Q4 2017 Earnings Call

Company Participants

- Lynn Good, Chairman, President and Chief Executive Officer
- Mike Callahan, Vice President, Investor Relations
- Steven Young, Executive Vice President and Chief Financial Officer

Other Participants

- David Paz, Analyst, Wolfe Research
- Jonathan Arnold, Analyst, Deutsche Bank
- Julien Dumoulin-Smith, Analyst, Bank of America Merrill Lynch
- Michael Lapides, Analyst, Goldman Sachs
- Michael Weinstein, Analyst, Credit Suisse
- Praful Mehta, Analyst, Citi
- Shar Pourreza, Analyst, Guggenheim Partners
- Stephen Byrd, Analyst, Morgan Stanley

Presentation

Operator

Good day and welcome to the Duke Energy Fourth Quarter Earnings Call. Today's conference is being recorded. At this time, I'd like to turn the conference over to Mike Callahan, Vice President, Investor Relations. Please go ahead.

Mike Callahan {BIO 19728882 <GO>}

Thank you, John. Good morning, everyone, and thank you for joining Duke Energy's fourth quarter 2017 earnings review and business update. Leading our call today is Lynn Good, Chairman, President and CEO, along with Steve Young, Executive Vice President and Chief Financial Officer.

Today's discussion will include forward-looking information and the use of non-GAAP financial measures. Slide 2 presents the Safe Harbor statement, which accompanies our presentation materials. A reconciliation of non-GAAP financial measures can be found on dukeenergy.com and 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 {BIO 5982187 <GO>}

Thanks Mike and good morning everyone. Today we announced adjusted earnings per share of $4.57, closing on a very successful year for our company. We made progress on our strategic investments and delivered earnings at the high-end of our narrowed guidance range, demonstrating flexibility in cost management and largely offsetting the impacts of mild weather. Our workforce pushed forward on our long-term transformation and never lost sight of our responsibility to meet the everyday needs of our customers.

We also announced our 2018 adjusted EPS guidance range of $4.55 to $4.85, which includes the impacts of tax reform and planned equity issuances to maintain the strength of our balance sheet. We are reaffirming our 4% to 6% growth rate through 2021 off of the midpoint of our original guidance range in 2017 and extending the growth rate through 2022. Rate base growth from our investment plans, coupled with additional rate base from the impact of tax reform will place us within the guidance range by 2019 and at the high -- mid to high-end of the range in 2020 and beyond. Steve will provide more context about our financial results, discuss our capital growth plans, and share how we are incorporating the impacts of tax reform into our planning assumption.

But first let me spend a moment on slide 4. The industrial proposition we introduced last year remains just as true today. The fundamentals of our business are strong and allow us to deliver growth in earnings and dividends in a low risk, predictable and transparent way. And given the capital intensive nature of our business, the importance of balance sheet strength remains a continued focus for the company. Our attractive dividend yield and demonstrated ability to grow our regulated businesses providing attractive shareholder return for our investors. This positions Duke as the strong long-term infrastructure investment.

Slide 5 underscores our established track record of delivering on our commitments. Overall, 2017 was an exceptional year for Duke Energy. We delivered results, advanced our long-term strategy and excelled in operations. We had solid growth in our electric and gas utilities, including the addition of Piedmont Natural Gas. We also responded with great flexibility, offsetting weak weather with cost management. And these results enable us to deliver strong earnings and increase the dividend by 4%. Our commitment to safety and outstanding operational performance continued in 2017. Our employees delivered outstanding safety metrics, with a total incident case rate of 0.36, a 10% improvement on our industry-leading performance in 2016.

For the second consecutive year, the combined capacity factor of our nuclear fleet reached record-setting levels above 95%. And in the wake of Hurricane Irma, our employees reserved [ph] power to more than 1.5 million customers in just over a week. Last month, Fortune magazine named Duke Energy to its 2018 list of the World's Most Admired Companies, a true indication that our stakeholders understand the journey we're on at Duke and the progress we're making.

Finally, we just demonstrated progress across our strategic investment programs, and we worked collaboratively with stakeholders to advance our regulatory modernization initiatives, better aligning recovery with our investment. We've seen the benefits of this approach this past year in Florida, with the approval of our multi-year rate settlement, including recovery in grid and solar investments in North Carolina, with the passage of HB 589 and the addition of rider recovery mechanisms for renewable.

Turning to Slide 6. We've outlined our 10-year investment priorities consistent with the plan we shared with you in early '17. Our investments will focus on: strengthening our energy delivery system by investing 25 billion to create a smarter energy grid; generating cleaner energy by investing 11 billion in natural gas and renewable energy; and expanding our natural gas infrastructure, doubling the contribution of this segment.

We will also continue to engage stakeholders on regulatory modernization and fundamentally change the way we operate to transform the customer experience and achieve top quartile customer satisfaction. And foundational to everything we do are our employees and their dedication to operational excellence. We will invest in infrastructure our customers value and deliver sustainable growth for our investors.

Let me walk you through how we plan to maintain our momentum and execute on our strategy in 2018. Slide 7 provides an update on our efforts to modernize the energy grid. Our objective is to improve system performance in all aspects: customer control and convenience, security and service reliability. In 2017, we announced the Power/Forward Carolinas initiative, our 10-year, $16 billion plan to modernize our grid in both North and South Carolina. This investment will provide a strong economic stimulus to the Carolinas, creating more than 17,000 jobs and more than $26 billion in economic output over the next decade. To recover this investment, we've proposed a grid rider mechanism in our pending Duke Energy Carolinas North Carolina rate case. We look forward to continuing this conversation at the evidentiary hearing scheduled to begin next week.

In Florida, our multi-year rate plan includes rate increases to recover our grid modernization investments in the state. Work is already underway. And in October, we completed work on our first self-optimizing grid network. This automation enables the grid to self-identify problems and reroute power to shorten or even eliminate outages for customers. If we expand this program in 2018, we plan to deploy 100 self-optimizing networks in our service areas.

In Indiana and Ohio, we've been recovering 600 million annually through our transmission and distribution riders, investing in hardening and resiliency and other grid improvements. Across our service territories, we are also deploying smart meters, providing increased convenience, choice and control for our customers. With installations of 1.2 million [ph] meters in 2017, 40% of our customer base now benefits from this technology. We plan to install an additional 1.4 million meters in 2018 and remain on track to fully deploy the program by 2021.

And we are leveraging emerging technologies to benefit our customers. We're deploying over 500 electric vehicle charging stations across our Florida footprint, supporting increased demand for this service and a potential source of new load. We're also installing battery storage across many of our jurisdictions, with 185 megawatts of projects installed or announced. Our grid improvement projects are essential to create the foundation for a smarter energy future. We will continue to engage with stakeholders to ensure the pace and scale of our investments align with customer needs in each of our jurisdictions and optimize value for our shareholders.

Slide 8 provides an update on the ongoing transformation of our generation fleet. We've made significant strides to reduce our environmental footprints and have already lowered our carbon emissions by 31% from 2005. In 2017, we extended our commitment to reduce carbon emissions by 40% by 2030. With more than 11 billion dedicated to building more efficient natural gas-fired plants and renewable generation, we will continue to diversify our generation portfolio, while maintaining competitive rates for our customers.

As part of our assessment of the launch from impact of our changing portfolio, we also announced that we will issue a new climate report in the first quarter of 2018. This report will outline our ongoing commitment to environmental stewardship and sustainable energy production.

Advancing our generation strategy, the W.S. Lee Plant located in South Carolina is near final commissioning and will start serving our Carolinas customers soon. Construction progresses on our Citrus County combined cycle project in Florida and the Western Carolinas modernization projects in North Carolina, which are expected to be in service in 2018 and 2019, respectively.

And we are expanding our investment in renewable energy. Our Florida multi-year rate plan allows us to build up to 700 megawatts of new solar generation in the state. Combined with the procurement of almost 2,700 megawatts of solar in North Carolina under HB 589, we are clearly making progress on our carbon reduction goal. Furthermore, these regulatory and legislative achievements in Florida and North Carolina reflects modern mechanisms to recover these investments, demonstrating the success of our stakeholder engagement efforts.

Finally, our nuclear units are fundamental to providing carbon-free generation to our more than 4 million Carolinas customers. These units represent the largest regulated nuclear fleet in the country and are essential to our long-term carbon reduction goal. As we look ahead, we're evaluating license extensions for these facilities for an additional 20 years to continue serving customers with the reliable service they expect.

Moving to Slide 9, let me update you on our natural gas business. October marks the 1-year anniversary of the Piedmont Natural Gas acquisition, and we're seeing the positive results of this transaction. Natural gas will play a major role in a cleaner energy future, and we are leveraging the overlap between our electric and gas businesses to better serve our customers.

We have added Marshall Steam Station to our list of dual-fuel projects in North Carolina. Our 3 dual-fuel projects announced over the last year represent a $500 million investment for both Duke Energy Carolinas and Piedmont, and demonstrates the complementary nature of our franchises and advantages of joint planning. We will use co-firing of coal and natural gas at Rogers, Belews Creek and Marshall to reduce our carbon emissions and increase our flexibility to manage costs, providing savings to customers.

We've reached important milestones for our midstream gas business. We recently completed Sabal Trail pipeline and the Atlantic Coast Pipeline, our critical infrastructure investments that will bring much needed gas supplies to the southeast as well as economic growth in rural areas at the region.

During the record cold weather in early January, heavy demand to heat homes, hospitals and industrial buildings caused natural gas prices to soar due to gas transportation constraints in North Carolina. This provides a clear reminder that ACP will serve as an important source of natural gas for our region and will help provide significant savings for customers.

We're pleased to see work has started on ACP under limited notices to proceed from FERC, beginning construction activities in permanent areas. After more than 3 years of comprehensive study, North Carolina's Department of Environmental Quality issued key permits for the pipeline in late January. These approvals, along with permits received from the Army Corps of Engineers, brings us several steps closer to beginning full construction of this pipeline. And we await receipt of the final permits from Virginia.

It has been a rigorous and transparent permitting process for the 600-mile pipeline, and we continue to target an in-service date of late 2019. Due to delays and more stringent conditions in the permitting process, ACP now estimates total project cost between 6 billion and 6.5 billion. As a reminder, Duke's share of this cost is 47%.

I want to close by saying that we have a clear view of the path ahead for Duke Energy. With our customers at the center of everything we do, we're transforming our company while providing reliable, safe and affordable energy. Stakeholders depend on us to deliver on our commitments, and we did just that in 2017. From financial results to operational excellence, we create value for our customers and shareholders, and this focus will continue into 2018 and beyond.

Now I'll turn the call over to Steve.

Steven Young {BIO 7307044 <GO>}

Thanks, Lynn. As mentioned, we had a solid year and delivered on our financial commitments. As you can see on Slide 10, we achieved adjusted earnings per share of $4.57, which was near the high end of our narrowed guidance range. We are already seeing the benefits of our portfolio transition with a focus on stable, predictable and regulated businesses.

We grew our electric utilities through higher pricing in riders, organic load growth and ongoing investments across our jurisdictions. Our gas segment also demonstrated growth, driven by Piedmont's contribution and additional earnings from our midstream pipelines. Additionally, we achieved our cost management targets, which offset the majority of the below-normal weather we experienced during the year. Overall, we are pleased with the growth across our businesses.

Turning to Slide 11. Let me walk you through key implications of the new federal tax law. As you know, the tax reform has been a key focus for the utility industry. We were successful in advocating for industry-specific provisions that will benefit both customers and shareholders. At the holding company, the lower income tax rate will reduce the tax shield on interest expense, resulting in lower earnings beginning in 2018.

At the utilities, tax reform will result in lower accrued tax expense, which provides opportunities for lowering rates to customers. However, because Duke Energy is not a significant cash taxpayer, any reduction to customer rates will place downward pressure on our consolidated cash flows. Recall, we have been in a net operating loss position for tax purposes for the last few years due to bonus depreciation. We currently estimate we would be out of the NOL in 2019 and begin using our accumulated tax credits through the balance of the 5-year plan.

In response to these issues, state regulators have initiated dockets in our jurisdictions. In general, we are recommending to use the lower tax rate to reduce customer rates in the near term as well as help offset future rate increases. We have made several proposals, including accelerated depreciation, recovering investments more quickly or amortizing regulatory assets. This would allow us to recover certain costs and maintain utility credit quality, while avoiding volatility in customer rates.

In Florida, the commission has already approved using the benefits from tax reform to offset the increase in customer rates for Hurricane Irma restoration and to accelerate depreciation of certain coal units. Overall, we expect customers to see savings over time, which will vary based on the regulatory outcomes in each state.

Tax reform also provides some benefits to cash flow due to the treatment of our alternative minimum tax credits. The new law provides for a full refund of AMT credits over the 2018 to 2021 tax shields. As of December 31, we had approximately $1.2 billion of credits subject to this refund.

Another major impact of tax reform is to increase the utility rate base. This occurs as the lower tax rate and elimination of bonus depreciation results in lower deferred taxes, which, in turn, increases rate base. As a result, we will see higher rate base growth for the same level of capital spend, resulting in an increase in the company's earnings power. Given that the positive drivers will take some time to manifest, we are taking steps to further strengthen our balance sheet and fund our capital program.

In 2018, we intend to issue $2 billion of equity, including our original expectation for $350 million of equity via the DRIP. We also have reduced our 5-year capital plan by approximately $1 billion. I'll share more details about the capital and financing plans in a moment.

On Slide 12, we have outlined more detail about the earnings impacts of tax reform. This morning, we announced our 2018 adjusted EPS guidance range of $4.55 to $4.85 per share. Earnings for 2018 will be driven by ongoing investment programs across our jurisdictions, load growth expectations and the continuation of our regulatory recovery activities. The effects of the lower corporate tax rate, including the dilution from planned equity issuances, will partially offset this organic growth. With this in mind, the midpoint of our 2018 guidance range is slightly below the 4% to 6% earnings per share growth rate we introduced last year. However, we expect to be within the range by 2019 and at the mid- to high end of the range in 2020 and beyond, given that the rate base will now grow at a faster pace.

Turning to Slide 13. Our growth will be supported by our 5-year $37 billion growth capital plan. Our investments align with our strategy to modernize the energy grid, generate cleaner energy and expand natural gas infrastructure. In light of tax reform, we have lowered our total capital over the 5-year plan by about $1 billion. We have expanded our cost management capability and applied this to capital spend. Furthermore, we are optimizing our operational capital around regulatory activity to minimize lag. We have modestly increased our level of investment in Commercial Renewables, and we'll look to utilize tax equity partners to continue investing in solar and wind projects. But the total capital plan is lower than originally outlined in 2017. Tax reform adds approximately $3.5 billion to rate base by 2021. Earnings base now grows at a 7% CAGR through this time frame, representing a 1% increase compared to what we presented last year. The new tax law will also provide additional headroom in customer bills, allowing us to continue making smart investments, while also keeping rates as low as possible. Overall, we are taking a balanced approach, and we are confident we will continue to meet the needs of customers and investors.

Moving to Slide 14, let me walk you through our 2018 financing plan. We are committed to maintaining the strength of the balance sheet as we look to finance our extensive capital plan over the forecast period. As I mentioned earlier, in 2018, we plan to issue $2 billion in equity, including the $350 million we already expected to issue through the DRIP. We plan to raise this equity through a discrete transaction within the next few months and by selling shares under our recently filed ATM program.

We may utilize a forward structure to better align proceeds from the equity offerings with the timing of our actual cash yields. This will help to avoid unnecessary share dilution in 2018. We will be opportunistic in completing our incremental equity needs with the goal of completing it by the end of the year. Going forward, we still expect to issue $350 million of equity per year through a combination of our DRIP and ATM programs.

We continue to be disciplined with our approach to capital, reducing the level of investment versus a year ago. Additionally, we will maintain our focus on cost control, which I will discuss in more detail in a moment. All of these actions will improve our credit metrics over the 5-year plan. Our balance sheet will be supported by the equity issuances and planned regulatory activity, which in turn our -- which will turn our investments into cash returns more quickly. By 2020, we expect our FFO to debt ratio to be in the range of 15% to 16%, and our HoldCo debt percentage to be in the low 30s, both aligning with our targets. We believe the combination of the 2018 and the ongoing annual equity issuances satisfies all of our equity needs and provides the balance sheet strength to execute on our business plan.

Turning to Slide 15. Our attractive service territories with constructive regulatory frameworks and our cost management efforts have allowed us to earn at or near our allowed ROEs. We're seeing strength in customer growth across our jurisdictions, particularly in the southeast and expect this to continue. This trend supports growth in our electric and gas utilities. We continue to plan for 0.5% annual retail load growth in our electric utilities. In 2017, weather-normalized retail load growth was 0.4%, equivalent to 0.7% when excluding the impact of the leap day in the prior year. This tracks with our planning assumptions. Several macroeconomic indicators support our load growth projection. Overall, the US economy is strengthening and leading indicators point to continued expansion for the commercial and industrial sectors. In addition, the US dollar continues to support domestic manufacturing, and optimism for retail and small businesses is near an all-time high. Furthermore, a key objective of the new tax law is to stimulate business investment, create jobs and grow the economy.

At this time, we have not incorporated effects from tax reform in our volume growth planning assumptions, but expect it could be an upside to our forecast. We are also managing our cost structure, using new technology and rolling out data analytics to extend our commitment to keep nonrecoverable O&M flat through 2022. The use of mobile applications is bolstering productivity, and we are keenly focused on identifying efficiencies through our operational and corporate functions.

As we look to the future, we are developing our digital capabilities to foster a connected culture. Through the modernization, of course, customer systems and grid infrastructure, we will see tangible benefits and savings. 2017 was a busy regulatory year for us. Slide 16 outlines our projected activity over the planning horizon to achieve timely recovery of our investments.

We have a robust capital plan that involves substantial investment in electric and gas infrastructure over the next 5 years, and we have modern regulatory recovery mechanisms in place for many of these investments. In Florida, we have the multi-year rate agreement through 2021. In Ohio and Indiana, we have riders to recover transmission and distribution investments and are requesting extension of the distribution rider in Ohio. In North Carolina, we now have renewables riders established through HB 589. And at Piedmont, we have distribution infrastructure riders. We will continue to pursue these types of recovery mechanisms to enhance our investment returns.

Let me take a moment to discuss our pending base rate cases in North Carolina. We expect an order on the Duke Energy Progress case any day and no later than March 1. New rates will be effective soon after the order is issued. Our Duke Energy Carolinas rate case has progressed with the evidentiary hearing scheduled to begin on February 27. We have requested rates will be effective May 1 in that case if approved by the commission.

Shifting to Slide 17. We understand the value of the dividend to our shareholders and are dedicated to growing in response. 2018 marks the 92nd consecutive year of paying a quarterly cash dividend, demonstrating the steadfast commitment to our investors. We expect to maintain our annual dividend growth rate at approximately 4% to 6% through 2022, consistent with our long-term earnings growth as we target a payout ratio in the 70% to 75% range.

Given the near-term impacts of tax reform, we expect the payout ratio will be higher than the target range initially. Therefore, dividend growth will be closer to the low end of the guidance range the next couple of years as we work the payout ratio back down. The growth rate will increase as we are more solidly positioned in the payout ratio range.

Before we open it up for questions, let me turn to Slide 18. Our history of operational excellence, coupled with the strategic plan that is already producing compelling results, gives us confidence as we continue to offer a solid long-term investment opportunity. Our attractive dividend yield, combined with earnings growth from investments in our Regulated Utilities, provides a strong risk-adjusted return for our shareholders. We are positioned to deliver results for both customers and shareholders and are confident in the plan we have for 2018 and beyond.

With that, we'll open the line for your questions.

Questions And Answers

Operator

Thank you. (Operator Instructions) And we'll take our first question from Shar Pourreza with Guggenheim Partners.

Q - Shar Pourreza

Good morning guys.

A - Lynn Good {BIO 5982187 <GO>}

Good morning, Shar Pourreza.

Q - Shar Pourreza

Just a quick modeling question. Just, can you elaborate a little bit on the drivers of growth from '18 to '19, Steve, I mean, to get you back within that previous 4% to 6% range by '19, you sort of would need a lot of growth year-over-year almost 8% just using the midpoint of the 2018 guide. I know it's not linear, but are we thinking about this step up in earnings correctly? Should we think more bottom end in '19, just remind us how you're closing that gap?

A - Steven Young {BIO 7307044 <GO>}

Well, let me discuss some of the drivers here for 2019, and they're really pretty similar to the drivers that we have in our businesses each year. We've got rate riders and rate cases that kick into play. We've got our normal volumes growth which has been pretty strong as well, and then there's AFUDC on various investments. When you look at 2019, you'll have the full year impact of the Carolinas rate cases, and then in 2019 we expect to see accelerated spending in Atlantic Coast Pipeline, those will be a couple of big drivers towards the earnings that you might see in that particular year, Shar.

Q - Shar Pourreza

Okay, that's helpful. And then just real quick on ACP, it's good that it's moving sort of ahead here, but at what point sort of in the construction cycle should we think about incremental growth opportunities? Is it sort of post the state approvals or with the latter part of the construction phase, like, how are you thinking about the next leg of growth with ACP 2 and ACP 3?

A - Lynn Good {BIO 5982187 <GO>}

Sure. Thanks for that question. We're proud of the progress that we've made over the last several months with state and federal permits, and our focus is ramping up, construction to hit a late 2019 in-service date. I think about additional investment opportunities in two ways, there is expansion of ACP which would occur in the form of compression, a very cost effective way to add capacity, and then extension would be another opportunity. I think at this point our focus is on building the initial project as it's established, we will then turn our attention to expansion, compression expansion really driven by needs of our customers and then following that we'll look at opportunities to extend.

Q - Shar Pourreza

Got it, that's helpful. And then just, Lynn, one strategic question. Duke falls in and out of M&A chatter, especially recently with some of the jurisdictions that you've been active in, which is Indiana and the Carolinas. Can you just sort of refresh our thoughts on how you're thinking about additional growth through inorganic opportunities in light of kind of what you're seeing as far as tax reform and sort of maybe even the stress on sort of the balance sheet?

A - Lynn Good {BIO 5982187 <GO>}

Our focus, Shar, is on organic growth at this point. We feel like we've got a very robust set of investments within our jurisdictions and very attractive jurisdictions that give us an opportunity to deliver benefits to customers and investors, with the steps we've taken around the balance sheet, with the equity issuance that also positions us to support that organic growth, and so M&A is not a part of our strategic plan to achieve what we've laid out before you. We look at that as opportunistic, but are really comfortable with the organic plan we have set forth.

Q - Shar Pourreza

Excellent. Thanks so much. I'll jump back in the queue.

A - Lynn Good {BIO 5982187 <GO>}

Thank you.

Operator

We'll take our next question from Stephen Byrd with Morgan Stanley.

Q - Stephen Byrd {BIO 15172739 <GO>}

Hi, good morning.

A - Lynn Good {BIO 5982187 <GO>}

Good morning, Steve.

A - Steven Young {BIO 7307044 <GO>}

Good morning.

Q - Stephen Byrd {BIO 15172739 <GO>}

Just wanted to touch on what you have mentioned in terms of further growth in renewables and the commercial segment. Just at a high level, I'm curious your thoughts on the competitive environments for renewables, the degree of growth potential there, what are you seeing out there on the competitive playing field for that business?

A - Lynn Good {BIO 5982187 <GO>}

Stephen, I think the business is a competitive business. I think there's some adjusting as the result of the tariffs that have recently been imposed. We'll have to see how that landscape plays out. We also are pacing the lower tax rate. We'll have to determine how tax equity markets perform, although we still expect them to be there. So we believe we have a very solid business, a business at scale. We believe we're capable of competing. But we have also been appropriately conservative with our assumptions around returns and are not going to chase it unless it's delivering a return above our cost of capital. And that will be our approach as we go forward. I would point to regulated renewables as well, so we've got 700 megawatts from building within Florida. HB 589 in North Carolina represents an opportunity for either our commercial or regulated business, so we'll be looking closely at those opportunities as well.

Q - Stephen Byrd {BIO 15172739 <GO>}

That's helpful and thank you. And then just, thinking high level around Amazon and the potential for them to put HQ number 2 in your service territory. Without getting too specific, I'm just curious, your thinking at a high level as to what will be required to accommodate that? What kind of incremental capital or operational changes you need to make to accommodate that?

A - Lynn Good {BIO 5982187 <GO>}

So Stephen, I think we're capable of serving Amazon today with a really robust system in the Carolinas. We have the pleasure to serve an expanding facility in Northern Kentucky that we're working closely with them on. The triangle area around Raleigh has been an important growth area for the company for some time, so we'll be anxious to put infrastructure in place if additional infrastructure is needed. And I think about our approach to economic development in general. We've been very aggressive in our service territories, making investments to attract businesses. And that will be our approach here as well if we have that opportunity for the Carolinas.

Q - Stephen Byrd {BIO 15172739 <GO>}

Thank you so much. If I could just maybe one more on changes to the grid. You've been spending a lot of time and effort thinking about grid modernization in a number of ways. I'm just curious, as you see it now, do you see incremental investment opportunities in grid modernization over and above what you've already laid out? Or is that likely to be a relatively long evolution in terms of changes you've been making there?

A - Lynn Good {BIO 5982187 <GO>}

I believe we have a robust plan, Stephen, where we have been disciplined in establishing business cases for each of these investments to deliver benefits to customers, whether it's greater customer experience, whether it's reliability metrics. We do have the ability to change the timing, accelerate, slow down, depending upon the needs of customers in each of the jurisdictions. And I would expect, as the system continues to grow, which we would see it doing over the next 10 years, with Southeast just attracting an incredible number of new citizens, people migrating to this area, that we'll find continued opportunities to expand our system. So we have a team of people focusing on modernization as a full-time assignment to ensure that we're building the infrastructure that our states count on. Same for Indiana, same for Florida, same for Ohio.

Q - Stephen Byrd {BIO 15172739 <GO>}

Okay. Thank you very much.

A - Lynn Good {BIO 5982187 <GO>}

Thank you.

A - Steven Young {BIO 7307044 <GO>}

Thank you.

Operator

And we'll take our next question from Michael Weinstein with Credit Suisse.

Q - Michael Weinstein {BIO 19894768 <GO>}

Hi, good morning everyone.

A - Lynn Good {BIO 5982187 <GO>}

Hi.

A - Steven Young {BIO 7307044 <GO>}

Good morning.

Q - Michael Weinstein {BIO 19894768 <GO>}

Hey, to what extent do you see the increase in earnings growth or -- earnings growth into 2019-2020 period as driven by the rate base increases coming from deferred tax amortization. In terms of -- does that give you increased confidence in that ability to get back up to the mid to high range, because this portion of the rate base growth is -- no, it's not -- it's a certainty, right?

A - Lynn Good {BIO 5982187 <GO>}

Yes. And Michael, I think the -- you can see the front-end impact of the loss of interest shield and the dilution. But as you flip back into our slide deck, looking at rate base growth, you can see $2.5 billion growing to $3.5 billion of rate base over that period, and that's without spending $1 of capital. So it's that rate base growth in the fundamental business that we operate low risk, high quality jurisdictions that give us confidence that we can maintain the 4% to 6% growth rate really after we've adapted to tax reform in '18, get back within the range in '19, mid-to high in '20 and beyond. So the point that you're making around the strength of the rate base growth is exactly right.

Q - Michael Weinstein {BIO 19894768 <GO>}

Okay. Great. And also maybe you can just comment a little bit about the tax equity market around renewables after the BEAT provisions in the tax reform package?

A - Lynn Good {BIO 5982187 <GO>}

So we believe we'll be successful in that market with our size of our company, scale and credit profile. I think all of this is something that we'll continue to monitor. We are actually in the tax equity market right now with a project and are seeing success in putting that together, so we are optimistic.

Q - Michael Weinstein {BIO 19894768 <GO>}

Are you seeing any additional opportunities that may be coming your way as a result of smaller players maybe having a harder time gaining access to that market now?

A - Lynn Good {BIO 5982187 <GO>}

Michael, there's a lot of opportunity flow that comes through and compliments to the team to approaching -- as they approach it in a disciplined fashion to identify projects that makes sense for us, but we do see good opportunity flow.

Q - Michael Weinstein {BIO 19894768 <GO>}

Okay. Thank you very much.

A - Lynn Good {BIO 5982187 <GO>}

Thank you.

Operator

And we'll take our next question from Jonathan Arnold with Deutsche Bank.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Good morning, guys.

A - Lynn Good {BIO 5982187 <GO>}

Hi, Jonathan.

A - Steven Young {BIO 7307044 <GO>}

Hi.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Hi. Steve, this -- when you talked about what you've assumed for the cash treatment of tax reform with regard to customer rates, it sounded like you were saying you've assumed you'll flow it back reasonably quickly, but then you talked about several things you're doing which would do the opposite. So is there any way you can give us a sort of a high level what the -- what's assumed in this FFO target versus the range of potential outcomes?

A - Steven Young {BIO 7307044 <GO>}

Yes, Jonathan. We've looked at a number of outcomes, and they may vary per jurisdiction. Certainly got a constructive outcome in Florida. In general, what we're thinking about here is that the impact of the rate decrease from the 35% to 21%, we'll work that back through prospective rates and give that aspect to customers. We're looking at the excess deferred tax piece. The protected piece will go back slowly, and we're looking at utilizing the other excess deferred taxes to be used as a mitt [ph] against the rate base increases that are coming as well to help reduce the volatility. But that's a general way to think about the way we've incorporated this into our plans.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Okay. So the -- so for example where you have rate cases pending at that point the 35 to 21 would be part of that case and in other jurisdictions it would be later, is that right?

A - Lynn Good {BIO 5982187 <GO>}

Jonathan, I think -- I'll talk about the Carolinas and Steve will chime in here, too. We are not expecting the tax reform will be a part of the DEP case that we are expecting an order on any time. There's a separate docket that the commission has established. A testimony will be presented in the DEC case around tax reform, and I think it's really an open question on whether or not it's dealt with in this case or in a separate docket. But I think in all events, there's an opportunity here to use tax reform to lessen the impact of rising prices or investments in the state. The other states, some of them will go automatically into place where there are riders. So in Indiana and Ohio, where there's a rider tracking mechanism, those tax reform impacts will go in immediately. Piedmont would be another example of that. And then we'll tailor other jurisdictions based on general rate case timing or separate dockets are established. And as Steve said, it will be really customized jurisdiction by jurisdiction.

Q - Jonathan Arnold {BIO 1505843 <GO>}

And can you just touch on ACP in that context?

A - Steven Young {BIO 7307044 <GO>}

The ACP project is benefited by tax reform. Again we've got several breaks with our customers on ACP and it's not a formula type rate there. And so that will be one of the things that benefits us more with the application to ACP.

A - Lynn Good {BIO 5982187 <GO>}

And you may remember, just one point on that. ACP was a competitive process early on with negotiated rates that came out of the competitive bidding process. And ACP was selected as the most cost effective solution and continues to be the most cost effective solution for customers.

Q - Jonathan Arnold {BIO 1505843 <GO>}

So you don't anticipate an adjustment there?

A - Lynn Good {BIO 5982187 <GO>}

That's correct.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Okay. Great. Thank you. And then could I just on -- just when I look at the FFO to that slide, you show '18, then you show the '19 -- the '20 to '22, does that -- should we assume like '19 is sort of -- part of a bridge to that new number, or does it go down a little then improve what's the -- what's the sort of '19 profile as you fill in that gap?

A - Steven Young {BIO 7307044 <GO>}

We'll be improving on our metrics throughout the plan, Jonathan. I don't want to give year-by-year guidance, but we do see improvement throughout the plan.

A - Lynn Good {BIO 5982187 <GO>}

It trends up from 2018, Jonathan.

Q - Jonathan Arnold {BIO 1505843 <GO>}

And have you had the opportunity to sort of download with the agencies on how the plan looks now you've framed out some of your equity piece.

A - Lynn Good {BIO 5982187 <GO>}

We have. Yes, we visited with all 3 of the agencies, Jonathan, in advance, sharing with them our prospectives, the actions we've taken, not only the equity, but the reduction in capital, our focus on cost management, the demonstrated track record in pursuing regulatory recoveries. So we've had a very comprehensive discussion. We believe we've put forward a credible plan to the agencies to support our rating. Of course, they will deliberate and look at that over the coming months. But we feel like we've had a very good discussion of a very credible plan like that.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Great. Thank you. And if I might, just the '18, you have 15% to 16% targeted effective tax rate. Is that the right ballpark going beyond '18? Or is it still low -- is that lower than you think it'll be?

A - Steven Young {BIO 7307044 <GO>}

I think that's certainly what we see for '18. We typically don't project beyond that, I don't know that it's going to vary a lot from that as we go forward though.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Great. Thank you, Steve. Thank you Lynn.

A - Lynn Good {BIO 5982187 <GO>}

Thank you.

Operator

We'll take our next question from Julien Dumoulin-Smith from Bank of America Merrill Lynch.

A - Lynn Good {BIO 5982187 <GO>}

Good morning, Julien.

Q - Julien Dumoulin-Smith {BIO 15955666 <GO>}

Hey, I just wanted to follow-up and clean up a few items from past questions here. First, on the growth in the '19 and then '20 and beyond. Just to make sure I heard you right, mid- to high end in '20 and beyond, is the right way to think about this that basically you're targeting a 7% rate base growth off of 2018 such that, that gets you to close-ish to 2019, the midpoint of that -- the range, as I think Shar initially asked? And then, again, as you roll forward, take 7% net out a small amount of equity dilution, and then, again, that's how you outperform the 4% to 6% from '19 into '20? Just want to make sure we're hearing the puts and takes appropriately here.

A - Lynn Good {BIO 5982187 <GO>}

So Julien, I would think about 2019 as being within the range -- within the guidance range. I think the lower end of the guidance range would be the way to think about '19 as we're still getting in to get that recovery of the increased rate base investment, because if you think about '19 earnings, it's going to have to be -- rate case is prosecuted in '18 for certain of those jurisdictions. We will see the rider impact and other things. But within guidance, that's the way I think about my team. And then by '20, mid to high, because we have an opportunity for another year of securing that revenue stream, building on that rate base growth. And so $3.5 billion of additional rate base growth without spending an additional dollar of capital in these jurisdictions we believe underpins our ability to get in that range by 2020, mid to high.

Q - Julien Dumoulin-Smith {BIO 15955666 <GO>}

Great. Excellent. And then coming back to a prior question on the commercial side of the business, specifically renewables. Can you elaborate a little bit on what's driving your thinking? I think, in the commentary, you suggested that you would actually be increasing the size investment. But then, perhaps in some of the Q&A, if I hear you right, you're a little bit more cautionary on tariffs, et cetera. Are you looking to expand this? Or is this really a statement around HB 589 and the opportunities there? Is there something beyond the Carolinas here that you guys are really seeing out there?

A - Lynn Good {BIO 5982187 <GO>}

Julien, there's about $1 billion of investment in Commercial Renewables last year. It is modestly higher than that this year. We have introduced tax equity for the first time. You may recall, before tax reform, we thought we would be a taxpayer and someone who could use credit sooner than what's going to happen. And so we have looked at that business in the -- through the lens of tax equity. We do see opportunities from HB 589. And as we just planned the implications of HB 589, we've put that capital in the commercial business for planning assumption. So I think our message here has been consistent. We like the business. We have scale in the business. We believe we can invest in a manner that's profitable for our investors, and the modest increase in capital is HB 589 and other market opportunities.

Q - Julien Dumoulin-Smith {BIO 15955666 <GO>}

Got it. Excellent. And just last, nitpicking on the FFO to debt question real quickly. The 2018 number you show, is that inclusive of the equity? Or should we be thinking about the jump -- the ratable improvement from 14% up to the 15% to 16% range, the equity being a big chunk of that improvement? Just want to make sure we're level setting here.

A - Lynn Good {BIO 5982187 <GO>}

The equity is in the upper side [ph].

A - Steven Young {BIO 7307044 <GO>}

Yes, the equity --

Q - Julien Dumoulin-Smith {BIO 15955666 <GO>}

It is reflected in that 14 already?

A - Lynn Good {BIO 5982187 <GO>}

Yeah.

A - Steven Young {BIO 7307044 <GO>}

Yes, that's correct.

A - Lynn Good {BIO 5982187 <GO>}

Julien, I think, as you know, an equity issuance impacts the denominator, right? So it's going to have an impact on FFO to debt, but it has a more dramatic impact on our holding company debt, which, of course, will be declining over the 5-year period to roughly 31%. So more aggressively than what we shared with you last year. The engine for production of FFO is our regulated businesses, and that has not changed from tax reform. So we will go after investment and delivering returns in the way that we historically have by delivering returns to the regulated process, and that's the engine that drives the FFO growth over the period.

A - Steven Young {BIO 7307044 <GO>}

That's right. And our ability to execute in our cost management has helped us exceed the original estimates we had for 2017 in our credit metrics.

Q - Julien Dumoulin-Smith {BIO 15955666 <GO>}

Right. Excellent. Thank you.

A - Lynn Good {BIO 5982187 <GO>}

Right. Thanks, Julien.

Operator

We'll take our next question from David Paz with Wolfe Research.

A - Lynn Good {BIO 5982187 <GO>}

Hi, David.

Q - David Paz {BIO 16573191 <GO>}

Hi, good morning. Just going back to the growth question. So looking on slide 12, when you say mid to high end of growth -- of the growth target in 2020, is that the growth over 2019 earnings, or is that a compounded average annual rate off the midpoint of your 2017 guidance?

A - Lynn Good {BIO 5982187 <GO>}

2017, David.

Q - David Paz {BIO 16573191 <GO>}

Okay, great. Thank you.

A - Lynn Good {BIO 5982187 <GO>}

Thank you.

Operator

We'll take our next question from Michael Lapides with Goldman Sachs.

Q - Michael Lapides {BIO 6317499 <GO>}

Hi, guys. More of a longer-term question.

A - Lynn Good {BIO 5982187 <GO>}

Hi, Mike.

Q - Michael Lapides {BIO 6317499 <GO>}

Hi, good morning. More of a longer-term question. How are you thinking about the jurisdictions where you have the most lag? What you can do to structurally change that to reduce that lag outside of just kind of continuing to file cases on a pretty frequent basis?

A - Lynn Good {BIO 5982187 <GO>}

Michael, I appreciate that question because we have drawn our attention to what we're calling regulatory modernization, which is trying to look at the regulatory mechanisms and match those mechanisms to the way investment occurs. And so Indiana, Ohio, multi-year rate plans in Florida, all of those are very well seasoned to work with the type of investments that we're making in the grid, in renewables, clean energy, et cetera. The Carolinas is where we have a little bit of work to do. We're pleased with the result of HB 589, which puts trackers in place for renewable and for a PURPA contract, both of which were important. And we, as you may recall, have also filed for a tracker around grid investments. In our DEC case, our intent is to follow on the dual path as we did with HB 589, ask the commission how far they believe they can go and then pursue legislation if need be to finalize that work. I believe it's a win-win. The types of investments that we're making will deliver immediate customer benefits. It minimizes the impact on price to customers. And I believe with tax reform as another tool, we should be able to find our way to something that works for customers and for the investments we're trying to put into play. So the focus of modernization is throughout all the jurisdictions, but we have some specific objectives we're trying to achieve in the Carolinas.

Q - Michael Lapides {BIO 6317499 <GO>}

Got it. And when you're looking at the Carolinas, how -- what's been the feedback in the rate cases regarding the grid modernization tracker?

A - Lynn Good {BIO 5982187 <GO>}

So Public Staff produced some testimony. They have some questions about what is modernization, really questioning the types of investments. They like some of them better than others. We believe that there's a strong case throughout the program around modernization, but they also introduce the notion of a cap if the commission were to approve the tracker. So I believe there was a good start to a conversation that will continue as part of this case.

Q - Michael Lapides {BIO 6317499 <GO>}

Got it. Thank you and much appreciated.

A - Lynn Good {BIO 5982187 <GO>}

Thank you.

Operator

We'll go next to Praful Mehta with Citi.

A - Lynn Good {BIO 5982187 <GO>}

Good morning.

Q - Praful Mehta {BIO 19410175 <GO>}

Hi, thanks guys. Hi. So, I guess just bringing together both the growth trajectory that you've talked about here and the credit that you've laid out. I wanted to understand how tax reform in this discussion with the regulators fits in, because you've kind of highlighted discussion around regulatory asset recovery, accelerated depreciation. So, if any of those variables change and the discussion with regulators are -- I guess better than expected or worse than expected, which variable should we look at that can impact either your earnings trajectory, or your credit or putting more pressure on the balance sheet, how should we track that?

A - Lynn Good {BIO 5982187 <GO>}

Yeah, Praful, I'll get it started and turn it over to Steve. He and his team have worked extensively on the implications of tax reform really dating back into 2017. But you can appreciate any time you put a 5-year plan together and you're putting it together with a range of assumptions. And that's the case here as well. We won't have complete certainty on the way the commissions are going to address tax reform until later into 2018. But as Steve indicated, we're assuming pretty current return or reduction in rates around the tax rate of 35% to 21%. And so I think that's a reasonable assumption that should play out in '18 and beyond in each jurisdiction. And then on the accumulated deferred taxes, the protected ones go back over light, consistent with normalization rule. And we are proposing that the unprotected deferreds go back over a reasonable period of time. In some of our jurisdictions, the deferred tax direction is related to property. So a longer period of time makes sense to us. That, of course, will be subject to negotiation. And we will check and adjust, and we always do depending on how that plays out. But I believe we have reasonable planning assumptions. Steve?

A - Steven Young {BIO 7307044 <GO>}

Right. I think Lynn covered it very clearly there that's kind of how we look at it, I think that makes sense. This is an opportunity to reduce customer rates pretty quickly. But we also have an opportunity here to utilize some of this to offset some of the rate base increases that are coming. And we'll be looking at the excess deferred as a tool for that, and that was what was done in Florida. I think a very constructive settlement there. And so we'll see how it plays out in the other jurisdictions.

Q - Praful Mehta {BIO 19410175 <GO>}

I got you. So how big is the unprotected fees that needs to be refunded and what assumption is being made on the timing of that refund?

A - Steven Young {BIO 7307044 <GO>}

Unprotected deferred taxes are about -- for the total corporation about 1.8 billion, protected are about 4.5 billion.

Q - Praful Mehta {BIO 19410175 <GO>}

I got you. And the assumption on the return of the unprotected, I'm assuming is quicker obviously because it's the -- not the average life of asset. You have some unprotected apparently that are connected to PP&E. But for the rest, is there a -- is it like a 5-year period? Just to get a sense for what kind of time frame should that refund have to take place in.

A - Lynn Good {BIO 5982187 <GO>}

Praful, I would just say a reasonable time frame at this point. We're early in the process of this discussion with our jurisdictions, and it's going to be jurisdiction by jurisdiction. As I said a moment ago, some of the riders mechanisms will be treated differently than the general base rate case. So as we learn more in these dockets that are open in front of the jurisdictions, we'll be prepared to share more specifics on that, but believe that we've put together a plan here with a reasonable set of outcomes.

Q - Praful Mehta {BIO 19410175 <GO>}

Understood. Fair enough. And just quickly just last point on the holding company debt, the -- it's going from -- to 31% to 32% I guess in the 2020-2022 time frame, that percentage, is that being achieved because the underlying denominator that is the total debt of the company is growing, or is that being achieved because the holding company debt is being paid down during that time frame?

A - Lynn Good {BIO 5982187 <GO>}

It's really reflecting the benefit of the equity issuance, Praful. So we are delevering the holding company with the equity issuance.

Q - Praful Mehta {BIO 19410175 <GO>}

I got you. So apart from the initial paydown there isn't anything incremental happening post the '18 time frame in terms of delevering at the HoldCo?

A - Lynn Good {BIO 5982187 <GO>}

So there is a modest trending up ACP and other things, and then down again so that's the starting point in '18, and the ending point are flat.

Q - Praful Mehta {BIO 19410175 <GO>}

I got you. So I'm just trying to confirm that post '19, is there any assumption of debt paydown at the HoldCo or no?

A - Lynn Good {BIO 5982187 <GO>}

Relatively flat end-to-end. We can probably take you through our financing schedules after the call, Praful, if there is more detail that we can help you with.

Q - Praful Mehta {BIO 19410175 <GO>}

Understood. That's super helpful. Thank you so much.

A - Lynn Good {BIO 5982187 <GO>}

All right. Thank you.

Operator

At this time I'd like to turn the conference back over to Lynn Good for any additional or closing remarks.

A - Lynn Good {BIO 5982187 <GO>}

Great, thank you, and thanks everyone for joining us today. We'll be available by phone and have an opportunity to meet with many of you over the next couple of weeks. I want to extend my thanks to the team who has put all of this together with tax reform coming late in the year.

It's been an all-out effort and we're really delighted to put it forward today. Thank you for your investment in Duke Energy.

Operator

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