

Company Name: Duke Energy  
 Company Ticker: DUK US  
 Date: 2016-11-04  
 Event Description: Q3 2016 Earnings Call

Market Cap: 53,357.90  
 Current PX: 77.45  
 YTD Change(\$): +6.06  
 YTD Change(%): +8.489

Bloomberg Estimates - EPS  
 Current Quarter: 0.928  
 Current Year: 4.625  
 Bloomberg Estimates - Sales  
 Current Quarter: 5846.000  
 Current Year: 24180.231

## Q3 2016 Earnings Call

### Company Participants

- Michael Callahan
- Lynn J. Good
- Steven K. Young

### Other Participants

- Michael Weinstein
- Ali Agha
- Maxwell S. Burke

## MANAGEMENT DISCUSSION SECTION

### Michael Callahan

#### *GAAP and Non-GAAP Financial Measures*

Today's discussion will include forward-looking information and the use of non-GAAP financial measures

Slide 2 presents the Safe Harbor statement, which accompanies our presentation materials

A reconciliation of non-GAAP financial measures can be found on [duke-energy.com](http://duke-energy.com) and in today's materials

### Lynn J. Good

#### *Business Highlights*

##### *Piedmont Natural Gas Acquisition*

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

##### *Business Portfolio Transition*

- Starting on slide 4, let me begin with our business portfolio transition
- On October 3, we closed the Piedmont Natural Gas acquisition, following approval by the North Carolina Utilities Commission

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- We're delighted to bring Piedmont's industry-leading expertise into our company, as we expand our natural gas platform, supporting our transition to a lower carbon future and growing investments in important natural gas infrastructure
- We've worked with and admired Piedmont for many years and our post-closing integration efforts are well underway

### ***Assets***

- In addition, on October 10, we announced agreements with China Three Gorges Corporation and I Squared Capital to sell our Latin American generation assets
- China Three Gorges will buy our assets in Brazil for approximately \$1.2B, including the assumption of debt
- We expect to complete the transaction in two to four months, once we receive required approvals in Brazil and China
- We're making good progress
- In fact, this morning, the Brazilian Antitrust Agency preliminarily approved the transaction without any restrictions
  - This begins a 15-day statutory objection period and if no objections are filed, the approval will become final

### ***Capital***

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

### ***Earnings and Cash Flow***

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

### ***Financial Reporting Segment Structure***

- Turning to slide 5, consistent with the transition of the portfolio, today, we are announcing the realignment of our financial reporting segment structure beginning with our fourth quarter results
- Prospectively, we will discuss performance for three primary business segments: Electric Utilities & Infrastructure, Gas Utilities & Infrastructure, and Commercial Renewables

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- Electric Utilities & Infrastructure will be comprised of our regulated electric utilities in the Carolinas, Florida and the Midwest
  - This segment will also include our commercial transmission investments

### ***Gas Utilities & Infrastructure Business***

- As previously noted, Frank Yoho will lead our Gas Utilities & Infrastructure business, which will contain Piedmont, our local gas distribution companies in Ohio and Kentucky, and our gas pipeline investments, such as Atlantic Coast Pipeline, Sabal Trail, Constitution and Piedmont's existing joint venture investments
- With the realignment of our business, Commercial Renewables will become its own segment
- Meanwhile, Other will continue to include holding company interest expense and our captive insurance results
- Other will also begin to include our National Methanol equity investment in Q4

### ***Latin American Generation Business***

- With the divestiture of the Latin American generation business, the balance of the International segment will be classified as discontinued operations starting in Q4 2016
- We will continue to report the earnings of this business and adjusted EPS until closing

## ***Q3 Results***

### ***Adjusted EPS***

- Turning to slide 6, let me update you on our strong financial results for the quarter
- We announced third quarter 2016 adjusted EPS of \$1.68, an increase of \$0.21 from the prior year
- We generated higher adjusted earnings with strong results at our Regulated Utilities, due to warmer summer weather and our continued commitment to cost management and operational excellence
- As a result of the strong results through the first three quarters of the year, we are trending toward the high end of our original 2016 adjusted diluted EPS guidance range of \$4.50 to \$4.70 per share
  - This excludes costs associated with Hurricane Matthew

### ***Capital Plan***

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

### ***Asheville Coal Units***

- Here are a few updates
- Site preparation activities are underway on our nearly \$1B Western Carolinas Modernization Project with plant construction anticipated to begin in early 2017

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- This project allows us to retire our Asheville coal units early, build cleaner natural gas units and install renewable energy on the site
- The project is on track to be completed by late 2019

### ***Markland Hydro Station***

- In September, we worked with the Indiana Office of the Utility Consumer Council to develop a plan to modernize and upgrade the Markland Hydro Station
- This multiyear effort will increase the output of the nearly 50-year-old facility, producing low-cost carbon-free electricity for Indiana residents for years to come
- Per the agreement, the approximately \$150mm investment and related expenses will be recovered through the recently approved renewable energy rider
- Last week, we issued an RFP for 400 megawatts of renewable energy in our Duke Energy Carolina service territory
  - This furthers our efforts to provide renewable energy to our customers
- Proposed projects must be in operation by December 31, 2018

### ***North Carolina***

- Also in North Carolina, we recently filed for a Certificate of Public Convenience and Necessity or CPCN for our Duke University combined heat and power project
- The project will consist of a natural gas-fired generator that also provide steam service to the campus and lowers the University's carbon dioxide emissions by 25%
- Combined heat and power projects represent an attractive energy solution that could benefit many of our universities and other large industrial customers in the years to come

### ***Natural Gas Infrastructure Investments***

- Shifting to our natural gas infrastructure investments, we continue to make investments in integrity management programs within our local distribution companies and advanced construction of our pipeline projects

### ***Sabal Trail, Atlantic Coast Pipeline and Constitution***

- Let me briefly update you on Sabal Trail, Atlantic Coast Pipeline and Constitution
- Construction on the Sabal Trail pipeline began in August and the project remains on track for a June 2017 in-service date
  - Since our last earnings call, we received FERC's notice of schedule for the Atlantic Coast Pipeline
- Based on the schedule, we expect to receive the final FERC certificate and begin construction in the third or Q4 2017
- This scheduled moves are expected in-service date to H2 2019
- In September, the project partners announced the selection of Spring Ridge Constructors as the lead construction contractor, representing a significant milestone for the pipeline

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- This firm is a joint venture of four leading U.S. natural gas pipeline construction companies with extensive experience in similar projects

### ***FERC***

- As you recall, we have now added Piedmont's 24% stake in the Constitution Pipeline to our portfolio
- FERC approved this project in December of 2014
  - However, in April of 2016, the New York Department of Environmental Conservation, DEC, refused to grant the projects' water quality certificate
- In response, the project filed lawsuits with the U.S. Court of Appeals for the Second Circuit and the U.S. District Court of Northern New York seeking to overturn DEC's action
- Both of these law suits continue to progress with oral arguments before the U.S. Court of Appeals scheduled for November 16 and we expect the decision in this case by mid 2017
- We continue to believe that the business case for this pipeline is compelling as the Northeast lacks adequate access to low cost supplies of natural gas that this pipeline provides

### ***Operational Accomplishments***

- Before I turn it over to Steve, I'd like to highlight on slide 8 several of our recent operational accomplishments made possible by the dedication of our employees
- As many of you know, we managed through two major hurricanes this fall
- After Hurricane Hermine hit the Southeast in early September, our team restored power quickly and safely for more than 200,000 Florida customers and 150,000 Carolinas customers

### ***Hurricane Matthew***

- Then Hurricane Matthew, as historic storm swept through our Florida and Carolina service territories in October
- The storm tragically resulted in multiple fatalities and widespread flooding, impacting many of our customers across the Carolinas
- The flooding, wind, and rain caused extensive damage to our energy system, leaving more than 1.7mm customers without power
  - Piedmont's infrastructure experienced minimal damage
- In terms of customer outages, Hurricane Matthew is the fifth worst storm to hit the combined Duke Energy Carolinas, Duke Energy Progress service area, with damage similar in scale to Hurricane Floyd in 1999 and Hurricane Hugo in 1989
- In response, we mobilized more than 10,000 workers to rebuild the system and restore power for our customers

### ***Cost***

- We continue to work with the hardest hit areas as they look to recover and rebuild
- I'm extremely proud of our employees and their unwavering commitment to serving our communities

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

### ***Generation Fleet Results***

- Moving to our generation fleet results
- In the quarter, our fleet responded well to the hot summer weather
- Our nuclear units at Catawba and McGuire set new generation records, and our Edwardsport plant set a new station record for generation in the quarter
- Also, in Q3, Duke Energy was named to the Dow Jones Sustainability North America Index for the 11 consecutive year
- This consistent run demonstrates the effectiveness of our sustainability, economics, environmental and social efforts
  - This is a significant achievement earned by the entire company

### ***Customer Base***

- In addition, we were named at Site Selection Magazine's annual list of Top 10 Utilities in Economic Development for the 12th consecutive year, another example of our focus on developing our communities and growing our customer base
- Through September, our economic development efforts have yielded almost \$3B of investment and more than 10,000 jobs across our service territories

### ***Conclusion***

In conclusion, I'm very pleased with our progress, on the transition of the portfolio and in delivering strong financial results in the quarter, and building momentum for a strong finish to 2016

We are advancing our strategic capital investments and maintaining our focus on operational excellence and value to our customers

Our portfolio of businesses is well positioned to deliver strong predictable earnings and cash flows to our investors

**Steven K. Young**

### ***Financial Highlights***

#### ***Opening Remarks***

- Today, I will walk you through the key drivers from Q3, as well as provide updates on the current retail volume trends within our service territories and regulatory activity underway in our jurisdictions
- I'll close with a look ahead to 2017 and our key investor considerations



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### ***Adjusted EPS Variance***

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

### ***Existing Segment Structure***

- As a reminder, this is the last quarter for our existing segment structure
- We begin managing the business under new segments at the beginning of Q4 upon the completion of the Piedmont acquisition

### ***GAAP Basis***

- On a reported or GAAP basis, 2016 third quarter EPS were \$1.70 compared to \$1.35 last year
- Third quarter adjusted diluted EPS were \$1.68, compared to \$1.47 in Q3 2015
- Regulated Utilities quarterly adjusted results increased by \$0.34 per share q-over-q
  - This strong performance was primarily driven by warmer weather across all of our service territories, which added \$0.14
- We also recognized a lower effective tax rate, primarily due to prior year tax adjustments, which contributed to an \$0.08 increase
- Higher revenues from energy efficiency riders in the Carolinas and grid investment riders in Ohio continue to be favorable drivers of earnings, adding \$0.05 to results for the quarter
- Weather-normal retail volumes also added \$0.04, with growth primarily in the Carolinas and Florida

### ***Cost Management Efforts***

- I'll discuss those details in a moment
- Finally, our cost management efforts across the business provided \$0.02 uplift, despite additional storm cost in Q3
- Our ongoing commitment to managing O&M costs and finding efficiencies throughout our business positions us to achieve our goal of maintaining a flat O&M cost structure through 2020
- Commercial Portfolio results increased by \$0.02 per share in Q3
- The higher results were largely driven by additional wind and solar facilities placed online this year and more favorable wind resources throughout the summer months

### ***Tax Rate***

- Moving on, Other was down \$0.14 for the quarter, largely driven by a higher effective tax rate due to prior year tax benefits and a current year unfavorable audit settlement
- These unfavorable tax items offset the favorable tax variance in the Regulated Utilities segment

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- For the year, we continue to expect the total company adjusted effective tax rate of approximately 31% compared to our original expectation of 32% to 33%
  - This is primarily due to the favorable tax benefit realized at International in Q1

### ***Piedmont***

- Our first three quarters have been strong, reflecting favorable weather and strong execution on the part of our team
- As we look to Q4, I would like to share a few considerations
- First, Piedmont will contribute \$0.03 to \$0.05 in Q4
- In Regulated Utilities, we have taken the opportunity to re-plan some of our O&M work, including advancing a fossil plant outage and some distribution projects into Q4

### ***Ohio Regulatory Settlement***

- In addition, the prior year results included a favorable Ohio regulatory settlement
- Meanwhile, at Commercial Renewables, we expect a relatively flat quarter compared to the prior year and for the segment to finish below original expectations for the full year
- Market returns continued to decline, and we remain disciplined on renewables capital deployment
- With our strong YTD results through Q3 and our expectations for Q4, we are trending toward the high end of our original guidance range, excluding costs associated with Hurricane Matthew

### ***Retail Customer Volume Trends***

- Moving on to slide 10, let's review our retail customer volume trends
- On a rolling 12-month basis, weather-normalized retail load was 0.6% through Q3 and continues to track our long-term expectations for approximately 0.5% load growth

### ***Residential Volume***

- Overall, we are pleased with the strength of our residential volumes, which continue to grow at 1.1% over the last 12 months, a strong 1.4% annual increase, and the number of new customers drives this growth
- Utility-sponsored energy efficiency programs and more efficient building codes and standards continue to partially offset this customer growth
- Recently, we have seen the decline in usage per customer begin to level out a bit
- Looking forward, positive trends in new job and wage growth, as well as a recovery in housing, are positive signs for continued residential growth

### ***Customer Class***

- Moving to the customer class, we experienced an increase of 0.4% over the rolling 12 months, an improvement compared to last quarter



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- Commercial usage is slowly improving across our jurisdictions as non-manufacturing employment improves and office vacancies continue to decline, even with new office space being added
  - These improvements are somewhat offset by commercial businesses supporting manufacturing
- In addition, we continue to see declines in the government and education sectors, especially in the Midwest

### ***Industrial Class***

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

### ***DEP South Carolina Rate Case***

- Moving to slide 11, let me take a moment to discuss the status of the DEP South Carolina rate case
- In October, we reached a constructive settlement with the Office of Regulatory Staff and other key intervening parties
- The settlement was reviewed by the Public Service Commission of South Carolina during a hearing earlier this week
- The major components of the settlement were largely consistent with our initial filing
  - We requested \$79mm increase, with an allowed ROE of 10.75%, and equity structure of 53%, and a rate base of \$1.3B
- Our significant energy infrastructure investments were the key drivers for the proposed increase

### ***Revenue***

- The settlement provides for \$56mm revenue increase and an allowed ROE of 10.1%
- We also agreed to a 53% equity structure and \$1.3B rate base
- If the settlement is approved as filed, new rates are expected to be effective in January 2017
- Customer rates will be implemented over a two-year period

### ***Coal Ash Cost***

- In year one, customer bills will increase by \$38mm and step up to \$56mm in year two
- DEP will reduce its cost to remove the liability by \$18mm in year one to provide a neutral earnings impact to the company in the first year of rate implementation
- Based on the settlement, coal ash cost that we had incurred will be recovered with a return over a 15-year amortization period, and we agreed to defer any future rate cases to 2019
  - This settlement is an important milestone and we expect an order from the commission in the coming weeks

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### ***Business Portfolio***

- With the transition in our business portfolio, I want to provide you some broad parameters for 2017 on slide 12
- Consistent with past practice, we will provide guidance for 2017, including a five-year capital plans during our February earnings call
- We anticipate growth in the core businesses, Electric & Gas Infrastructure and Commercial Renewables, of about 5% off of the \$4.30 midpoint of our 2016 adjusted EPS guidance range
- Accretion from Piedmont is expected to be \$0.08 to \$0.10 per share in 2017, a strong first year, reflecting the benefits of early integration
- We will provide additional perspective on growth capital in all of our segments in February

### ***International Results***

- International results through closing, use of sales proceeds and National Methanol are expected to contribute between \$0.10 and \$0.15 per share in 2017
- National Methanol will move to Other and contribute \$0.05 per share based on prevailing Brent crude oil prices, and our ongoing ownership percentage, which is expected to step down in 2017
- The use of proceeds from the sale of our Latin American generation assets of \$1.7B to \$1.9B will displace future financings at the holding company, and will also contribute about \$0.05 per share based on current interest rates
- We estimate first quarter operating results from our International business could also add up to \$0.05 per share of earnings depending upon the timing of the close
- We look forward to further discussion of 2017 and beyond in February

### ***Cash Flow***

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

## **QUESTION AND ANSWER SECTION**

<Q - **Michael Weinstein**>: Could you discuss in a little more detail the – I think you said that there was – the results from Commercial Renewables was not as what you expected. Just wondering if we could discuss some of the issues surrounding that?

<A - **Lynn J. Good**>: Michael, I would direct you to slide 16 of the deck, which gives you a comparison of where we are for YTD results against original expectations. So you see Commercial has delivered about \$65mm of net income against our original expectations of \$140mm. We are not expecting that we'll deliver \$140mm for 2016. Some of that shortfall will be the result of lesser capital deployment, as Steve mentioned, returns have been very market-driven, so great for customers, but low for investors. And then we continue to expect to be slightly behind on wind and solar resources as a result of what we've seen in weather patterns. So, those are the two things I'd point to.

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**<Q - Michael Weinstein>**: Is it that the market for investment has become more competitive than you expected, let's say, a year ago, that returns on acquisitions are just smaller than you thought or is this more of a weather issue?

**<A - Lynn J. Good>**: I think returns are lower, Michael, and I think the other thing to consider for Duke as an investor, we are in an NOL position as a result of bonus depreciation. And so as we look at returns, we consider that the monetization of tax credits need to reflect when we will be a cash taxpayer. So, the DCF of that can challenge our returns. So, that's something that we'll continue to monitor as the time progresses. We understand the market well. We have great expertise in both wind and solar based on the business that we built. We still like the business. But, we are disciplined in the way we deploy the capital based on the returns we're seeing in the market.

**<Q - Michael Weinstein>**: How long does that NOL position go out to? What do you expect?

**<A - Steven K. Young>**: Currently, we are expecting, assuming there are no further extensions of the bonus, that we would come out of the NOL position in 2019. We would then begin using tax credits, ITC production tax credits, so we would still not be a significant cash taxpayer for a few years after that.

**<Q - Michael Weinstein>**: So that would – that in theory could make the Renewables business a little more competitive for you, right?

**<A - Lynn J. Good>**: I think as we get closer to that period of tax where we burn off the NOL, that will impact our view of returns, Michael, because the relative value of the tax credits will be greater.

**<Q - Ali Agha>**: First question, Steve, the proceeds from international sale, as you mentioned, you're going to use to pay off parent debt. Can you remind me, on average, what's the average interest rate on the debt that you're paying off?

**<A - Steven K. Young>**: Well, when we did the calculation there, we came out with roughly \$0.05. We're looking at a long-term holding company rate. It might be in the 3.5% to 4%-type range of that nature. So that's the basis of what we're looking at, and we baked that into our financing plans anticipating that to happen. We'll initially take down some bridge facilities of shorter term with the proceeds.

**<Q - Ali Agha>**: Okay. But there's enough – that high cost or relatively high-cost debt available to get that kind of savings?

**<A - Steven K. Young>**: Well, what I'm speaking about is we've anticipated this and baked it into our financing plans to avoid issuances of HoldCo debt at that higher level.

**<A - Lynn J. Good>**: Yeah. So one way to think about it is \$1.7B to \$1.9B of proceeds coming into the holding company. So the average rate that Steve referenced is consistent with that.

**<Q - Ali Agha>**: I see. Then second, the Commercial results that you're getting, \$65mm YTD or \$140mm for the year, I guess a little lower now, how much of that, roughly, is recognition of tax credits?

**<A - Lynn J. Good>**: Tax credits are going to be a significant part of those renewable returns. Ali, I don't have a exact number in front of me. We do have a modest amount of contribution in Commercial from the pipelines at this point through Q3. We'll move that to the Gas Infrastructure segment in Q4, [ph] how would you add? (29:39)

**<A - Steven K. Young>**: That's correct. The results for the Commercial Portfolio reflects small amounts of AFUDC on the pipelines. That will be growing. But, right now, it is primarily from the Renewables business, and that is heavily driven by the recognition of the tax benefits.

**<Q - Ali Agha>**: Got it. Last question. Lynn, as you look at this portfolio now post the international sale and you look at your utility footprint, is everything essentially core as far as Duke is concerned? And related to that, as you're looking at growth over at least the next three, four years, does M&A come back into the mix for you as you're looking to deliver growth for shareholders?

**<A - Lynn J. Good>**: So, Ali, the businesses that we own coming out of the transition are all core. And I think the strength of the franchises we own in the Southeast with Gas and Electric and then a strong position in the Midwest are

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all core businesses. And we'll be looking to drive growth through investments that build on cleaner forms of generation and strengthening our grid and driving growth, and providing value to customers. That'll be job one at Duke. I believe the M&A represents something that we will continue to look at as opportunities arise, and I think we've demonstrated a track record of successful integration of M&A candidates. But job one, as I said, is growing the core businesses that we own.

**<Q - Maxwell S. Burke>**: So maybe just coming back to your Renewable portfolio, so when you're underwriting these investments, do you generally assume that the PPA cash flows are going to cover the full investment costs, or do you assume some residual value post-PPA in order to recover that investment?

**<A - Lynn J. Good>**: We will typically assign some terminal value beyond the contract period.

**<Q - Maxwell S. Burke>**: Okay. Got it. And maybe just as a follow-up, can you provide any guidance on, like, how you think about valuation post-PPA? Can you make some assumption around re-contracting? Or do you apply \$1 to every multiple or some other method?

**<A - Lynn J. Good>**: We look at a variety of things as we think about terminal value, including forward curves, as well as market experience. And so our contracts are the majority of the value that we're looking at, and so terminal is something that we look at a range of possible outcomes.

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