



Conference Call Transcript

DUK - Q1 2009 Duke Energy Corporation Earnings Conference Call

Event Date/Time: May. 05. 2009 / 10:00AM ET

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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 call over to Mr. Bill Currens, General Manager, Investor Relations. Please go ahead, sir.

Bill Currens - Duke Energy Corporation - General Manager, IR

Good morning and welcome to Duke Energy's first quarter 2009 earnings review. Leading our discussion today, are Jim Rogers, chairman, president, and chief executive officer, and David Hauser, group executive and chief financial officer. Jim will begin today's presentation by providing a general overview of the quarter's results. Then David will provide more detail and context around the quarterly results for each of our businesses, as well as our credit and liquidity positions. Jim will close with updates on our operational performance, regulatory initiatives, the Cliffside and Edwardsport coal projects, and our wind energy business. Following those prepared remarks, we will open the lines for your questions.

Before we begin, let me take a moment to remind you that some of the things we will discuss today, concern future company performance, and include forward-looking statements within the meaning of the securities laws. Actual results may materially differ from those discussed in these

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forward-looking statements, and you should refer to the additional information contained in Duke Energy's 2008 Form 10-K filed with the SEC, and our other SEC filings concerning factors that could cause those results to be different than contemplated in today's discussion. In addition, today's discussion includes certain non-GAAP financial measures as defined under SEC Regulation G. A reconciliation of those measures to the most directly comparable GAAP measures is available on our Investor Relations website at www.duke-energy.com. With that, I will turn the call over to Jim.

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

Thank you, Bill. Good morning, everyone. Thank you for joining us today, and thank you for your interest and investment in Duke Energy. Before I begin, I would like to thank Sean Trauschke for his service to our company. Many of you have been working over the past several years with him in his role in Investor Relations. After 20 years in various roles here at Duke Energy, most recently as senior VP of Investor Relations and Financial Planning, Sean left us last month to become chief financial officer at OGE Energy in Oklahoma City. This was a good move for Sean, and we wish him well. While we work to replace Sean, Bill Currens, our general manager of Investor Relations, will be working with all of you all.

In our news release this morning, we announced adjusted diluted earnings per share of \$0.28 per share for the first quarter of 2009, versus \$0.35 in the first quarter of 2008. We're pleased with these results because the \$0.28 is in line with our internal plan. We achieved these results even though we incurred more than \$44 million in winter storm costs during the quarter. These costs were substantially higher than our historic experience. After the first quarter, we're on track to achieve our 2009 employee incentive target of \$1.20 per share on an adjusted diluted basis.

We have no plans for public equity issuance through 2013, aside from what we're doing with our dividend reinvestment program and other internal plans. With our strong balance sheet, we continue to have access to the capital markets during these turbulent times. David will talk more about this in a few minutes.

Our quarterly results demonstrate that we were impacted by things we can't control, such as the weather and the economy. But as you would expect, we're executing on what we can control, including managing our costs, improving our operational performance, including providing reliable service to our customers, and restoring service after storms as quickly and safely as we can, maintaining the our liquidity and strong balance sheet, and making progress on our regulatory and legislative initiatives.

To give you a sense of how well our employees are managing our costs, recall that for 2009, we added a measure to our corporate short-term incentive goal for employees, and that was to reduce O&M expenses by \$100 million. We're on track to achieve that incentive, even with the storm cost I previously mentioned. We have done this by freezing salaries for exempt employees, and by reducing our travel costs and third-party contractor expenses among many other things. And the best news is that this strong focus on cost management has not come at the expense of operational performance in the first quarter. I'll have more to say about that later. With that, let me turn it over to David for more details on the quarter.

David Hauser - Duke Energy Corporation - CFO, Group Executive

Thank you, Jim. I'll begin my review of our first quarter 2009 business segment results with our largest segment, US Franchised Electric and Gas. The segment reported first quarter 2009 adjusted segment EBIT of \$557 million, compared to \$637 million in last year's first quarter. The segment's lower results were primarily driven by substantially higher storm costs, and a decline in weather adjusted sales volumes. You may recall that during the quarter we experienced significant winter storms, in both the Midwest and the Carolinas. These storms resulted in increased costs of \$39 million in the first quarter of 2009, when compared with the same quarter last year. Lower weather-adjusted sales volumes to retail customers across all of our service territories led to a \$37 million decline in the segment's results. In a moment, I will give you a little more context around sales volumes.

But first, let me discuss a few items we have mentioned in previous quarters that continued to impact the segment's first quarter results. Rate changes had an overall positive impact on the segment's results. This was driven by approximately \$31 million of increases in our Midwest rates, primarily related to riders for environmental capital and IGCC costs in Indiana. This impact to rates was partially offset by the expiration of a rider in North Carolina at the end of 2008. As you may recall, the North Carolina rate order resulted from the 2007 rate review, included an \$80 million one-time rider related to merger savings. During the first quarter last year \$14 million was collect in rates under this rider.

With that, let me now give you additional context around our sales volumes. Our overall customer base continues to grow, but at a slower pace than in the past. On average, we added about 11,000 customers since the first quarter of 2008, mostly in the Carolinas. However, declining sales

volumes, driven by reduced industrial activity, offset the growth of our customer base. Overall, weather-adjusted volumes were down approximately 5%, when compared to the first quarter of last year. This decline was driven by a significant drop in industrial volumes of approximately 20% on a weather-adjusted basis. All of our industrial customer classes were down in each of our jurisdictions. The industries experiencing the most significant declines were chemicals, primary metals and textiles.

Net margins were down about 2% quarter-over-quarter. And as you would expect, this decrease was also driven by industrial customers. As you can see, the decrease in volumes does not result in the same percentage drop in net margins. This is because in addition to paying energy charges based on the kilowatt-hours used, industrial customers also pay fixed capacity charges based on their historical energy demand. As a result, the impact on net margins is less than the percentage drop in kilowatt- hours sold.

On the other hand, residential volumes for the quarter were higher in the Carolinas, and flat in the Midwest. This helped offset the impact of the lower industrial sales volumes. However, the impact of the recession heightens our concerns about all of our customers' ability to pay their bills. Compared to last year's first quarter, the percentage of customer accounts in arrears is slightly up, but has not changed significantly. We have noticed that customer payments are slowing, as they face the challenges of the economic downturn. But we have not seen a significant increase in bad debt expense during the quarter, when compared to the first quarter of last year. We will continue to watch customer bill payment activity closely throughout the year.

As we told you in February, our 2009 financial plan assumes recessionary pressures will continue in 2009, and result in essentially flat kilowatt-hour sales for the year, on a weather-adjusted basis in both the Carolinas and the Midwest. Sales volumes for the first quarter of 2009 were unfavorable compared to our plan. But the drop in volume resulted in only about a \$5 million adjusted EBIT variance to our plan.

Next I will review Commercial Power. Adjusted segment EBIT for Commercial Power for the first quarter 2009 was \$103 million, an increase of approximately \$4 million over the first quarter of 2008. Commercial Power's increased adjusted segment EBIT was driven by improved native margins, resulting from increased rates of \$20 million in Ohio due to the implementation of the Electric Security Plan at the beginning of this year. Another positive driver resulting from the ESP, was the absence of unfavorable timing of the collection of fuel and purchased power costs. In the first quarter of 2008, the timing of the collections of those costs had a negative impact of \$13 million. Under the ESP in Ohio, a portion of the rate riders, such as fuel and purchased power for generation, serving our native load customers, now receives regulatory accounting treatment. As a result, the timing of the collection of those riders no longer has an impact on Commercial Power's results.

The segment also benefited from a positive adjusted EBIT contribution of \$2 million from our Midwest gas-fired assets, due to higher generation volumes and PJM capacity revenues. We expect these assets to be EBIT positive on an adjusted basis in 2009. Partially offsetting these positive drivers, were increased plant O&M expenses, primarily due to the timing of plant outages. Additionally, higher net purchase accounting expenses resulting from the expiration of the rate stabilization plan amortization at the end of 2008, had a negative impact on the segment's results. We expect total purchase accounting expenses for 2009 to be approximately \$50 million, which is consistent with what we have told you in the past. Non-native margins were principally flat when compared to last year. This was primarily due to the impact of \$20 million of increased gains on non-native coal sales, offset by lower generation margins and lower sales of emission allowances during the quarter.

The recent decrease in power market prices has prompted questions from some of you about customer switching. We have experienced some switching in Ohio. However, to date the level of customer switching has not been significant.

Commercial Power's wind portfolio continues to grow, and we currently have more than 500 megawatts of wind power in operation. At present, the adjusted EBIT contribution from the wind business is immaterial. I will talk more about this later. But it is important to remember, that our wind operations qualify for certain incentives such as production tax credits, investment tax credits or grants in lieu of the investment tax credit.

Now let's turn to our International business segment. For the first quarter of 2009, Duke Energy International reported adjusted segment EBIT of approximately \$93 million, compared to \$114 million in last year's first quarter. The decline in DEI's results was due to lower margins at National Methanol driven by lower commodity prices. Unfavorable average foreign exchange rates also drove the decline in DEI's results. This was principally due to the Brazilian currency which weakened against the US dollar late last year. These negative impacts were partially offset by higher prices and favorable hydrology in Brazil. As I said in our last earnings call, over the past three years, our share of National Methanol's results have contributed about 25% to 30% of DEI's adjusted EBIT results. For 2009, we continue to expect National Methanol's contribution to be around 20%.

Next, I will review our Other category, which primarily includes costs associated with corporate governance, Duke Energy's captive insurance company, and Duke Energy's real-estate joint venture, Crescent Resources. The weak real-estate market and the overall economic conditions continue to have a negative impact on Crescent. As a result, Crescent is in discussions regarding a number of potential strategic and financial

alternatives, that could affect Duke Energy's role as a guarantor of certain Crescent obligations. As you will recall, we are a named guarantor on surety bonds and letters of credit, related to projects at Crescent in progress at the time of the creation of the joint venture in 2006. As we have discussed in previous quarters our maximum exposure to these guarantees was estimated to be approximately \$40 million.

In light of Crescent's current situation, we believe it is likely that Duke will be required to perform under certain Crescent obligations, for which we are a named guarantor. Consequently, we have recognized \$33 million of related charges during the first quarter of 2009. These charges are included in special items, and are excluded from our adjusted net expense for other. As a result of the recognition of these charges, we believe any remaining exposure to Crescent is insignificant. Duke Energy continues to have a zero book basis in its investment in Crescent.

With that, let me get back to our quarterly results. Other reported a first quarter 2009 adjusted net expense from continuing operations of \$50 million, compared to \$65 million in the first quarter of 2008. The \$15 million decrease in Other's net expense was primarily due to reduced governance O&M.

Now I will review a few important non-operating financial items. Interest expense, net of capitalized interest, was flat when compared to the same period in 2008. Capitalized interest, including AFUDC debt, was approximately \$13 million during the quarter, which is a decrease of \$5 million from the same period last year. Equity AFUDC was \$28 million in the first quarter 2009, compared to approximately \$33 million in the first quarter of 2008. Interest income and other was \$35 million during the quarter. It was \$47 million in the first quarter of 2008. The effective tax rate for the quarter was approximately 34%, compared to 32% for the same period last year. The effective tax rate for 2009 is expected to be 34%.

I want to reiterate that we continue to have strong liquidity. Our total available liquidity was approximately \$2.2 billion at March 31, 2009, which includes approximately \$1.5 billion available under our \$3.1 billion Master Credit Facility. We ended the quarter with approximately \$750 million of cash, cash equivalents and short-term investments, excluding approximately \$500 million in foreign jurisdictions. It is important to note, that our Master Credit Facility does not expire until June 2012.

Additionally, we continue to have strong access to the capital markets, and we'll continue our opportunistic approach as to when and where we finance. As we do so, our focus will remain on preserving our liquidity, and funding our business plan. We also continue to issue commercial paper at low rates. At March 31st, approximately \$450 million of commercial paper was outstanding, at an average rate of 1.32%, and an average maturity of approximately five days. As of April 30th, our current weighted average rate has decreased to approximately 0.63%, while our average maturity has increased to around ten days.

During the first quarter of 2009, we completed fixed-rate financings of \$750 million at Duke Energy Corporation, \$450 million at Duke Energy Ohio, and \$450 million at Duke Energy Indiana. The weighted-average rate for these financings was approximately 6.1%. For the remainder of 2009, we expect to finance up to \$650 million at Duke Energy Carolinas, and less than \$100 million at Duke Energy Kentucky. However, we may be opportunistic and pre-fund certain 2010 cash requirements in 2009, if we consider the markets to be favorable.

During the first quarter 2009, we generated approximately \$175 million from the dividend reinvestment plan, and internal plan equity issuances. For the remainder of the year, we expect to generate at least an additional \$175 million from these sources, and have not changed our original intention to limit these equity issuances to approximately \$600 million over our five-year planning period. And it's important to keep in mind, that in our five-year plan through 2013, we do not need any additional public equity issuances.

In February, we made a \$500 million contribution to our qualified pension plan. As a result, our plans are adequately funded, and the total pension and post-retirement costs are expected to be approximately \$100 million in 2009, a portion of which will be capitalized. We don't anticipate making any additional contributions to our pension plans for the remainder of 2009.

Our strong liquidity and cash position is evidenced by our dividend. We're very proud of our history of paying dividends to our shareholders, and we are comfortable with our ability to continue to pay, and grow our dividend over time. It's important to note that we enjoy solid investment grade credit ratings from S&P and Moody's, and all of our rated entities have been given either positive or stable outlooks. We are in frequent discussions with the rating agencies to make sure that they are aware of our strong liquidity position, our stable balance sheet, and our ability to finance our business plan. In fact, we met with the rating agencies in the past several weeks, and we're pleased with those discussions. Our current ratings reflect our plans to only issue \$600 million in equity through our dividend reinvestment plan and internal plans, with no other equity assumed to be issued. Our goal is to maintain or improve our current ratings, and the credit rating agencies understand this goal.

Before I move on to capital expenditures, I want to spend a few minutes discussing a topic that has received quite a bit of attention recently. As you are aware, the American Recovery and Reinvestment Act of 2009 was enacted into law in February. This legislation, better known as the

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stimulus package, includes various provisions that will benefit Duke Energy. Specifically, the stimulus package has extended the 50% first year bonus depreciation for one year, making it applicable to assets started in either 2008 or 2009, and placed into service by December 31, 2009.

Additionally, bonus depreciation can be taken for assets that qualify for either the production tax credit, investment tax credit, or grants in lieu of credits. The stimulus package also provided for a three-year extension of the production tax credit for wind facilities until December 31, 2012. In addition, the package created the ability to receive, in lieu of a production tax credit, an investment tax credit or a Department of Treasury grant, equal to 30% of qualifying capital costs for wind facilities placed into service by December 31, 2012. In the case of the grant, the construction must have started prior to December 31, 2010. Company-wide, we anticipate that these provisions of the stimulus package will generate approximately \$400 million of positive cash flow in 2009. You should note that the impact of these provisions was not included in the original 2009 cash flow projections we previously shared with you.

You have seen this slide before, but I want to show it again to emphasize the flexibility that we have in implementing our capital expenditure program. Our CapEx spending flexibility is best demonstrated if you think of it in three buckets. First of all, there's committed capital. Secondly, there's on-going capital. And third, there's discretionary capital. About \$7 billion is committed capital, including the dollars allocated for completing our two new advanced coal-fired plants. Roughly \$13 billion is for on-going capital spending such as maintenance, which has some flexibility, as to when it is spent. The remaining \$5 billion of our potential investment is discretionary growth capital. We won't invest these discretionary dollars, unless we secure constructive regulatory treatment for projects in our regulated businesses. And in our commercial businesses, these dollars will only be invested if we find opportunities that meet our return expectations. With that, I will turn the call back over to Jim.

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

Thank you, David. I will now quickly run through some of the fundamentals supporting our first quarter results, including our operational performance and regulatory initiatives. I will also provide an update on our two largest capital projects, Cliffside and the Edwardsport coal plants, and our growing commercial wind energy business.

I mentioned earlier that our strong focus on cost management in the first quarter was not at the expense of operational performance. As you can see this operation's scorecard for the first quarter says it all. Our regulated generation fleet is performing at a very high level in most of our key metrics. And while I'm on this topic, I want to highlight a success story that we recently learned of. Duke Energy's nuclear fleet, on a cost per kilowatt-hour basis, was rated as the lowest cost fleet in the United States for 2008. And this was according to the Electric Utility Cost Group. When you put this cost metric alongside the high nuclear capacity factor we achieved in the first quarter, as shown on this scorecard, you get a good sense of our employees' strong focus on operational excellence. I truly appreciate their commitment to our company.

Now let me update you on our regulatory initiatives. We continue to make progress on many of our initiatives. In February, we filed a petition with the North Carolina and South Carolina Commissions requesting to defer costs associated with the Allen Steam Station scrubber construction, and the portion of the Catawba Nuclear Station we purchased from Saluda River Electric Co-op in 2008. This request was approved by both Commissions. Recovery of the deferred costs will be requested in upcoming rate case filings I will talk about in a few moments.

Last month, we reached a tentative settlement agreement with most of the parties in our request to increase electric distribution rates in Ohio by \$55.3 million. We expect final approval by the Public Utilities Commission of Ohio in the second quarter of '09, with rates becoming effective shortly thereafter.

Next is our Construction Work in Progress, or CWIP, riders for the IGCC project in Edwardsport. This rider is updated every six months to track the financing costs associated with our construction of this plant. You may recall that in January 2009, the IURC approved our first CWIP rider, which was filed last May. This approval allowed us to begin recovering a CWIP return on approximately \$128 million of plant costs from retail customers. That order also approved our revised cost estimate for the project, as well as our proposal to study the capture and possible storage of CO2 from the plant. In March, the Commission held hearings on our second CWIP request which we filed last November. We expect an order on our second CWIP filing by the end of the second quarter. Assuming approval by the Commission, the cumulative amount of the Edwardsport CWIP rider would be increased to \$291 million. Last Friday, we filed our third IGCC CWIP rider which, when approved, will bring the cumulative amount to about \$550 million. We expect a hearing on that filing this summer, and an order in the fall. We expect to file a fourth CWIP rider in November.

We're also working to transition to a 21st century regulatory model in each of our jurisdictions. And not surprisingly, these efforts have been more challenging. We are disappointed with the conditions of the North Carolina Utilities Commission set in late March in our efforts to serve

Orangeburg, South Carolina, which is located outside of our service territory. We continue to evaluate next steps, as we believe that expanding our service, even if outside of our traditional service territory benefits all stakeholders, including our existing customers. We've got more work to do here. Our save-a-watt energy efficiency initiative is taking longer than expected, but we continue to persevere. save-a-watt was approved late last year in Ohio, and we're working with the commissions in our other four states on its approval. Again, we have more work to do in this area.

Here's how our regulatory calendar shapes up for the rest of the year. In Indiana, we have hearings scheduled for June on the deployment of our proposed smart grid program that in state. In North Carolina and South Carolina, we plan to file separate electric rate cases, this summer with rates becoming effective January 2010. Even with these increases, we're projecting that our rates will remain below the national average in four of our five jurisdictions. In Ohio, we are at the national average.

With the significant amount of capital we are investing in modernizing our regulated infrastructure, I thought it was important to update you on our two largest capital projects, Cliffside and Edwardsport which are on track to be completed on time and on budget. At Cliffside in North Carolina, we're investing \$1.8 billion in capital, not including AFUDC of about \$600 million to build a supercritical 825 megawatt coal unit. At the end of the first quarter we had committed nearly \$900 million to the project, and it was approximately 35% complete. We're making very good progress on the erection of the steel for the boiler, the turbine pedestal and pollution control equipment. We plan to complete the boiler about two years from now - with the plant fully online for summer peak 2012.

Beyond the good construction progress, we received very good news in March when the North Carolina Division of Air Quality found that the Cliffside new boiler will be a minor source of hazardous pollutants. This finding confirms that the plant will have the strictest, most effective air emission controls available, to protect public health and the environment. While certain environmental groups continue to use the legal process to challenge this plant's construction, we believe that the state's minor source determination was a significant legal hurdle for us to clear, to complete the plant.

In Indiana, we're investing approximately \$2.35 billion, including about \$125 million in AFUDC to build the 630-megawatt IGCC unit at Edwardsport. At the end of the first quarter, we committed nearly \$1.2 billion to the projects, and it was about 30% complete. This updated photo shows the plant footprint taking shape as we poured the first concrete last month. As I noted a few minutes ago, the Indiana Commission approved our first CWIP rider for the project as well as a Front End Engineering and Design study, or FEED study to capture 15% to 18% of the CO2 the plant emits. We have also filed a request to study carbon storage from the project. Edwardsport is scheduled to be completed in the summer of 2012.

Now, a quick update on our growing wind business. David noted some of the specific tax impacts, and incentives from the stimulus package that specifically apply to this business. These commitments show that the government is serious about accelerating the development of renewable energy, and these initiatives will help us further grow our wind business. We believe we are well positioned to bring 250 megawatts of wind energy on line annually. Our preference is to secure long term purchase power agreements, and then invest in capital in the assets.

But the stimulus package isn't just about the wind. We are working on securing various grants and credits for clear coal, carbon capture and storage, Smart Grid, and other infrastructure improvement projects. We have a multi-state team working with state and local governments which will distribute the funding, as well as the U.S. Department of Energy. This work is helping to define the application criteria for eligible projects. It also gives us the opportunity to help state and local government understand and support the regulatory framework associated with a stimulus-funded projects.

We covered a lot this morning, but I believe you can see how we remain focused on executing on our business plan. As I close, let me remind you that the economy and weather drive our results. Longer term, our results are driven by providing affordable and reliable service to our customers, accessing reasonably priced capital, developing opportunities to reinvest in both our commercial and regulated businesses, and working in constructive regulatory environments. All in all, this is our proven business model. Our value proposition for investors remains strong, and is underpinned by this business model.

Before we open it up to your questions, I want to let you know that we plan to host an informational session on nuclear power on June 3rd in New York City. Our group executive and chief nuclear officer, Dhiaa Jamil will conduct the session. You will soon be receiving an invitation for that meeting. I would also like to remind that you our Annual Shareholders meeting is this Thursday, at 10 a.m. The meeting will be webcast live, and a listen-in option is available. Details are on our website. Now let's take your questions.

QUESTION AND ANSWER

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Operator

Thank you very much.

(Operator Instructions)

And we will take our first question from Ashar Kahn from Incremental Capital.

Ashar Kahn - Incremental Capital - Analyst

Good morning.

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

Ashar, thank you for your question.

Ashar Kahn - Incremental Capital - Analyst

I just wanted Jim, to get a perspective. You finished the first quarter. Was it above expectations, below expectations, and based with incentive target, does it imply that we're going to have a flat earnings comparison going for the next nine months?

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

I would say it is slightly above our internal plan and expectations, and that we are on track to hit the \$1.20 employee incentive target.

Ashar Kahn - Incremental Capital - Analyst

Okay, thank you.

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

Thank you very much.

Operator

And our next question comes to us from Michael Lapedes from Goldman Sachs.

Michael Lapedes - Goldman Sachs - Analyst

Hey guys, a question for you on the Pioneer transmission line. I have seen a little news flow on that, in terms of the FERC granting incentive ROEs, but still a long way to go, I think in terms of the state and RTO process. Can you just provide a regulatory update on what the, kind of what the path is for getting that line approved?

Jim Turner - Duke Energy Corporation - Pres, COO of U.S. Franchised Electric & Gas

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Michael, it's Jim Turner. We do have the FERC approval on the ratemaking, and that really is, in our view, the biggest hurdle. We're going to work hard with the states to make sure we're solving any issues they may have, as well as with the MISO. So, we feel very good about where the project is at this point. But obviously, this is one that's going to take some time in all events, for us to get done.

Michael Lapedes - Goldman Sachs - Analyst

And just what's the process with the MISO and with the states. I mean what are the things that investors and analysts should keep their eyes on over the coming year?

Jim Turner - Duke Energy Corporation - Pres, COO of US Franchised Electric & Gas

Well again, I think a lot of the heavy lifting has been done with FERC. And what we're going to do with the states and MISO -- and obviously with MISO, we have to make sure that we're coordinating with the ISO and the region. And with the states, we have to make sure we're solving any residual concerns they may have about their jurisdictions and siting and those sorts of things. So, I would see that as something that unfolds probably over the next year or so, Michael.

Michael Lapedes - Goldman Sachs - Analyst

Okay, thank you.

Operator

Thank you, and our next question comes to us from Hugh Wynne from Sanford Bernstein.

Hugh Wynne - Sanford C. Bernstein & Company, Inc. - Analyst

Morning.

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

Good morning, Hugh.

Hugh Wynne - Sanford C. Bernstein & Company, Inc. - Analyst

I had -- kind of bigger picture, longer term type of question. I noticed in the release that the total capital invested in the business, the debt and the equity invested in the business has gone up by about 10% year-over-year. And yet, of course this has been a year where operating revenues are down 1% Q1 '09 versus Q1 '08, and as a result, operating income is down 9%. And that combination of rapid investment in the business and declining revenues and operating income is reflected in what I estimate to be a decline in the return on invested capital from a 7% annual rate in Q1 '08 to a 5% annual rate in Q1 '09. And my question is, and I realize that one can't turn utility CapEx around on a dime, particularly when you're building coal plants and IGCCs. But my question is, what are your -- what is your thinking about this issue going forward? How do you hope to see it work out in the years ahead? What are your contingency plans if revenues and operating earnings remain at these low levels?

David Hauser - Duke Energy Corporation - CFO, Group Executive

Well, Hugh, this is David. Let me make a couple of comments for you. First of all if you look at the biggest plants we're building, the Edwardsport and the Cliffside, we do earn our allowed return on those while they're in construction. Cliffside currently through ADC, Edwardsport through ADC, then updating the riders in Indiana as we go. So our incremental investments are earning very well. The second one I would want you to focus on is the wind business, because we're deploying some significant capital in wind. Wind earns excellent cash returns. And if you look at the wind business, though, the returns tend to be from an accounting view, more back end loaded. So for example, if you take a 30% investment tax credit on a wind farm, you have to amortize that over the life of the wind farm. So your cash returns, and your accounting

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returns are very different in that case. So that would be three examples of where, we think we're doing the right things with investing the capital, and we are earning good returns on them.

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

I would add to David's response by saying we are filing rate cases, in both North and South Carolina this year, and that will allow us, and these cases primarily are rate-base cases, and they will allow us to include in rates, returns on investments that we have made in both North and South Carolina.

Hugh Wynne - Sanford C. Bernstein & Company, Inc. - Analyst

Great. Thank you very much.

David Hauser - Duke Energy Corporation - CFO, Group Executive

See you, Hugh.

Operator

Thank you. (Operator Instructions)

And we have a question from Emily Christy from RBC Capital Markets.

Emily Christy - RBC Capital Markets - Analyst

Good morning.

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

Good morning, Emily.

Emily Christy - RBC Capital Markets - Analyst

Given your liquidity, demonstrated access to capital markets, and some utility assets and wind assets that may be on the block in the U.S., what's your appetite for M&A right now? Is Duke an active buyer in this market?

David Hauser - Duke Energy Corporation - CFO, Group Executive

Well, I would say this. Let me get to specific assets. To the degree there are opportunities, where somebody is distressed with a wind farm or something like that, we're interested, and we do have the capital, and so we're interested in that. We're also interested in responding to requests for proposals for new wind farms. So we're doing a lot of that. On a broader M&A, the challenge with broader M&A right now is everybody's stock price, everybody's set of issues regarding carbon, and so I think broader M&A is more challenging right now.

Emily Christy - RBC Capital Markets - Analyst

Okay, thank you.

Operator

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Thank you very much. Our next question comes from Dan Jenkins from the State of Wisconsin.

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

Good morning, Dan.

Dan Jenkins - State of Wisconsin Investment Board - Analyst

Good morning to you. I was kind of curious, looking at your cash flow from operations, it's down quite a bit on a year-over-year basis. And I wondered if you could give a little more color on that. And then secondarily, I was wondering with the industrial sales being down 20%, if you are seeing any more visibility going forward? And are things stabilizing? How do you see that playing out for the rest of the year?

David Hauser - Duke Energy Corporation - CFO, Group Executive

Dan, this is David. If you look at the net cash provided by operating activities, that's down from basically \$1 billion last year to \$200 million this year. Keep in mind, that the biggest single thing that's different in there, is we contributed \$500 million to our pension fund. So that is the biggest driver of that difference. Secondly, we have had some increases in inventory. Our coal inventory is up about \$100 million. So those are the two biggest drivers of that change. Does that answer the question on cash flows?

Dan Jenkins - State of Wisconsin Investment Board - Analyst

Yes.

David Hauser - Duke Energy Corporation - CFO, Group Executive

So the pension, of course, is a one-time contribution.

Dan Jenkins - State of Wisconsin Investment Board - Analyst

Okay. And how about then on the industrial sales?

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

On industrial sales, Dan what we see is that we believe that they seem to be bottoming out. Maybe they will be slightly down. That's kind of our sense of things as we look at it, not just year-over-year but month-to-month. And again, I think we're at a place that we haven't really seen sales obviously come back, going from one shift to two shifts, or turning the plant back on. Employees are still, as you look at the states we serve, we serve some of the largest -- I mean Indiana is the largest steel producing state in the country. Also, there are a lot in Ohio and Indiana. Auto manufacturing facilities as well as auto suppliers. So I think there's a lot of question marks with respect to those sectors at this moment.

But our sense, from conversations, and I was meeting yesterday with leading steel manufacturers in the U.S., the sense is, is that it's kind of bottomed out. And that the big question is when the recovery actually starts. And there, the sense is, the recovery will be very weak and spread out over a long period of time. So that is our read, and as you know, electric sales are an early indicator of what's going to happen in the economy. So more to come.

Dan Jenkins - State of Wisconsin Investment Board - Analyst

Okay, thank you.

Operator

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And our next question comes to us from Jonathan Arnold from Merrill Lynch.

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

Good morning, Jonathan.

Jonathan Arnold - BAS-ML - Analyst

Hi. Two questions. One, has there been any traction on possible legislation related to electricity matters in the North Carolina legislature? Anything you can update us on that?

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

Well first, we continue to work with the legislature. This is a long session. More -- in fact, I have met with both, Speaker of the House, as well as the President and Senate, and we're working the legislative process. We have a tremendous amount of work to get done, to build a consensus around a variety of different issues, including the notion of special legislation providing for regional -- the building of regional nuclear plants. We also think there ought to be legislation with respect to CWIP, so that there is a tracking provision very similar to the South Carolina law. But again, it's a long process at the state level. And in fact, we may not be successful this year in achieving exactly what we want, and it may occur in the next session. We have time.

But the fact of the matter is, is it's critical to our decision to build a plant in this region of the country, is -- critical to our decision is legislation that really supports a tracking of CWIP, and legislation that provides for the regional building of legislation. And quite frankly, the Orangeburg decision by the North Carolina Commission, in many senses of the word, if from a theoretical standpoint, indicates sort of a reluctance to see regional sharing of generation, both to Co-ops and Munis within your service territory, as well as out. And I think quite frankly over time, the state commission and legislature will come to know and believe, that it's in the best interest of all consumers in the Carolinas to allow regional -- the regional building of nuclear generation, as well as allowing companies like ours to sell to Munis and Co-ops throughout both North and South Carolina because retail customers in this state are going to demand it.

Jonathan Arnold - BAS-ML - Analyst

If something were to happen this year is there any kind of deadline that we should be focused on?

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

The legislative process, as you have heard so often, is like the making of sausage. It's not a pretty process. I really don't have a prediction, other than what I said earlier, is my sense is, is that legislation may not come together this year, and it may be next year before we achieve the type of legislation we want.

Jonathan Arnold - BAS-ML - Analyst

Okay. Thank you, Jim.

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

Thank you.

Jonathan Arnold - BAS-ML - Analyst

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My second question was on -- can you comment -- and I apologize if you covered in this the prepared remarks. But could you comment on how your -- what the dispatch levels you've been seeing on coal plants, any gas switching and what sort of inventory levels you're running in terms of coal? And whether you're at capacity in terms of inventory and how that's working out in terms of contracting and the like?

David Hauser - Duke Energy Corporation - CFO, Group Executive

We -- this is David, Jonathan. We are seeing is an increase in our days supply of coal, and one of the reasons our working capital is hurt, we have about a \$100 million more invested in coal than we normally do. So we actually have been selling some of the coal, and so I think we're in good shape, but the inventory is clearly up. With regard to the gas plants, is that the other question you asked?

Jonathan Arnold - BAS-ML - Analyst

Whether you're seeing increased dispatch.

David Hauser - Duke Energy Corporation - CFO, Group Executive

Well, if you look at the only part of our market that's competitive, well first of all, we are not selling as much through our bulk power marketing, because of the price. So the -- basically the decline in the gas prices mean we're not selling as much through bulk power marketing, and that did affect us in the first quarter, although we sold more wholesale in the first quarter. So that was the two offsets. That was part of our strategy. With regard to the gas plants in the Midwest, we ran those a lot more than we did last year in the first quarter, even though the price was lower, and that was because we were able to get capacity on pipelines that was now available, that historically hadn't been available in the winter.

Jonathan Arnold - BAS-ML - Analyst

Okay. So on the coal question, you'd say you're more selling supply that you have, rather than not taking deliveries?

David Hauser - Duke Energy Corporation - CFO, Group Executive

I think that's right.

Jonathan Arnold - BAS-ML - Analyst

Okay. Thank you.

Operator

Thank you. And our next question comes from Steve Fleishman from Catapult.

Steve Fleishman - Catapult Capital Management - Analyst

Hi, gentlemen.

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

Good morning, Steve.

Steve Fleishman - Catapult Capital Management - Analyst

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Just wanted to clarify a couple points. I think you said that you still expect to be able to cut costs by a \$100 million, even including the \$44 million of storm?

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

That's correct.

Steve Fleishman - *Catapult Capital Management - Analyst*

So that means you are basically cutting costs a \$144 million

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

Well --

Steve Fleishman - *Catapult Capital Management - Analyst*

Or more?

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

Let me just give you a number, for the end of the first quarter.

Steve Fleishman - *Catapult Capital Management - Analyst*

Okay.

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

When you look at O&M expense for us at the end of the first quarter, we are up about \$26 million year-over-year, but of that \$39 million is the storm, so --

Steve Fleishman - *Catapult Capital Management - Analyst*

Okay.

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

So we are being very successful at the cost cutting efforts. And so the answer is yes, we think we will achieve our \$100 million goal.

Steve Fleishman - *Catapult Capital Management - Analyst*

Okay, and then just also to clarify on the sales, that even with the -- lower sales, that you are in the quarter only like \$5 million off from a margin standpoint.

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

From what we planned, we're off \$5 million, that's exactly right.

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Steve Fleishman - *Catapult Capital Management - Analyst*

Okay, that seems pretty small. Okay.

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

Okay.

Steve Fleishman - *Catapult Capital Management - Analyst*

Thank you.

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

See you.

Operator

(Operator Instructions)

And we do have a question from Carl Seligson from Utility Financial.

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

Good morning, Carl.

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

Carl?

Operator

Mr. Seligson, your line is open, please go ahead. And hearing no response --

Carl Seligson - *Utility Financial Experts - Analyst*

Hello?

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

Carl.

Carl Seligson - *Utility Financial Experts - Analyst*

Hi.

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

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Good morning.

Carl Seligson - Utility Financial Experts - Analyst

Jim, could you give us some comments generally on how you see the climate change bill going? I understand the President has been meeting with the entire Democratic committee members today, and wonder what you foresee as far as the position on that.

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

I think we're in a very delicate period now in the negotiations in the House Subcommittee, as well as in the House Committee. Chairman Waxman and Chairman Markey are pushing hard to get legislation out of committee by Memorial Day.

Carl Seligson - Utility Financial Experts - Analyst

Right.

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

And there's really detailed negotiations going on now in the subcommittee that, as you know, proposal was presented that had exhaustive testimony, with respect to the proposal. The missing piece of the proposal, or the elephant in the room, was there was no legislative language addressing how the transition would work, how the allowances would be allocated, when the auction -- when we would when we would evolve into a full auction. So my belief is that much of the debate internally, between moderate Democrats in the coal states, and the other Democrats on the subcommittee, is really with respect to the transition and the allocation of allowances, as well as the time line and targets. So I think there is -- this was said at the beginning, this is a critical period in order to achieve Chairman Waxman's goal of Memorial Day, they have to get some agreement before they go to mark-up. Or in all likelihood it will go to the full committee, and maybe even to the floor. So again, I think there's a terrific effort being made to get something done. I think the President will be weighing in today, and trying to encourage people to come together with respect to the transition, which I think is politically the more difficult part, as well as the time line and targets.

Carl Seligson - Utility Financial Experts - Analyst

Okay, thanks.

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

Thank you very much.

Operator

And we have no additional questions at this time. I would like to turn the call back over to Mr. Currens for any closing remarks.

Bill Currens - Duke Energy Corporation - General Manager, IR

Thank you, Nicole. We want to thank you for joining us today. And as always, our Investor Relations team is available to answer any follow-up questions you may have. Have a great day.

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

Thank you very much.

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Operator

And, once again, ladies and gentlemen, that does conclude today's presentation. We appreciate your participation.
