remains on track for a June 2017 in-service date.

Since our last earnings call, we received FERC's notice of schedule for the Atlantic Coast Pipeline. Based on this schedule, we expect to receive the final FERC certificate and begin construction in the third or fourth quarter of 2017. This schedule moves our expected in-service date to the second half of 2019. In September, the project partners announced the selection of Spring Ridge Constructors as the lead construction contractor, representing a significant milestone for the pipeline. This firm is a joint venture of four leading U.S. natural gas pipeline construction companies with extensive experience in similar projects.

As you'll recall, we have now added Piedmont's 24% stake in the Constitution pipeline to our portfolio. FERC approved this project in December of 2014. However, in April of 2016, the New York Department of Environmental Conservation, DEC, refused the grant the project's water quality certificate.

In response, the project filed lawsuits with the U.S. Court of Appeals for the Second Circuit and the U.S. District Court of Northern New York, seeking to overturn DEC's action. Both of these lawsuits continue to progress, with oral arguments before the U.S. Court of Appeals scheduled for November 16, and we expect a decision in this case by mid-2017.

We continue to believe that the business case for this pipeline is compelling, as the Northeast lacks adequate access to low-cost supplies of natural gas that this pipeline provides.

Before I turn it over to Steve, I'd like to highlight on slide 8 several of our recent operational accomplishments made possible by the dedication of our employees. As many of you know, we managed through two major hurricanes this fall.

After Hurricane Hermine hit the Southeast in early September, our team restored power quickly and safely for more than 200,000 Florida customers and 150,000 Carolinas customers. Then Hurricane Matthew, a historic storm, swept through our Florida and Carolinas service territories in October. The storm tragically resulted in multiple fatalities and widespread flooding, impacting many of our customers across the Carolinas.

The flooding, wind and rain caused extensive damage to our energy system, leaving more than 1.7 million customers without power. Piedmont's infrastructure experienced minimal damage.

In terms of customer outages, Hurricane Matthew is the fifth worst storm to hit the combined Duke Energy Carolinas/Duke Energy Progress service area, with damage similar in scale to Hurricane Floyd in 1999 and Hurricane Hugo in 1989. In response, we mobilized more than 10,000 workers to rebuild the system and restore power for our customers. We continue to work with the hardest-hit areas as they look to recover and rebuild. I'm extremely proud of our employees and their unwavering commitment to serving our communities.

Given the magnitude of the storm, we intend to request a deferral of incremental costs, and will ask that they be considered as part of our next base rate cases for Duke Energy Progress, where the majority of damage occurred. Our current estimate of incremental cost is approximately $200 million. We are still in the process of refining this preliminary cost estimate.

Moving to our generation fleet results in the quarter, our fleet responded well to the hot summer weather. Our nuclear units at Catawba and McGuire set new generation records, and our Edwardsport plant set a new station record for generation in the quarter.

Also in the third quarter, Duke Energy was named to the Dow Jones Sustainability North America Index for the 11th consecutive year. This consistent run demonstrates the effectiveness of our sustainability, economic, environmental and social efforts. This is a significant achievement earned by the entire company.

In addition, we were named as Site Selection magazine's annual list of Top 10 Utilities in Economic Development for the 12th consecutive year, another example of our focus on developing our communities and growing our customer base. Through September, our economic development efforts have yielded almost $3 billion of investment and more than 10,000 jobs across our service territories.
In conclusion, I am very pleased with our progress on the transition of the portfolio and in delivering strong financial results in the quarter and building momentum for a strong finish to 2016. We are advancing our strategic capital investments and maintaining our focus on operational excellence and value to our customers. Our business portfolio is well positioned to deliver strong, predictable earnings and cash flows to our investors.

Now let me turn the call over to Steve.

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Steve Young - Duke Energy Corporation - EVP and CFO

Thanks, Lynn. Today I will walk you through the key drivers from the third quarter, as well as provide updates on the current retail volume trends within our service territories, and regulatory activity underway in our jurisdictions. I'll close with a look ahead to 2017 and our key investor considerations.

I'll start with the quarterly results on slide 9 and discuss our adjusted earnings per share variances compared to the prior-year quarter. For more detailed information on segment variances versus last year, and a reconciliation of reported results to adjusted results, please refer to the supporting materials that accompany today's press release and presentation.

As a reminder, this is the last quarter for our existing segment structure. We begin managing the new business under new segments at the beginning of the fourth quarter, upon the completion of the Piedmont acquisition.

On a reported or GAAP basis, 2016 third-quarter earnings per share were $1.70 compared to $1.35 last year. Third-quarter adjusted diluted earnings per share were $1.68 compared to $1.47 in the third quarter of 2015. Regulated Utilities' quarterly adjusted results increased by $0.34 per share quarter-over-quarter. This strong performance was primarily driven by warmer weather across all of our service territories, which added $0.14.

We also recognized a lower effective tax rate, primarily due to prior-year tax adjustments, which contributed to an $0.08 increase. Higher revenues from energy efficiency riders in the Carolinas and grid investment riders in Ohio continue to be favorable drivers of earnings, adding $0.05 to results for the quarter. Weather-normal retail volumes also added $0.04, with growth primarily in the Carolinas and Florida. I'll discuss those details in a moment.

Finally, our cost management efforts across the business provided a $0.02 uplift, despite additional storm cost in the third quarter. Our ongoing commitment to managing O&M costs and finding efficiencies throughout our business positions us to achieve our goal of maintaining a flat O&M cost structure through 2020.

Commercial Portfolio results increased by $0.02 per share in the third quarter. The higher results were largely driven by additional wind and solar facilities placed online this year, and more favorable wind resources throughout the summer months.

Moving on, Other was down $0.14 for the quarter, largely driven by a higher effective tax rate due to prior-year tax benefits and a current-year unfavorable audit settlement. These unfavorable tax items offset the favorable tax variance in the Regulated Utilities segment. For the year, we continue to expect a total company adjusted effective tax rate of approximately 31% compared to our original expectation of 32% to 33%. This is primarily due to the favorable tax benefit realized at International in the first quarter.

Our first three quarters have been strong, reflecting favorable weather and strong execution on the part of our team. As we look to the fourth quarter, I would like to share a few considerations. First, Piedmont will contribute $0.03 to $0.05 in the fourth quarter. In Regulated Utilities, we have taken the opportunity to re-plan some of our O&M work, including advancing a fossil plant outage and some distribution projects into the fourth quarter. In addition, the prior-year results included a favorable Ohio regulatory settlement.

Meanwhile, at Commercial Renewables, we expect a relatively flat quarter compared to the prior year, and for the segment to finish below original expectations for the full year. Market returns continue to decline, and we remain disciplined on renewables capital deployment.

With our strong year-to-date results through the third quarter and our expectations for the fourth quarter, we are trending toward the high end of our original guidance range, excluding costs associated with Hurricane Matthew.

Moving on to slide 10, let's review our retail customer volume trends. On a rolling 12-month basis, weather-normalized retail load was 0.6% through the third quarter, and continues to track our long-term expectations for approximately 0.5% load growth.
Overall, we are pleased with the strength of our residential volumes, which continue to grow at 1.1% over the last 12 months. A strong 1.4% annual increase in the number of new customers drives this growth. Utility-sponsored energy efficiency programs and more efficient building codes and standards continue to partially offset this customer growth. Recently we have seen the decline in usage per customer begin to level out a bit.

Looking forward, positive trends in new job and wage growth, as well as a recovery in housing, are positive signs for continued residential growth.

Moving to the commercial class, we experienced an increase of 0.4% over the rolling 12 months, an improvement compared to last quarter. Commercial usage is slowly improving across our jurisdictions, as non-manufacturing employment improves, and office vacancies continue to decline, even with new office space being added. These improvements are somewhat offset by commercial businesses supporting manufacturing. In addition, we continue to see declines in the government and education sectors, especially in the Midwest.

In the industrial class, we see growth of 0.2% on a rolling 12-month basis. Industries that support construction and automotive continue to show resilience. However, the metals industry is once again experiencing declines. We will closely monitor economic conditions in our customer usage patterns throughout the remainder of the year and into 2017.

Moving to slide 11, let me take a moment to discuss the status of the Duke Energy Progress South Carolina rate case. In October, we reached a constructive settlement with the office of regulatory staff and other key intervening parties. The settlement was reviewed by the Public Service Commission of South Carolina during a hearing earlier this week.

The major components of the settlement were largely consistent with our initial filing. We requested the $79 million increase with an allowed ROE of 10.75%, an equity structure of 53%, and a rate base of $1.3 billion. Our significant energy infrastructure investments were the key drivers for the proposed increase.

The settlement provides for a $56 million revenue increase and an allowed ROE of 10.1%. We also agreed to a 53% equity structure and $1.3 billion rate base. If the settlement is approved as filed, new rates are expected to be effective in January 2017. Customer rates will be implemented over a two-year period. In year one, customer bills will increase by $38 million, and step up to $56 million in year two. DEP will reduce its cost-of-removal liability by $18 million in year one to provide a neutral earnings impact to the company in the first year of rate implementation.

Based on the settlement, coal ash costs that we had incurred will be recovered, with a return over a 15-year amortization period. And, we agreed to defer any future rate cases to 2019. This settlement is an important milestone, and we expect an order from the Commission in the coming weeks.

With the transition in our business portfolio, I want to provide you some broad parameters for 2017 on slide 12. Consistent with past practice, we will provide guidance for 2017, including five-year capital plans, during our February earnings call.

We anticipate growth in the core business, electric and gas infrastructure and commercial renewables, of about 5% off of the $4.30 midpoint of our 2016 adjusted earnings per share guidance range. Accretion from Piedmont is expected to be $0.08 to $0.10 per share in 2017, a strong first year, reflecting the benefits of early integration. We will provide additional perspective on growth capital in all of our segments in February.

International results through closing, use of sales proceeds and National Methanol are expected to contribute between $0.10 and $0.15 per share in 2017. National Methanol will move to Other, and contribute $0.05 per share based on prevailing Brent crude oil prices and our ongoing ownership percentage, which is expected to step down in 2017.

The use of proceeds from the sale of our Latin American generation assets of $1.7 billion to $1.9 billion will displace future financings at the holding company, and will also contribute about $0.05 per share based on current interest rates.

We estimate first-quarter operating results from our international business could also add up to $0.05 per share of earnings, depending on the timing of the close. We look forward to further discussion of 2017 and beyond in February.

I'll close with slide 13. Duke Energy has tremendous scale, offering an attractive investor value proposition, which includes balanced growth in earnings and reliable dividends over time. Within months, we expect to complete our multi-year portfolio transition, affirming our commitment to provide low-risk, high-quality earnings and cash flows, and supporting our long-term growth projections. We will continue to invest in cleaner energy resources, modernize the energy grid, build our natural gas platform and provide enhanced services for our customers.

With that, let's open the line for your questions.
Could you discuss in a little more detail the results and any issues from commercial renewables, given that it was not as what you expected?

Lynn Good - Duke Energy Corporation - Chairman, President and CEO

Michael, I would direct you to slide 16 of the deck, which gives you a comparison of our year-to-date results against original expectations. Commercial has delivered about $65 million of net income against our original expectations of $140 million. We are not expecting that we will deliver $140 million for 2016. Some of that shortfall will be the result of lesser capital deployment.

As Steve mentioned, returns have been very market-driven – great for customers, but low for investors. We expect to be slightly behind on wind and solar resources as a result of what we've seen in weather patterns. Those are the two things I'd point to.

Michael Weinstein - Credit Suisse - Analyst

Is it that the market for investment for commercial renewables has become more competitive than you expected a year ago and returns on acquisitions are just smaller than you thought, or is this more of a weather issue?

Lynn Good - Duke Energy Corporation - Chairman, President and CEO

Returns are lower, Michael. As an investor, the other thing to consider for Duke is that we are in an NOL position as a result of bonus depreciation. As we look at returns, we consider that the monetization of tax credits needs to reflect when we will be a cash taxpayer, so the DCF of that can challenge our returns. We will continue to monitor that as the time progresses. We understand the market well – we have great expertise in both wind and solar, based on the business that we've built. We still like the business, but we are disciplined in the way we deploy the capital, based on the returns we're seeing in the market.

Michael Weinstein - Credit Suisse - Analyst

How long does that NOL position go out to? What do you expect?

Steve Young - Duke Energy Corporation - EVP and CFO

Currently we are expecting, assuming there are no further extensions of bonus, that we would come out of the NOL position in 2019. We would then begin using tax credits, such as ITC production tax credits, so we would still not be a significant cash taxpayer for a few years after that.

Michael Weinstein - Credit Suisse - Analyst

That could make the renewables business a little more competitive for you, right?

Lynn Good - Duke Energy Corporation - Chairman, President and CEO

As we get closer to that period of tax where we burn off the NOLs, that will impact our view of returns, Michael, because the relative value of the tax credits will be greater.
Ali Agha - SunTrust Robinson Humphrey - Analyst

Steve, you mentioned you are going to use the proceeds from the international sale to pay off parent company debt. What's the average interest rate on the debt that you are paying off?

Steve Young - Duke Energy Corporation - EVP and CFO

When we did the calculation there, we came up with roughly $0.05. We're looking at a long-term holding company rate in the 3.5 to 4% range. We have baked that into our financing plans, anticipating that to happen. We will initially take down some bridge facilities of shorter-term debt with the proceeds.

Ali Agha - SunTrust Robinson Humphrey - Analyst

Okay. But there is enough of the high cost, or relatively high cost, debt available to get that kind of savings?

Steve Young - Duke Energy Corporation - EVP and CFO

We have anticipated this and baked it into our financing plans to avoid issuances of HoldCo debt at that higher level.

Lynn Good - Duke Energy Corporation - Chairman, President and CEO

Correct, about $1.7 billion to $1.9 billion of proceeds will come back into the holding company. The average rates that Steve referenced are consistent with that.

Ali Agha - SunTrust Robinson Humphrey - Analyst

I see. The commercial results of $65 million year-to-date, or $140 million for the year, is little lower now. How much of that roughly is the recognition of tax credits?

Lynn Good - Duke Energy Corporation - Chairman, President and CEO

The tax credits are going to be a significant part of those renewable returns. Ali, I don't have an exact number in front of me. We do have a modest amount of contribution in commercial from the pipelines at this point through the third quarter. We will move that to the gas infrastructure segment in the fourth quarter.

Steve Young - Duke Energy Corporation - EVP and CFO

That is correct, Lynn. The results for the commercial portfolio reflect small amounts of AFUDC on the pipelines – that will be growing. Right now, it is primarily from the renewables business, and that is heavily driven by the recognition of the tax benefits.

Ali Agha - SunTrust Robinson Humphrey - Analyst

Last question, Lynn, as you look at this portfolio now, post-International sale, and you look at your utility footprint, is everything essentially core as far as Duke is concerned? And related to that, as you are looking at growth over at least the next three, four years, does M&A come back into the mix for you as you are looking to deliver growth for shareholders?
Lynn Good - Duke Energy Corporation - Chairman, President and CEO

Ali, the businesses that we own coming out of the transition are all core. I think the strength of the franchises we own in the Southeast, both gas and electric, and then a strong position in the Midwest, are all core businesses. And, we'll be looking to drive growth through investments that build on cleaner forms of generation, and strengthening our grid and driving growth and providing value to customers. That will be job number one at Duke.

I believe M&A represents something that we will continue to look at as opportunities arise. I think we have demonstrated a track record of successful integration of M&A candidates. But job one, as I said, is growing the core businesses that we own.

Operator

Maxwell Burke, Citi.

Maxwell Burke - Citigroup - Analyst

Back to your renewable portfolio, when you are underwriting these investments, do you generally assume that the PPA cash flows are going to cover the full investment cost? Or do you assume some residual value, post-PPA, in order to recover that investment?

Lynn Good - Duke Energy Corporation - Chairman, President and CEO

We will typically assign some terminal value beyond the contract period.

Maxwell Burke - Citigroup - Analyst

Okay, got it. As a follow-up, can you provide any guidance on how you think about valuation, post-PPA? Do you make some assumptions around re-contracting, or do you apply a dollar per kilowatt multiple, or some other method?

Lynn Good - Duke Energy Corporation - Chairman, President and CEO

We look at a variety of things as we think about terminal value, including forward curves as well as market experience. Our contracts are the majority of the value that we are looking at, and terminal is something we look at a range of possible outcomes.

Operator

There are no further questions at this time. I would like to turn the conference back to Ms. Lynn Good for closing remarks.

Lynn Good - Duke Energy Corporation - Chairman, President and CEO

Thank you, everyone, for your interest and investment in Duke Energy. We've made tremendous progress this quarter and look forward to seeing many of you in the coming months, and at the EEI Financial Conference next week. Thank you.