EDITED TRANSCRIPT
DUK - Q4 2016 Duke Energy Corporation Earnings Call

FEBRUARY 16, 2017 / 10:00 AM

THIS TRANSCRIPT HAS BEEN EDITED FOR BREVITY AND CLARITY.
Good day, ladies and gentlemen, and welcome to the Duke Energy fourth-quarter earnings conference call. As a reminder, today's call is being recorded. And now for opening remarks and introductions, I would like to turn the conference over to Mr. Mike Callahan. Please go ahead, sir.

Mike Callahan - Duke Energy Corporation - VP of IR

Thank you, Catherine. Good morning, everyone, and thank you for joining Duke Energy's fourth-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.

Lynn will cover the key milestones we reached in 2016 as we completed our portfolio transition. She will also provide an update on our strategy and growth initiatives and insight on our vision for the Company over the next 10 years. Steve will then provide an overview of 2016 financial results, insight into our 2017 earnings guidance, and visibility into our expectations for future earnings growth.

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 in today's materials.

Please note the appendix for today's presentation includes supplemental information and additional disclosures.

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

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

Thank you, Mike, and good morning, everyone. Today we announced adjusted earnings per share of $4.69, closing out a very successful 2016. We delivered strong operational and financial results, ending the year at the high-end of our guidance range. We completed our multiyear transition of our business portfolio with the well-
executed exit from our International operations and the acquisition of Piedmont Natural Gas. Through it all, we maintained strong earnings growth in our core businesses and continue to increase our dividend. 2016 was clearly a pivotal year for Duke Energy – and it’s a key indicator of the success we expect going forward.

As you see on slide 4, today's Duke Energy enters 2017 with premier electric and natural gas franchises, operating in constructive jurisdictions and with a demonstrated track record of strong execution. With our scale and portfolio of complementary businesses, we benefit from a wide range of investment opportunities. And as you will hear today, we are excited about our five-year $37 billion growth capital plan, up approximately 25% from last year. We have strong growth in every segment underpinned by capital delivering value to our customers.

Today we extended our consolidated growth rate of 4% to 6% through 2021, which is off of the midpoint of our 2017 adjusted EPS guidance range of $4.50 to $4.70. Our capital plan and regulatory strategy has been designed to produce earnings within this range each year of the five-year plan. And, as the investments build and recovery accumulates, we are even more confident of our ability to reach the high-end of the growth range.

The assets we have, coupled with a strategy that produces real results, offer a solid, long-term investment opportunity. We are positioned to deliver growth in earnings and dividends in a low risk, predictable, and transparent way, providing an attractive risk-adjusted shareholder return for our investors.

As a capital-intensive business, our growth is supported by the scale and strength of our balance sheet which remains the continued focus for our company. In short, our attractive yield and demonstrated ability to reliably grow our regulated businesses positions Duke Energy as the leading infrastructure investment.

We have a great story to share today, and in a moment, Steve will provide details on our five-year capital plan. I want to spend the next few minutes offering insight into our long-term vision for Duke Energy and where we plan to take our company in the next decade.

Our industry is undergoing transformation from increasing customer and stakeholder expectations to rapid technology development and new public policy requirements. The companies that succeed in this dynamic environment are those who anticipate and adapt. We see great opportunity in this period of transformation, and our focus is highlighted on slide 6, investing in infrastructure our customers value and delivering sustainable growth for our investors.

Slide 7 shows how that vision has manifested. We will invest in areas that position us well for this transformation. Strengthening and modernizing our energy grid, generating cleaner energy through natural gas and renewables, and building natural gas infrastructure to support the growing need for this important resource. And, by building on a foundation of customer satisfaction and stakeholder engagement, everything we do begins with customer service, and we also understand that working collaboratively with our stakeholders is critical to our success.

To paint a clearer picture of where we're going, we have pulled back the lens and outlined on slide 8 our aspirations for the next 10 years. We will relentlessly pursue our goal of achieving and sustaining top quartile customer satisfaction, placing the customer at the center of everything we do. We will strengthen our energy delivery system, investing $25 billion to create a more modern, smarter energy grid. We will generate cleaner energy through natural gas and renewables, investing $11 billion as we move to a lower carbon future. We will expand our natural gas infrastructure to meet customers' needs, doubling the earnings contribution of our natural gas business, and we will enable more timely recovery of revenues in all of our jurisdictions as we work to improve regulatory cost recovery mechanisms.

Of course, any success we achieve is grounded in our commitment to maintaining industry-leading safety standards, and operational excellence remains as a foundation of all we do. Our success starts here. Today, Duke Energy leads the industry in employee safety, and we will continue that leadership in the years ahead.

This is our path. It's ambitious and it's achievable.

Let me spend a few minutes on each investment area. First turning to slide 9, I will discuss grid modernizations and our objective to improve systems performance and enable additional capabilities through smarter energy infrastructure. Our transmission and distribution network is the largest in the nation, and on its own, our Carolinas system is the sixth largest. Our scale requires constant capital investment, but in this era of transformation, the demands in our system have never been greater. And while the system is reliable, recent events such as Hurricane Matthew have highlighted opportunities to strengthen the grid.

We have outlined a 10-year $25 billion plan to modernize, building a more flexible, reliable system. We have already begun this important work in the Midwest with plans to expand it into our other jurisdictions. We are using data analytics to inform our investment plans, delivering the highest value to our customers. This work will direct our targeted undergrounding programs, as well as a number of other reliability and integrity upgrades.

Additionally new technologies available today will advance our energy grid and deliver services our customers and communities increasingly expect. Our initial investment will focus on enhancing basic services with smart meters and communication technologies, increasing power quality, and improving reliability. These investments will also support more distributed energy resources on our systems. Subsequent capital spending will integrate emerging technologies such as storage and improved remote monitoring, communications and control.
We expect to reduce our outage frequency and duration rates by 50% and significantly reduce our O&M expenses through the deployment of more advanced technology. Much of this work will also support our goal of moving the company into the top quartile for customer satisfaction.

Our next major investment platform focuses on generating cleaner energy. I'm proud of our efforts to reduce our environmental footprint, including reducing our carbon dioxide emissions by 29% in 2005. As you can see on slide 10, our retirement of more than 40 older, less efficient coal units, coupled with the addition of clean natural gas plants and renewables, is driving our emissions reduction. In the next 10 years, we will invest $11 billion, increasing new, highly efficient natural gas generation to 35% of our portfolio and cleaner renewable energy sources to approximately 10%. These renewable energy sources include hydro, wind and solar. With these investments and our carbon free nuclear generation, by 2026 we will reduce carbon emissions by 35% from our 2005 levels.

In addition to regulated renewables, we will also invest in commercial renewable assets as we continue to pursue projects that meet our return criteria. Reducing our carbon footprint is important to many in our community. We remain focused on being a leader with environmental stewardship at the forefront of our plans.

Moving to slide 11, our third area of investment focus is natural gas infrastructure. We look at the future of this industry and the future generation needs of our company. Natural gas will continue to play a major role.

With the acquisition of Piedmont, we now operate a five-state gas distribution business and have investments in midstream natural gas pipelines. We rank second nationally for natural gas consumption across our electric utilities and LDCs. This underscores how these businesses will continue to complement one another.

With more than 90% of our margins and the LDC business mostly fixed, through decoupling and weather normalization mechanisms, and our low-risk natural gas pipeline investment portfolio, we have very little exposure to volumetric risk in this business.

Similar to our electric businesses, our LDCs, which serve more than 1.5 million customers, are located in states with strong customer growth of over 1% over the last five years, including customer growth of 1.5% at Piedmont.

Our growing midstream business is anchored by our investments in highly contracted pipelines such as Atlantic Coast, Sabal Trail, and Constitution. This infrastructure will bring much-needed gas supplies to the eastern U.S., spurring economic growth and helping us grow our customer base in the Southeast.

The Atlantic Coast Pipeline is a prime example of the tremendous overlap between our electric utilities, LDCs and midstream pipeline investments. Driven by transportation contracts with our natural gas-fired plants and Piedmont, ACP will provide opportunities for industrial and manufacturing growth and infrastructure investment in our eastern Carolinas communities. This growth, as well as combined heat-and-power, coal-to-gas conversions, and dual-fuel projects will boost our gas business.

We look forward to benefiting from coordinated infrastructure planning between our electric and gas utilities as we prepare for new gas-fired generation facilities that will maximize this new gas platform. We also anticipate continued economic development opportunities across the region as a result. In the next 10 years, we expect our natural gas platform to account for 15% of our portfolio, up from 8% today, as we expand and scale our natural gas business.

Before turning to Steve, let me turn to slide 12 and touch on a few policy issues that are top of mind for investors. We are engaged with Congress and the new administration as they begin to address important policy issues impacting our Company and customers. The President and Congressional leaders have an ambitious agenda that includes a few particular areas of focus for us, including tax reform and infrastructure policy.

While it's early in the process and much work remains ahead, Duke Energy supports many of the goals of comprehensive tax reform, which could benefit our customers and support critical investments needed for economic growth. No specific legislation has been introduced, so we are working with the administration's campaign tax plan and the House GOP blueprint. We have analyzed a number of scenarios to evaluate the range of potential impacts to our business.

Our preliminary analysis shows that the Administration's tax plan, which would allow the option to retain interest deductibility and forgo immediate expensing of capital, is neutral to slightly accretive for our company on a consolidated basis.

On the House GOP plan, the range of potential outcomes will be impacted by a number of factors, including the treatment of existing debt and other transition rules. The loss of interest deductibility and immediate expensing of capital will impact our utility rate base over the long-term. But given our NOL position, it is not expected to have a material impact over the next five years. It is important to recognize, however, that loss of interest deductibility will permanently impact the cost of capital to our customers, whereas expensing is a timing difference.
Now let me walk you through additional details of our five-year plan for our electric business. On slide 16, you’ll see our focus on upgrading our transmission and projects such as elevating substations located in vulnerable or low-lying areas and making our power poles more resilient. 45% of the capital we invest in the grid will be devoted to storm hardening to ensure our system is better prepared for severe weather events. We will focus on key infrastructure to make the system smarter and more reliable. The other $7 billion would be devoted to investing in our system for additional customer growth. Nearly distribution system. We have allocated nearly 60% of our $30 billion plan to transmission and distribution, which includes $10 billion for modernizing our grid close ash basins across our system. These significant investments drive a strong earnings-based CAGR of over 5.5% for our electric business through 2021.

Turning to slide 15, growth in our electric business will be supported by our five-year $30 billion growth capital plan. Investments align with our strategy to modernize the energy grid and to generate cleaner energy. Our plan also reflects environmental compliance costs with over $4 million, including approximately $3 billion to safely close ash basins across our system. These significant investments drive a strong earnings-based CAGR of over 5.5% for our electric business through 2021.

In 2017 our results will be driven by our ongoing investments in electric and gas infrastructure and retail and wholesale customer growth. Positive results in the electric business will also be driven by our base rate increases in Duke Energy Progress South Carolina and the generation base rate adjustment mechanism in Florida. These positive drivers will be partially offset by higher depreciation, interest expense and other taxes as we continue to place new assets in service. Given that we completed the International sale in December, we will not have results from that business in 2017, but we will have an approximate $0.05 benefit from the use of proceeds from that sale and another $0.05 contribution from National Methanol, which we retained and is now reported in Other.

Moving to slide 14, we have a robust five-year capital plan of nearly $50 billion in place to drive our 4% to 6% earnings growth. In fact, we have increased our growth capital plan to $37 billion, an increase of $7 billion, largely driven by grid modernization investments in the Carolinas and our growing gas platform. This investment plan will drive earnings base growth in our combined electric and gas businesses of approximately 6% over the next five years.

As we look at each of our segment's contributions, electric utilities and infrastructure representing 89% of our adjusted earnings is well positioned to grow at 4% to 5% over the next five years. Our gas utilities and infrastructure business will contribute approximately 8% to our 2017 results with a five-year growth rate of 10% to 12%. And our commercial renewable segment, which includes owned wind and solar assets, as well as our operating services and third-party contracts, will contribute approximately 3% with a five-year growth rate of 8% to 12%. We are confident these businesses will generate stable earnings and cash flows, delivering solid results in 2017 and beyond.

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We are also identifying areas more susceptible to frequent power outages, using data analytics capabilities. This information will be used as we develop our targeted undergrounding programs, where we have allocated 25% of our grid investment to increase the reliability of our system for our customers.

Another part of the program will include installing smart meters to provide better information and services for our customers, as well as additional cost efficiency. To date we have completed this effort in Ohio, and we will be moving forward with smart meter installations in our other jurisdictions. We expect to fully deploy all smart meters across our system over the next five years. This accelerated deployment will allow us to offer additional products and services and help to reduce our overall O&M costs, given that the advanced technology will avoid the need for many manual processes.

Moving to slide 17, we are committed to further reducing our environmental footprint with plans for new natural gas generation and renewables. Our five-year plan includes investment of $3.3 billion in highly efficient natural gas-fired combined-cycle plants. This will include completing our Lee combined cycle facility in South Carolina, our Western Carolinas Modernization Project in North Carolina and our Citrus County plant in Florida, and beginning work on plants with in-service states beyond 2021.

We are pursuing additional generation projects such as dual-fuel capabilities and combined heat-and-power facilities to increase the flexibility of our system as we continue to meet growing energy demands in a dynamic environment. We will also increase our focus on additional renewables in our regulated utilities. Our $1.3 billion investment plan for carbon-free, utility-owned renewables will be led by investments in Florida and the Carolinas.

Moving on to slide 18, we operate in attractive service areas where customer growth remains strong, especially in the Southeast, and continues to support load growth in our electric business. That, coupled with cost management, allowed us to earn our ROEs, even without significant rate cases since 2013. We are committed to earning these ROEs and generating stable earnings growth for our shareholders while we invest in infrastructure or our customers’ value.

In 2016, weather normalized retail load growth was 0.2%. This was largely driven by lower-than-expected results in the industrial sector. One of our large Duke Energy Carolinas’ customers in the metals industry is reorganizing and plans to begin returning to full operations in 2018. And, some other industrial customers saw similar pullbacks from operations, but expect to ramp up as we go forward.

Looking ahead, we continue to expect approximately 0.5% load growth in our long-term planning assumptions. Several factors give us confidence this assumption remains true.

We are experiencing consistently strong customer growth, especially in our Carolinas and Florida regions given a recent uptick in construction in our service areas and greater housing permit applications. We have also seen a recent shift away from starts of multi-family homes to single-family homes. This shift is highlighted by the fact that four major cities within our service territories recently ranked among the top 16 in the country for the number of single-family building permits filed. Two of these metro areas ranked in the top five.

The decline in the government sector has leveled out a bit, and we are cautiously optimistic about increased business investment and manufacturing as inventory levels have declined from previously elevated levels. Based on current and expected economic trends, we are also optimistic about potential for the industrial sector to pick up in the next few years. These positive factors will be partially offset by the continued adoption of more efficient building codes and standards and utility-sponsored energy efficiency programs.

While these programs do offset some of our customer growth, they also contribute to earnings through our approved energy efficiency writers. Overall, we believe all of these factors will allow us to achieve 0.5% load growth during our planning horizon.

Regarding cost control, we have held O&M flat since 2014, and will look to continue that trend going forward, creating headroom and customer builds for important energy and infrastructure investments. In 2016, we reduced our O&M costs, even with unusually high storm costs compared to the prior year and after re-planning O&M activities on behalf of our customers to take advantage of the above normal weather. We committed to reducing our O&M costs in 2016, and we clearly delivered on that commitment.

We have outlined our electric growth plan and significant capital investments that we will make over the next five years.

Now let me take a few minutes on slide 19 to discuss our plans for cost recovery as we balance our growing business and maintaining competitive rates for our customers.

We will be very active in the regulatory space over the next five years. As we have done in the past, we will continue to work constructively with key stakeholders to achieve results that benefit our customers and shareholders while managing our costs to keep bill increases at a moderate level and overall rates below the national average. The investments we have planned will drive economic growth in our desirable service areas and support additional customers and new technologies.
As you can see, we will file two base rate cases with the North Carolina Utilities Commission in 2017, one for our Duke Energy Carolinas utility and the other for Duke Energy Progress. Both North Carolina cases are scheduled to be filed in the summer of 2017, anticipating new rates effective in the first half of 2018.

These filings will be the first in North Carolina in four years to recover costs associated with our capital investments in more efficient generations such as the lead combined cycle facility, nuclear projects, and coal ash basin closure activities.

Looking beyond 2017, we’re making substantial investments in the grid. As we look to accelerate those investments over the next five years, we will be engaged in the regulatory and legislative process to pursue recovery mechanisms such as multi-year rate plans and trackers, which are better suited to grid infrastructure.

As these regulatory modernization initiatives move forward, we will also evaluate more frequent base rate cases in the interim to ensure timely recovery and more moderate rate impacts to our customers. Updated constructs would avoid the need for filing numerous larger rate cases and level out the rate impact to our customers.

Turning to Florida, we are also planning additional transmission investments and additional renewable energy projects as we look to 2019 and beyond. The regulatory construct in the state of Florida, which includes generation base rate adjustments, solar base rate adjustments and multi-year rate plans, is well suited to our investment plan. We will continue to make significant investments in the transmission and distribution systems in Indiana and Ohio with timely recovery of the investments through previously-approved riders.

As we turn to our gas segment on slide 20, we have outlined a five-year $6 billion growth capital plan to expand our natural gas infrastructure and further develop this platform. Our plans are split evenly between investments in our LDCs and our midstream gas pipelines. This business will grow rapidly, driven by an earnings base CAGR of 11%, over the next five years as part of our larger 10-year plan to grow this business to 15% of earnings. Growth in this segment will come from strong organic growth opportunities in our LDCs and midstream investments. We expect to deploy approximately $3 billion in our gas LDCs systems with Piedmont accounting for more than two-thirds of our LDC’s earnings base and the Midwest accounting for the remaining third.

Our LDCs will continue to invest in infrastructure for our growing customer base, as well as integrity management programs that maintain the safety of our system. These integrity investments are recovered efficiently through well-established writers in several of our jurisdictions.

Moving to our midstream investments, we plan to invest an additional $3 billion in our pipelines during the five-year period, much of which will contribute to the completion of ACP. This project is now anticipated to cost between $5 billion and $5.5 billion, and is still expected to meet the second half 2019 in-service date. We look forward to growing this platform as we expand our natural gas infrastructure and leverage the expertise of our Piedmont team.

Turning to slide 21, I have already mentioned our $1.3 billion investment in regulated renewables. In addition, we will also invest $1 billion in commercial renewable assets. This expands upon the more than $5 billion we have already invested in our contracted commercial renewables business since 2007, focusing on entering long-term power purchase agreements with creditworthy counterparties. Our commercial renewables business continued to expand its wind and solar portfolio, ending the year with nearly 3,000 megawatt in 14 states. These commercial investments, plus our growing regulated renewables footprint, have positioned us as a top-five renewables company in the country, and our plan will continue to advance that position.

Though we do not currently pay significant cash taxes due to our corporate net operating loss tax position, we will continue our disciplined approach to capital deployment in our commercial business, focusing on projects that meet our return criteria. Given the more attractive tax credit profile from the production tax credit, or PTC, we’ll explore more wind projects more aggressively than solar in this segment. In 2016, we invested in approximately 1,000 megawatts of new wind projects that qualify for the 10-year PTC under Safe Harbor rules. This gives us flexibility to bid on RFPs over the next several years. Historically, we have not employed tax equity to finance our renewables projects, given that we have had more efficient and less costly options. We are always seeking the most cost-effective means to develop and finance these projects, and will continue to evaluate other capital sources, including tax equity structures, when appropriate.

Our strong balance sheet and credit quality are foundational to our overall financial objectives. Slide 22 shows our high-level 2017 cash flows and financing plan. With our portfolio transition complete, we have a better risk profile with more predictable and stable earnings and cash flows. We are supporting the balance sheet with $350 million of DRIP equity per year from 2018 to 2021, which will advance our efforts to fund the increasing level of growth investments in our business. We expect the frequent rate case activity and equity through our internal plans to strengthen our financial metrics over the five-year plan.

I would also like to highlight S&P’s recent affirmation of our ratings and revision of our outlook from negative to stable. This action reflects the strength of our balance sheet and confidence the rating agency has in our ability to execute on our commitments.

Before I turn it back over to Lynn for closing remarks, let me turn to slide 23. We understand the value of the dividend to our shareholders and are committed to growing the dividend responsibly. We have paid a dividend for 91 consecutive years, demonstrating the steadfast commitment to our shareholders.
Moving forward, we expect to maintain our annual dividend growth rate at approximately 4% to 6% through 2021 as we target a payout ratio in the 70% to 75% range.

With that, I will turn it back over to Lynn.

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

Steve thanks, and thanks to all of you who have joined the call today. We are excited about the future and remain confident in our ability to deliver strong growth and financial results. We have an ambitious and achievable strategy focused on investing in the grid, cleaner generation and natural gas infrastructure, all while modernizing our cost recovery mechanisms and providing customers with the service they value.

As this slide shows, we bring many advantages to this conversation, including scale, constructive jurisdictions, a track record of execution, and importantly, we are unencumbered by the challenges that we have successfully put behind us.

In conclusion, our vision for where we want to take Duke Energy is clear and compelling. Our strategy to achieve the vision is well underway. We have the right plan and are working the plan. It is producing results, and we enter 2017 with confidence. We are well positioned to deliver value for customers and steady growth, strong yields, and an attractive risk-adjusted total shareholder return for our investors. That is the compelling investor proposition, representing a solid long-term holding for our shareholders. Foundational to this proposition is the strength of our dividend, and with an adjusted earnings growth plan of 4% to 6%, we feel confident in our ability to continue to grow the dividend.

Over the long term, the combination of these factors has the potential to generate 8% to 10% total shareholder return to our investors.

Now let's open up the call for questions.

QUESTION AND ANSWER

Jonathan Arnold - Deutsche Bank - Analyst

I just have a question on the financing and the split between Holdco and the utility and project financing. This year it looks like a little over 40% Holdco. On a net basis, is that something we should anticipate going forward if you stick with that structure, or is this Holdco a little above where the trend will be?

Steve Young - Duke Energy Corporation - EVP and CFO

I don't know that it's necessarily going to be a trend. It will be related to timing of maturities and other investments, so I don't think that there is any trend in that, Jonathan.

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

Jonathan, our target, as we have laid out on the credit metrics slide, is to have low 30% overall Holdco debt to total. So that is the long-term trend you should be thinking about.

Jonathan Arnold - Deutsche Bank - Analyst

I guess that was the thrust of my question, that it seems in 2017, you will be moving away from the target and then it comes down a little bit by 2021. So how should we think about the 34? Do you consider that to be in the target range, or is it more backend of the decade that you get further back down towards it?
Steve Young - Duke Energy Corporation - EVP and CFO

As Lynn said, our target is in the low 30s, and we are a bit above that as we work through this transition of our portfolio. We will be looking to move the Holdco debt into our target range, and we're making progress through our five-year plan, and we will continue to strive to get it to that point.

Jonathan Arnold - Deutsche Bank - Analyst

Okay. Great. And then if I may just on tax, what gives you confidence that the downside scenario under the House GOP, the interest deduction, would only apply on new debt?

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

Jonathan, this is a fluid situation, as you know, and we have looked at a variety of scenarios. We thought presenting the new Holdco debt would give you a sense of where the exposure is – we recognize we do have downside exposure under the GOP plan. As this continues to develop when legislation is introduced and we learn more specifics, of course, we will update that. We thought it was a reasonable planning assumption to share with you at this point based on our understanding of how things are developing.

Jonathan Arnold - Deutsche Bank - Analyst

Okay. But if we wanted to think about what the implications of losing it on the embedded -- the existing debt, we would take the 557 of Holdco, 2017 interest, plus the 87 in commercial renewables and eliminate the 20%?

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

I will give you a quick answer. It is closer to 7%.

Stephen Byrd - Morgan Stanley - Analyst

I thought that was a very thorough and thoughtful update on your strategy and growth outlook. I want to just follow up on tax reform, which I imagine is a popular topic.

When you look at potential levers, I am thinking first about the potential loss of or the potential immediate expensing of CapEx. You have a lot of growth levers at your disposal. How would you think about potentially changing your spending profile to the extent that that actually got enacted that you immediately expensed CapEx?

Steve Young - Duke Energy Corporation - EVP and CFO

If you move in that direction with the immediate expensing of CapEx, one thing I would say, we are currently in an NOL position throughout the majority of our five-year planning horizon. The immediate expensing to CapEx would deepen that NOL position at the back end of our plan, so it's not a significant rate base change for us during the five-year plan. Broadly speaking, as you heard from our capital planning as a whole, we have a lot of investment opportunities as we rebuild the grid and decarbonize and produce cleaner energy, and those opportunities, I think, will carry us for quite a while.

Stephen Byrd - Morgan Stanley - Analyst

Understood. Thank you. And then shifting over to solar and energy storage and grid modernization, I think you are pretty clear on your plans, but let's assume that costs for solar continues to fall and storage continues to fall. Later in the decade, is there a potential for accelerating spending there? How do you think about solar and storage for your regulated territories in terms of the potential for additional spending there?
Lynn Good - Duke Energy Corporation - Chairman, President and CEO

Stephen, I think that is a developing area that we continue to pursue. I think you are aware we have an RFP out now for 400 megawatts in the western part of the Carolinas and we are also in discussions around our avoided cost filing, which could provide a pathway for additional solar. We believe there is a wealth of investment opportunities, and in putting forward $1.3 billion, we are targeting a substantial investment. But, I can see scenarios in which it can go higher. Our objective is to own some amount of the solar in the state of North Carolina and Florida and our other service territories, and we are working to move in that direction.

Stephen Byrd - Morgan Stanley - Analyst

Okay. Thank you. And on storage, Lynn, is there a role for storage anytime soon, or is it really just premature given the fairly low penetration for renewable energy in your territories?

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

It is modest, Stephen, over the next five years. We have probably half a dozen to a dozen that are under development where we have batteries in place on our system, ranging in size from small residential all the way up to a 35-megawatt battery paired with the wind farm in West Texas. As we look at this planning horizon, we do have some battery megawatts in our plan, but we see it as being a greater contributor from 2021 to 2025 than we do over the next five years.

Steve Fleishman - Wolfe Research - Analyst

In your early prepared remarks, you mentioned something about potentially being at the high-end of the 4% to 6% growth rate over time. I missed the intro of that. Could you repeat that and just what would you need to see to either be looking more at the high-end?

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

Steve, what I talked about is that it's really successful execution of this plan, which includes ramping up investments such as the grid investment in the Carolinas, coupled with timely recovery. These give us greater confidence at the higher end of the range. We feel like we've got a plan that gives us that potential and our assignment is to execute it.

Steve Fleishman - Wolfe Research - Analyst

Okay. And one thing might just be getting maybe through resolutions for some of these rate cases to get better visibility on those.

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

Sure. We have rate cases filed this year. I think better visibility might present to you how we have addressed rate cases for historical investments. Steve, I think it's important to recognize that we have a demonstrated track record of successful execution of regulatory outcomes. If you look at what we have accomplished around our jurisdictions, whether it's related in Florida to new generation, Crystal River and Levy, in Indiana, rate cases in the Carolinas, we have confidence that we can find the right balance between customers and investors and putting capital to work in jurisdictions in a constructive way. So, we come at this with a plan that we believe we can execute.

Steve Fleishman - Wolfe Research - Analyst

Okay. And should we assume the earned ROEs that you are assuming in 2017 for the different states, is that roughly the range for the five-year plan?

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

I think that is a reasonable assumption.
Okay. And then one other question just on the coal ash. In the 2017 guidance, what are you assuming on how that is treated? Just a continued deferral at a debt return or an equity return?

For GAAP purposes, Steve, we only record a debt return on coal ash.

That's correct. We will continue to defer up until the point of a Commission order.

And, we will request coal ash recovery in the upcoming cases here in 2017.

Just to follow up on Steve's question a little bit – are you saying that the successful execution of the plan gets you to the higher end or the upper end of the range and that, even if there were some problems, you would still be at the midpoint? Is that a good way of looking at it?

Exactly, Michael. We have put together a plan that, if we successfully execute, will position us at the higher end of the range.

Got it. Could you discuss the impact of the NOL position on the renewables growth plan? I remember it is a little bit slower now, and it sounds like you are even more focused on wind going forward. How is that being impacted by the NOL position, and also what is the status of the 500 MW plan for Florida solar?

Regarding our NOL position and how it is impacting our commercial renewables, we've talked about this a bit in the past. We have been in a NOL position for a while, and under current rules, we are projecting to come out of that in 2020. That affects the timing of the ability to monetize the various tax credits that these projects generate. In spite of that, we've been able to land projects and bring them in very efficiently and economically. What we've seen over the past years is that it is a competitive landscape with some narrowing margins. We've still been able to put in service 500 megawatts of commercial renewables in 2016.

So, as we look forward, what we wanted to do was get an indication here that recognizing our NOL position, we will look at tax equity partnership arrangements as a possible financing tool. We've looked at that in the past. We haven't found anything that was acceptable, and we found other options that were more beneficial to us. But we will be open and continue to examine those possibilities.

Michael, a couple of additional things I would point to. As we get toward the end of the decade, we are planning at this point to be out of an NOL position. Now that is setting aside tax reform, which could, of course, change the landscape. We believe we will become increasingly competitive as we enter the latter part of the decade under current tax law.
And, the other thing I would point to consistent with your question on Florida, is that we have directed more capital in this plan to regulated renewables – $1.3 billion in the Carolinas and Florida, which we believe will be underpinned by improving economics in those states, and we will look for ways we can add that form of renewables, which has a better return profile for our investors.

Michael Weinstein - Credit Suisse - Analyst

Okay. Great. Thank you and also just one last question on taxes. I don't think you made any comments on the border adjusted tax and how that might affect your operations at all.

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

Michael, we do have some exposure to border adjusted tax within our regulated businesses. I point to our nuclear fleet as being impacted with fuel and so on. I think what's important is to recognize that our nuclear fleet is regulated, that this would become a part of our cost of service. As we advocate around impacts to customer rates, the benefits of low-cost energy and other items, we are pointing this out in our advocacy plan to our key legislators as important to Duke Energy and Duke Energy customers.

Michael Weinstein - Credit Suisse - Analyst

That's great. Thank you very much, and by the way, the presentation looks great. The new slides look very well done, so congratulations whoever did that.

Chris Turnure - JPMorgan - Analyst

You have touched on a couple things around the rate cases that you're going to file for in North Carolina this year, but I wanted to try to get some more detail there. If we think over the last four years what has changed since the last filings and decisions there, I'm wondering how we can think about that. You have had some load growth. You definitely had rate-based growth, but a big chunk of that is deferred with the coal ash expenses. So are we looking at you guys pretty much earning your authorized ROE right now and the main benefit of these cases being just a cash recovery on coal ash?

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

Chris, I would point to a couple of things. I think the other variable and what has happened over the last four years is we have executed very effectively on cost management, which gives us some headroom in order to put a capital investment in and recovery without raising prices in a significant way for our customers, and that's very important as we enter in a rate case.

We do have capital investment. We intend to recover nuclear costs, Lee combined-cycle, and we have deferred costs in the form of Hurricane Matthew, and of course, we have recovery of cash. It will be a mix of cash recovery and returns, and as we get closer to filing, we will give you more specifics on what we are filing for and the composition, and you can expect that later this year.

Chris Turnure - JPMorgan - Analyst

Okay. And then my next question is on your capital plan for the next five years. You already talked about commercial renewable growth in there, but are there any placeholders that we should be aware of for large lumpy projects that are not yet approved or maybe even aspirational on the pipeline side or things of that nature for pipelines or other?

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

We do have growth capital in the plan, Chris, and I would think of it in the $500 million range over this five-year period. We typically maintain some level of growth capital, if you look at us historically, because you think about five years, there is time to develop, and we want to put those aspirations out there. So, there is some growth capital in $500 million to $700 million range in the gas plan.
Okay. But nothing particularly large that would move things year to year if you were not successful in getting them?

That's correct.

I had a quick question on holding company debt and tax reform. If the interest deductibility does go away, do you plan to change the target holding company level that you want to have in terms of debt? And if you do, what are the levels you have in your tool kit right now to think about how you will reduce that level over time?

Let me start and I'm sure Steve has some thoughts on this as well. As we think about tax reform, we turn the discussion to the holding company because of the impact, but I think, as you face tax reform, you also have to look at what is happening to the underlying earning power at the utilities and what options we have there. That would be a part of the decision process on how we would address the holding company.

Certainly de-levering could be something we would consider, but I think there's a lot of work to do before we would reach a conclusion like that. As this develops, we will continue to keep you informed, and we understand the importance of mitigating the impact to the extent we can, and that is one of the benefits of looking at scenarios. That work is underway right now.

On the utility side, the growth profile you provided was very helpful through 2021. But if we have to look at the retail customer rates -- I know there was a slide you provided with the rates in 2017 -- but just to get a sense for what kind of load growth you are looking at over that timeframe and how do you think rates would go or increase over that timeframe to get a sense for the sustainability of that growth over time?

We focus very keenly on customer rate impact, and you will have more visibility into specifics as we think about the plans in 2017 as we announce those rate cases. But over a longer term, we target rate of inflation for a CAGR for customer rates, so that might be in the range of 2% to 3.5% depending on the jurisdictions, and we actually use that when we think about capital deployment and our cost of service because of the importance of keeping competitive rates.

I think you recognize that we operate in a very competitive environment where our rates in the Carolinas in particular are 20% below national average, and that is an advantage to our service territories if we can continue to perform in that way.

And, we have seen rate reductions due to fuel over the past several years to our customers, so that is part of the overall picture as well.

That is very helpful. Just a quick follow-up. So if there is, in fact, tax reform that reduces customer growth just because of lower tax rates, does that mean you have more headroom to spend more CapEx during that timeframe?
Steve Young - Duke Energy Corporation - EVP and CFO

Yes, in general, if income taxes are lowered, like any other operational expense, that provides an opportunity for a utility to make further investments in infrastructure under the rate construct. Those can be beneficial situations that we have taken advantage of in the past.

Brian Chin - Bank of America Merrill Lynch - Analyst

Following up on Praful's earlier questions related -- on the Holdco debt, does the 5% diluted comment on the House plan -- does that incorporate expected changes to the Holdco debt structure, or is that just holding the Holdco debt outlook in your plan constant, and then you could react to it later to mitigate that 5% dilution?

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

It is the modest level of Holdco debt in our five-year plan also considering cash flow impacts that we can see in a very preliminary way from the utilities up to the parent. So that is about 5% dilutive, Brian.

Brian Chin - Bank of America Merrill Lynch - Analyst

Okay. Great. And then one other thing. The grid modernization CapEx update is pretty helpful here. What proportion of the grid modernization spending is subject to legislative approval? I think based on the last couple of conversations I've had with you, there were some legislation in Carolinas, for example, that was necessary for some of that spending. Can you just give a little bit of color on that?

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

There is nothing subject to legislative approval, Brian. We believe the compelling customer value for this is quite strong. We have been discussing the importance of infrastructure growth in our jurisdictions, specifically in the Carolinas, at both the regulatory and legislative levels to inform these stakeholders of the opportunity that exists here and the value we think we can deliver. We also see it as the economic development driver in our service territories. As we set out a long-term plan where workforce could be developed to work in areas that are rural areas of the state, we think there is a compelling business case for the leaders of the state.

Michael Lapides - Goldman Sachs - Analyst

Hey, guys. Congrats on a good start to the year. I am looking at the detail you provide on slide 18, and you show the adjusted book ROEs by state. Then you talk about O&M cost management and the need to file rate cases in North Carolina, and I'm a little confused because you are expecting to earn a 10% to 10.5% ROE in the Carolinas and you are also managing O&M in the Carolinas as one of your bigger jurisdictions. So just curious what drives the need for a case, especially in a state that typically uses historical test years?

Steve Young - Duke Energy Corporation - EVP and CFO

Yes, Michael, we have a number of things occurring here. We have been deferring a lot of costs on our balance sheet that we need to start receiving some recovery on. Coal ash is certainly one of those items – we've spent about $900 million on coal ash to date. We requested and have deferred Hurricane Matthew costs to the tune of about $150 million as well. So, we will be seeking recovery in some form or fashion. Additionally, we have had infrastructure buildups, nuclear operations, and the Lee combined cycle as two good examples there that we'll be incorporating into rates.

Michael Lapides - Goldman Sachs - Analyst

Got it. But if they are already in service, you would have lost the AFUDC. Wouldn't they be weighing on the earned returns, and yet it seems like you are doing a great job of actually earning your ROEs there?
Steve Young - Duke Energy Corporation - EVP and CFO

We have been. To the extent you make capital investments and put them into plant and service, they will weigh on the earned returns, but that's where we have worked very diligently to control our O&M costs and expand our wholesale sales, to keep our regulated ROEs up. But now, as we move forward, it is time to catch up that rate base growth, and also, we do have the singular Lee combined cycle plant as an example that will be timed with rate recovery, which will be moving from CWIP to in-service.

So there are a number of factors, as we mentioned earlier. Some deferred cost cash recoveries and some earnings uplift potentials as well. A mix of the two.

Michael Lapides - Goldman Sachs - Analyst

Got it. And last thing, just thinking about the O&M cost management, when you are saying a 5% reduction, is it that a 5% reduction on the total GAAP level of $6.2 billion or a 5% reduction on that smaller number, the $4.6 billion or $4.7 billion?

Steve Young - Duke Energy Corporation - EVP and CFO

It's on the non-recoverable O&M number, the smaller number there. The larger number has recoverables and pass-through type items, as well as some cost-to-achieve type items. So we're looking at the non-recoverable lower number.

Roger Song - SunTrust - Analyst

Just a really quick question on the 4% to 6% across the five years. Should we think about it linear across the five years, or is it more front-end or backend loaded?

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

As we said in our prepared remarks, we have designed this plan to deliver within the range every year, both the capital and the recovery mechanisms.

Lasan Johong - Auvila Research Consulting - Analyst

A couple of questions on the tax issue. One, Steve, I thought what you said was very interesting. If the corporate tax rate goes down, you sound like you were suggesting that you get to keep that benefit and then take that money and reinvest it in new infrastructure. Is that right, or I would have thought that the rates would be reduced to compensate for the lower tax rates?

Steve Young - Duke Energy Corporation - EVP and CFO

Not necessarily. There are a number of options that can be put forth here as we work with the various stakeholders, but we have had the cost of O&M items drop in the past. There are a number of things that can be done. You can reinvest in capital and keep your ROE the same under the current rates, but advance your infrastructure for customers. You can use situations like this to accelerate amortizations of regulatory assets and things of that nature when O&M cost declines and keep current rates where they are at. We've done that in the past, so there are a number of strategic opportunities that exist out there.

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

I think the important point is, if customer rates are otherwise going down for a reduction in the tax rate, that gives you the opportunity to deploy capital without an increase in ROEs. So that's the point we are trying to emphasize here.

Lasan Johong - Auvila Research Consulting - Analyst

Okay. That's excellent. Gas LDC M&A, is that something that is still in the mix?
Lynn Good - Duke Energy Corporation - Chairman, President and CEO

This plan does not contemplate M&A. We feel like, with the portfolio of businesses we have, that we have a good growth trajectory. On asset acquisitions, if we saw something that fit with one of the businesses, we, of course, would be opportunistic, but there is no what I would call corporate M&A contemplated here.

Lasan Johong - Auvila Research Consulting - Analyst

Got it. Personal tax rates going down, I would assume if that happens, your 4% to 6% growth rate would start to look very low, correct?

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

If personal tax were to go down?

Lasan Johong - Auvila Research Consulting - Analyst

More money to the consumer. Consumers spend more, more household formations, therefore more electric connections and gas connections, no?

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

That's probably the best thing that can happen to our business, so let's move to the Southeast, let's build industrial in the Midwest. We're all for it.

Steve Young - Duke Energy Corporation - EVP and CFO

To the extent the economy picks up based on various tax initiatives, whether corporate or personal and discretionary spending increases, that will certainly help our business. And, certainly our Southeast jurisdictions are very desirable areas with a lot of growth. We would love to see that uptick.

Lasan Johong - Auvila Research Consulting - Analyst

Got it. Last question. If you are going to Washington to influence the outcome of the tax results, why not push for a deduction of dividends?

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

You know, that's an interesting question because a legislator raised that in an early conversation. So all things are on the table.

Operator

Thank you and now I would like to turn the conference back over to Ms. Lynn Good for any additional or closing remarks.

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

Well, thank you, everyone, for joining us today and for your attention during a slightly longer call and set of prepared remarks. We will be available as we always are for additional discussion and feedback, and we look forward to seeing many of you in the days ahead. Thanks again for your investment in Duke Energy.