



**Duke Energy First Quarter 2002 Earnings Conference Call**  
**Wednesday, April 17, 2002, 10:00 a.m. ET**

**Operator:**

Good morning everyone, and welcome to the Duke Energy first quarter 2002 earnings conference call. Today's call is being recorded. At this time, for opening remarks, I would like to turn the call over to the Senior Vice-President of Investor Relations, Ms. Sue Becht.

**Sue Becht:**

Welcome and thank you for joining us today. Today's call is also being webcast from our website at [www.duke-energy.com](http://www.duke-energy.com). Before we begin the meeting, I would like to review with you our Safe Harbor Statement:

Some of the things we will discuss in today's call in reference to our views on future company performance and results, and other statements not dealing with historical facts, will be forward-looking statements within the meaning of the securities laws. This is to inform you that actual results may materially differ from those discussed in these forward-looking statements, and you should refer to the additional information contained in our filings with the SEC concerning factors that could cause those results to be different than contemplated in this discussion.

With me today is Robert Brace – Executive VP and Chief Financial Officer. Robert will begin the call with some prepared remarks and then we'll take your questions. Also participating in the Q&A portion of the conference call was Harvey Padewer, President of Energy Services; Jim Donnell, President and Chief Executive Officer of Duke Energy North America; and Dorothy Ables, Senior Vice President and Chief Financial Officer for Duke Energy Gas Transmission.

**Robert Brace:**

**Opening Remarks:**

For the first quarter of 2002, Duke Energy reported earnings per share of 48¢, compared to reported earnings per share of 61¢ in 2001. The amount for 2001 included a 13¢ one-time charge related to the cumulative effect of an accounting change for SFAS 133. Excluding this charge, ongoing earnings per share for the first quarter of 2001 were 74¢.



While earnings for the quarter are significantly lower than first-quarter earnings last year, it is important to note that we are slightly ahead of our plan for the quarter and on track for the year. The plan for the year recognizes two important factors: the first is the extraordinary market conditions prevalent throughout the first quarter of last year, and the second is the increasingly bell-shaped curve of our business results. I'll discuss both of these points in more depth in a moment.

The primary earnings drivers for the first quarter were the decline in commodity prices and associated volatility from last year's unusually high levels, including natural gas, power and natural gas liquids, lower earnings at Duke Power, partially offset by one month of strong earnings from the Westcoast acquisition.

You'll recall that commodity prices and volatility levels were at record levels last year.

Last year, the average price for natural gas was about \$7 and average NGL prices were 60¢. This quarter, the average natural gas price was \$2.32 and the average NGL price was 31¢.

Last year, spark spreads and volatility levels were significantly higher than historical norms. For example, the historical daily volatility for natural gas in the West was approximately 50% in the first quarter of this year. The historical daily volatility for the first quarter of 2001 was more than 3 times that amount (180%). Volatility for power in the West has followed a similar trend (310% in the first quarter of 2001 and 110% for the first quarter of 2002). Spark spreads in the West were also significantly lower in 2002, as compared with the first quarter of 2001.

Earnings at Franchised Electric were lower this year as a result of a nuclear insurance distributions recorded as income and favorable settlement of forward power sales contracts in 2001, and warmer weather in Duke Power's service territory in 2002.

On the upside – Natural Gas Transmission's earnings got a boost as a result of the acquisition of Westcoast Energy. Union Gas, the gas distribution company located in Ontario, had strong results in March due to colder weather in its service territory.



Duke Energy reported total segment earnings before interest and taxes of \$747 million for the first quarter. This represents a decrease of 33% from last year's total segment EBIT of \$1,123 million.

Overall, our competitive businesses contributed 59% of total segment EBIT for the first quarter of 2002, compared with 65% in 2001.

The Energy Services group reported EBIT of approximately \$132 million, compared with \$428 million for last year's results. This group contributed 18% of total segment EBIT for Duke Energy.

While the first quarter's earnings were lower than last year, the results for the first quarter of 2002 were above plan for the quarter. We remain committed to our current earnings guidance which is toward the higher end of the 10 – 15% compound annual growth in earnings per share from a base of \$2.10 in 2000.

Let me talk about each of our business segments in more detail.

#### **North American Wholesale Energy:**

For the first quarter, North American Wholesale Energy reported EBIT of \$67 million. EBIT for the first quarter of 2001 was \$348 million.

The decrease in quarterly results was primarily attributable to a decrease in trading and origination earnings as compared with last year. Last year's results, if you'll recall, were driven by unusually high natural gas and power prices and volatility levels, especially in the West. The pricing and volatility levels this quarter have shown a return to more historical norms.

Development activity during the quarter has been focused on completing the construction on another 6,700 megawatts of new generation that will begin commercial operation this summer. DENA is also looking at a number of opportunities to purchase generation facilities as we see chances to buy plants cheaper than we can currently build them.

Origination activity continues to pick up as customers are returning to the market and should provide sustainable earnings growth in the future.



**Additional disclosures:**

The first thing I'd like to address is Duke Energy's Daily Earnings at Risk or DER. DER computations are based on a historical simulation, which utilizes price movements over a specified period of time – generally ranging from 7 to 14 days – to simulate forward price curves in the market used to estimate, at a confidence level of 95%, the favorable or unfavorable impact of one day's price movement on the existing portfolio.

The average DER for Duke Energy in the first quarter of 2002 was \$17 million, compared with an average DER of \$30 million for the same period last year.

DER limits are established by the Risk Management Committee, chaired by the Chief Risk Officer. Counterparty credit limits are determined at the corporate level and include all transactions with counterparties – not just our trading and marketing business.

Next, I'd like to review the metrics for our mark-to-market and accrual portfolios for the company.

**Valuation of portfolio as of March 31, 2002:**

Mark-to-market	\$1.0 billion
Accrual	\$6.8 billion

The forward value of the accrual and mark-to-market books was roughly an 85/15 split of the total valuation of the portfolio. The numbers associated with that split are for the accrual book – approximately \$6.8 billion – and for the mark-to-market book – approximately \$1.0 billion. The fact that the accrual book is 6 times the size of the mark-to-market book is a good measure of the quality and sustainability of our earnings.

**Realization Period – cumulative percentages:**

<b><u>Portfolio</u></b>	<b><u>2002</u></b>	<b><u>2003</u></b>	<b><u>2004</u></b>
Mark-to-market	23%	40%	54%
Accrual	11%	22%	35%



Approximately one half of the value of the mark-to-market book will be realized over the next couple of years.

For Duke Energy, the unrealized portion of mark-to-market margin included in the first quarter results was a negative \$68 million, compared with a positive margin of \$560 million in first quarter 2001.

Another metric for North American Wholesale Energy that should be familiar to you is the percentage of our expected generation output that is hedged forward.

**The annual hedged percentages as of March 31 were:**

**2003: 74%                      2004: 60%                      2005: 59%**

Our hedging portfolio for 2002 is being actively traded and the hedging level for the remaining 9 months of the year is still substantially hedged.

**International Energy:**

For the first quarter of 2002, DEI reported EBIT of \$67 million, a decrease of nearly 12% from the same period last year. Earnings for the quarter were down as a result of lower earnings from the company's regional energy businesses in Latin America and Europe. The Latin American operations were affected by lower demand, primarily in Brazil, where 5% power rationing was in effect until mid-March. We expect to see demand levels increase to more normal levels over time. Our European trading operations were affected by lower margins in the trading business.

You'll notice DEI reported a significant increase in revenues during the quarter along with a commensurate level of operating expenses. This is primarily due to increased trading and marketing activities in Europe.

During the quarter, DEI began construction of the onshore portion of the Tasmanian Gas Pipeline, which is expected to be in operation in mid-2002. The offshore portion of the pipeline is already complete. Also, in Australia, the expansion of the Bairnsdale generating facility began commercial operation. In Latin America, we broke ground on a new 165 MW thermal generation plant in Guatemala, which will double our current capacity in that country. The plant is expected to be in operation by November of this year.



**Other Energy Services:**

Other Energy Services reported an EBIT loss of \$(2) million this quarter. The decrease for the quarter is primarily due to a \$15 million reserve taken to account for the anticipated loss on the sale of DukeSolutions. This decrease was partially offset by positive earnings from Duke/Fluor Daniel.

In addition to the sale of DukeSolutions, we also announced the sale of DE&S during the quarter and expect both of these transactions to close in the second quarter.

**Field Services:**

Field Services reported EBIT of \$35 million for the first quarter of 2002. The large decrease for the quarter was primarily due to significantly lower natural gas liquids prices, partially offset by lower natural gas prices. NGL prices for the first quarter of 2002 averaged 31¢, compared with 60¢ last year. Natural gas prices averaged \$2.32 in the first quarter of 2002 compared with \$7.09 in the first quarter of 2001.

Natural gas gathering volumes increased 2% and NGL production increased 5% for the quarter.

During the quarter, Field Services announced an agreement to acquire ChevronTexaco's 33.3% interest in Discovery Producer Services. This acquisition will significantly increase Field Services' presence in the Eastern Gulf of Mexico. The transaction is expected to close during the second quarter.



**Annual Pricing Sensitivities (without hedging):**

<u>Commodity</u>	<u>Change in Pricing</u>	<u>Annual EBIT Current Impact</u>
NGL Prices	Increase 1¢/gal	\$25 million
Natural Gas	Increase 10¢/MMBtu	\$(5) million

**NGL Pricing Sensitivity (net to Duke Energy Corp with hedging):**

<u>Commodity</u>	<u>Change in Pricing</u>	<u>Annual EBIT Current Impact</u>
NGL Prices	Increase 1¢/gal	\$6 million

**Pricing History:**

**Weighted avg. NGL price (\$/gal):**

	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>
2000	0.50	0.47	0.55	0.62
2001	0.60	0.48	0.39	0.31
2002	0.31			

**NYMEX Henry Hub (\$/Mcf):**

	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>
2000	2.52	3.47	4.27	5.29
2001	7.09	4.67	2.88	2.45
2002	2.32			

**Fractionation Spread (\$/MMBtu):**

	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>
2000	3.32	1.96	2.01	1.92
2001	(0.03)	0.93	1.56	1.11
2002	1.19			



### **Gas Transmission:**

The Gas Transmission segment reported EBIT of \$268 million for the first quarter of 2002, compared with \$175 million last year. Gas Transmission continued to see increased earnings for the quarter from market expansion projects and realized an \$9 million after-tax gain on the sale of one-third of its interest in Northern Border Pipeline. This is an asset we've held for quite some time and we had an opportunity to monetize a portion of our limited partnership shares.

Gas Transmission also realized one month's earnings from the Westcoast transaction of \$62 million. We realize that you may need some help in adding Westcoast to your models and we will be in a position to give you additional, more specific information in the near future.

In addition to closing the Westcoast acquisition during the quarter, construction continued to move forward on the Gulfstream pipeline project. The project is nearly complete and remains on schedule to be in service by June 2002. We also received preliminary approvals from the FERC on the Patriot, Maritimes and HubLine projects.

### **Franchised Electric:**

EBIT was \$385 million for the first quarter of 2002, a decrease of 16% from the same period last year. This decrease is primarily due to a nuclear insurance distribution of approximately \$33 million that was recognized as earnings in the first quarter of 2001 and then reclassified from the income statement to a balance sheet account in the third quarter of 2001, pending the outcome of a regulatory audit. Mild weather conditions and lower sales also had a negative effect on earnings for the quarter. Unlike the first quarter of 2001, which benefited from winter temperatures slightly colder than normal, this year winter in the Carolinas has been warmer than normal.

Electric sales totaled 19,521 GWh for the first quarter, a 1% increase from the same period last year (19,362 GWh). While sales to industrial, commercial and residential customers were down for the quarter, we had an increase in volumes sold through bulk power marketing.

The total number of customers increased by 1.3% during the first quarter, with general service customers up 3.4% and residential



customers up 0.9%. The number of industrial customers showed a decrease of 3.7% for the quarter.

Heating degree hours decreased 6.6% in the first quarter.

Nuclear Operations reported 44 outage days for the quarter. Capacity utilization for the first quarter was 95%, compared with 89% last year.

### **Earnings Outlook:**

With a good start to the year, I'd like to reiterate – we still expect earnings toward the high end of our target range of 10 – 15% compounded annual growth in earnings per share from a base of \$2.10 in 2000. For 2002, this translates into an EPS range of \$2.54 to \$2.78 per share.

Looking at historical trends for Duke Energy's quarterly earnings profile, you would see that it resembles a bell curve with the largest percentage of our earnings realized in the third quarter of each year. Duke Energy operates several seasonal businesses, which provide earnings in a cyclical pattern.

On the natural gas side of the business, the pipelines deliver a fairly steady stream of earnings throughout the year due to their rate structure. Market Hub Partners, one of our newer businesses, is a system of salt dome gas storage facilities that provide high-deliverability of natural gas during peak periods. The earnings stream associated with this business is also relatively even throughout the year. Our newest addition, Union Gas, which is a gas distribution company in Ontario and was part of the Westcoast acquisition, is a seasonal business. Their strongest earnings are expected in the first and fourth quarters of the year in association with the winter heating season. Approximately 80% of Union Gas' annual earnings are typically recognized in that six-month period.

Field Services, our natural gas gathering and processing business, tends to not follow seasonal trends. You'll see fluctuations in their earnings stream as the price for natural gas liquids rises and falls, as well as with changes in the strength in the economy. The pricing sensitivities we've provided should help you model through these pricing fluctuations.

On the power side of the business, Duke Power, our regulated utility in the Carolinas, typically has its strongest quarter in the third quarter. Our merchant generation business, with its fleet of combined cycle and



peaking facilities, also follows a similar earnings trend as these power plants ramp up for the cooling season. The cooling season generally runs from May through September.

On average, our peaking facilities realize roughly 95% of their annual contribution during the cooling season, while combined cycle facilities realize about 60-65% of their annual contribution during that same period.

This summer, DENA expects to complete the construction of another 6,700 megawatts, nearly doubling its current operating portfolio of 8,600 megawatts. In fact, three units at our Southaven peaking facility in Mississippi began commercial operation on April 10th. These new facilities will provide significant earnings growth in the third quarter. The earnings expectations for our merchant generation, along with trading and origination activities, will enable us to earn toward the higher end of our guidance range of \$75 to \$120 of EBIT per kilowatt.

Looking at 2002, we are focusing on:

- More normalized expectations for commodity pricing and volatility in the energy markets
- More business opportunities to grow our energy businesses, primarily through acquisitions and development

We believe our diversified strategy of combining energy asset positions with trading expertise will provide us with the ability to weather market cycles and allow us to deliver consistent earnings growth.

Once again, we remain committed to our stated guidance of 10 – 15% compound annual growth in earnings per share from a base of \$2.10 in 2000. We believe results in that range continue to be a goal that Duke Energy will achieve over the next several years. For 2002, we expect to earn toward the high end of the 10-15% range.

That concludes the prepared remarks for today.

We'll be happy to take your questions now.



## Question and Answer Session:

### Andre Meade – Commerzbank:

**Andre Meade:** Hi good morning, couple of quick questions on Duke Field Services for Q4 versus Q1. Your operating costs G&A line went up about 15% and account for the bulk of the drop in earnings versus Q4 and Q1, what's really behind that?

**Robert Brace:** Expenses have increased a bit. Dorothy, would you like to comment on the specifics.

**Dorothy Ables:** Expenses did go up between Q4 and Q1 this year from some extra operational costs. We're looking at it very closely to see if we can bring down the run rate so that that is not an ongoing run rate for the rest of the year. So, we are looking at that very closely and trying to get that down.

**Andre Meade:** And, so if I hear correctly it might just be a one-quarter movement up?

**Dorothy Ables:** That's what we're hoping it is. Our expenses are up over all of last year because we had more assets that were operating and we are consolidating our DP and mobile bay assets, but we believe that this should be just a one quarter just a one quarter extra expense.

**Andre Meade:** On your Gas Transmission segment throughput I see is up just about a third and EBIT up over 50%. Can you just explain if that throughput was lower than expected due to weather or what?

**Robert Brace:** What we reported in the Gas Transmission segment was one month of Westcoast Energy, we realized about \$62 million of EBIT in the quarter as a result of one month consolidation of the Westcoast Energy acquisition.

**Andre Meade:** Right, but why the disconnect between throughput and EBIT? Your EBIT line is growing much quicker than throughput, is it just that your fixed charges.

**Robert Brace:** Well, it's not exactly a like for like comparison because we changed the structure in the quarter by adding in Westcoast for the one month and so if you back out the \$62 million of EBIT you get a slightly



different trend and as I said we will be helping you with a detailed Westcoast information in the not too distant future, so you can work it through for the rest of the year and beyond.

**Dorothy Ables:** Westcoast volumes were approximately 250 of that 750 number.

**Andre Meade:** Okay and then, finally, the decision to sell Duke Solutions - can you just discuss your opinion on the ability to make money in that business? I guess you're not so bullish on that.

**Robert Brace:** We don't think it's a bad business, we just decided where we want to focus our efforts and energies and we decided that wasn't part of our core strength and capability in the company. We wanted to concentrate on developing our merchant generation capability in the energy industry and develop our gas transmission operations. It's just a focusing decision and we think other people can do quite well in that business and make money. We just decided it wasn't really a business for us.

**Andre Meade:** Okay and lastly, tax rate fell from about 37% down to about 29%, what's the basis behind that?

**Robert Brace:** We had some one time tax credits this quarter, they just happen to fall in this quarter, we just had a few rulings in our favor. I think a good guidance for the full year is around 35% - 36% tax rate taking into account this quarter which, you know, had some favorable movement. It's good news. It's real money and you can spend it but it's not an ongoing run rate that you can look at those favorable rulings every quarter.

**Andre Meade:** Okay, thank you very much.

**Kit Konolige - Morgan Stanley:**

**Kit Konolige:** Good morning everyone. Just a couple of related questions. One is on your report on how much of merchant generation expected output is hedged in '03 and going forward. Can you remind us is that of the plants that are currently in operation or of the ones that you project to be in operation by '03?

**Robert Brace:** These numbers include all the plants we have on the books today, all the plants we expect to have in operation in '02 and the ones that are currently authorized and being built for '03, so it really is the latter.

**Kit Konolige:** Could you address the unrealized mark to market margin in the first quarter? There's a negative number in there, can you give us a little



color on what contributed to that. Obviously the environment in general, but any specific movements or types of contracts and maybe some sense of how the second quarter is developing and what you see over the summer?

**Robert Brace:**

Let me take it a step at a time. What we said is that the mark to market valuation at the end of the 31<sup>st</sup> of March was a billion, so that's the amount of profit that we have taken in, in prior period on a mark to market basis. The actual movement in the unrealized amount in the period was minus 68 million and that's a combination of pluses and minuses. I think it's been a relatively subdued quarter from a trading and marketing point of view and we're not particularly surprised by that. I'm not sure I want to go into too much detail about individual contracts or what current trading is but we're planning for a more normalized year in terms of volatility and pricing and at the moment and I think it's sort of a bit subdued. We'll see what happens for the rest of the year. We don't anticipate a 68 million negative every quarter. So it's not a run rate sort of issue.

**Kit Konolige:**

Can I just finish by asking do you expect for the year the mark to market EBIT to be positive or to be near last year's – I think it was 700 million or so?

**Robert Brace:**

It's not typical for us to give a particular forecast for that, but we certainly don't expect it to be negative, whether it will reach and exceed last year's number, we'll have to wait and see.

**Carrie Stevens:**

This is Carrie Stevens – to further comment on that - Could you say that based on your confidence in the high end of the EPS guidance that the 700 million is not assumed and that you're assuming a normalized a level below 700 million?

**Robert Brace:**

I think that's reasonable. You've got to take into account that we've got a lot of power coming on stream in the next quarter and quarter three at DENA, and so they're very busy building power plants at the moment. We have sold lot of that forward as well but we've still got quite a bit of it to sell in the future years.

**Paul Ridzon - McDonald Investments:**

**Paul Ridzon:**

Good morning, three quick questions. Can you tell us what the EPS impact was on the \$628 million mark to market swing? The first question, the second question is what this reclassifying of nuclear



funds is going – how that's going to flow through the year, and lastly, how management compensation is related to earnings for the year?

**Robert Brace:**

Okay, let me do them backwards. In terms of management compensation the – we've announced before that the on target earnings for the management is around \$2.75, so \$2.75 is required achieve a 100% pay out. If we're below \$2.55 there's zero pay out and if we're above \$2.85 then there's a maximum pay out, which is 200% of the target and obviously the target amount varies by individual, but you can see some of them published for the prior years in our Proxy Statement. So, we're highly incentivized to sort of hit our budget and exceed the budget. In terms of reclassification of the nuclear insurance distributions, we have two distributions in abeyance at the moment on the balance sheet – last year's and this year's because the 2001 Q1 distribution was credited to P & L, it was reversed under the instructions from the regulators in quarter three and so that held in abeyance \$33 million and this year's quarter one's distribution is also held in abeyance. We anticipate the orders to be clarified in the coming months. It's not exactly under our control, but three months or six months, and at that point in time we'll take whatever the appropriate action. In terms of the EPS for \$628 million, I'm not sure I really understood that one, would you repeat that please?

**Paul Ridzon:**

Your mark to market evaluation you had – if I'm reading this right – you had a \$560 million margin benefit last year and it looks like it swung by \$628 million –

**Robert Brace:**

Right.

**Paul Ridzon:**

I wonder what that did to the EPS?

**Robert Brace:**

Well there's roughly 800 million shares in issue, 628 margin, we've estimated that about 20% variable costs, you take 80% of that, say 480 million and you divide by 800 million, so that's about sixty cents.

**Steve Fleishman - Merrill Lynch:**

**Steve Fleishman:**

Couple of questions, wondering first if you could comment whether there were any credit reserves taken in the quarter for the Nevada Utility situation in your mark to market. Secondly, just wanted to really clarify the percentage hedged numbers and whether they do include the expected 2003 megawatt additions and what that number is right now in terms of expected 2003 megawatt additions. And, then finally, just on that same topic a little flavor on – you've moved that



number up significantly over this last quarter the despite relatively low pricing in the market, I'm just curious if you or Harvey could give some flavor on how you achieved that?

**Robert Brace:**

In terms of the credit reserves we keep everything under tight control. I don't want to comment particularly on individual hedging movement, suffice it to say we think we are aware of known events in the marketplace that affect our positions. In terms of the 74% in '03 and '04, maybe I can hand it over to Harvey and he can give you his views on that.

**Harvey Padewer:**

Well, first with respect to Nevada Power, I just like to re-enforce what Robert said. Nevada Power has not filed for bankruptcy. In fact what they're saying publicly and privately is that they don't intend to file and that they can get through this situation. We certainly continue to monitor the situation and work to understand and manage our exposure, but we've taken no reserve in the first quarter relative to Nevada Power. Secondly, with respect to hedges, for 2003 we have 74% of our production hedged and that includes all the new plants that are under construction and coming on stream for '03, and that number, of course, as the year goes by and as opportunity presents itself we would hedge additionally beyond the 74% if we have that opportunity.

**Steve Fleishman:**

Harvey, how did you bring that hedge percent up during this quarter when prices seemingly were quite low?

**Harvey Padewer:**

Well, we just look at our own bias with respect to the market place and we adjust our hedges accordingly.

**Robert Brace:**

It was 64% as we told you back in January at the 31<sup>st</sup> of December. So, it has gone up a bit, but not dramatically.

**Jay Dobson – Deutsche Banc A. Brown:**

**Jay Dobson:**

Thanks and good morning. Couple of questions. If I could comment on a couple of issues that have already been touched. I guess of the 6700 coming on this year – is it fair to assume just straight up about 91% of that is hedged? You say the entire '02 output is substantially hedged relative to the 91% you indicated at year end, I'm just trying to parse a little bit between, you know, existing capacity and capacity coming on?

**Robert Brace:**

Well, the way we are is that the 2002 hedge number that we gave you at the 31<sup>st</sup> of December, which was 91%, hedged of our expected



normalized output. That included the 6700 megawatts coming on stream. With eight months to go, we've not given you a percentage of how much we'll hedge for the next eight months and there are a few reasons for that. One is that we are trading actively. Secondly, is that there's only eight months to go in the year and the closer you get to the actual end of the contract period then the more proprietary that information becomes and we don't particularly want every body to know what our position is on a daily basis. So what we feel comfortable telling you that we're still substantially hedged, but we're not actually giving you a percentage figure at this time and we don't really intend to update that for the prompt year as we go forward.

**Jay Dobson:**

Okay, fair enough and just back to a previous question on the '03 hedging, you probably don't to give an exact price, but could you characterize the pricing that you hedged at for the increase in '03 percent hedged?

**Robert Brace:**

I don't think we really want to get dragged into that – I agree it's a useful number for you to know, but it makes it more and more difficult for us to trade if we actually give out as it would state the parameters of every trade that we do.

**Jay Dobson:**

I'm not looking for every trade, It was Steve or someone previously was talking about '03 and you brought it up and the hedging amount in the relatively low commodity price environment.

**Robert Brace:**

Well, what I think you could deduce is that clearly the very high prices haven't been there, but as Harvey said, you know, we hedged at a price that we felt comfortable with, so we're not uncomfortable with it otherwise we wouldn't do it and there's still quite a long time to go before we get to the delivery of the power or the end of the contract in '03 and I suspect before that happens we'll buy some more power and we'll sell some power, so what exactly the margin ends up at may be a totally different figure from that which we've sold at today. We've just locked in something today, but that will move and hopefully we'll improve on that as we go through the 12 or 18 months.

**Jay Dobson:**

Okay, fair enough. I was wondering if perhaps Harvey can talk a bit about the environment for origination and I'm thinking about the origination in the trade and marketing business at DENA.

**Harvey Padewer:**

In terms of volume of origination activity, it's actually gone up. We see that the amounts of the contracts that we're entering into aren't as great as last year but that's only a timing issue and we see that the



origination market is still strong and still an important and growing component of the earnings growth.

**Jay Dobson:** Margins, I assume have come down in that business relative to say the fourth quarter?

**Harvey Padewer:** Well, that's hard to say because in reality when we do origination contracts what we're trying to do is capture optionality either in customer positions or our positions, and so very often the contracts are not just purely commodity contracts, but they have sufficient optionality in them to create incremental value, so you can't characterize them and say that because of the underlying commodity prices are low then the margins on these contracts must be low. The two don't correlate that way.

**Jay Dobson:** Okay, fair enough. Last two questions if I can. Can you just confirm, Robert that the five cents that you indicated in the press release which was tax settlement and sort of other tax benefits. Is that five cents all the tax settlements that you indicated here were maybe non-recurring.

**Robert Brace:** On the analysis sheet we've done that. Those are the ones we highlighted.

**Jay Dobson:** If we wanted to look at a more normal tax rate we could add back that five cents.

**Robert Brace:** My estimate to you is that for the full year, including quarter is that it will come out with a tax charge of around 35% to 36%.

**Jay Dobson:** Okay, fair enough and then this last issue on equity – I know you covered this in late March, but just your sort of thoughts on the convertible and the equity issue that you have facing you this year timing wise?

**Robert Brace:** What we've said is that we anticipate issuing about a billion dollars worth of convertibles later this year - before the end of December and we don't have a particular date when we have to do it by. That was just an indication we gave to people. We're likely to be opportunistic depending on markets conditions; it was more likely to be towards the back end of the year than the front end of the year.



**David Fleischer - Goldman Sachs:**

**David Fleischer:**

My question also has to do with wholesale energy and originations – you’ve indicated that your origination activity, you know, has been strong and yet your major competitors have not fared nearly as well with customers seem as if they’re choosing to do shorter term deals with them and seemingly being worried about their balance sheets. So I guess my question to you is what have you been hearing from customers in terms of seeing a long term benefit from the difficulties that others are facing with their balance sheets and what you can tell us about the length and character of these deals and your ability to close longer term deals. What is the advantage of your balance sheet that you’re seeing here and who are your competitors in doing these transactions now?

**Harvey Padewer:**

Well we are seeing greater opportunity for a number of reasons. First, we believe that there is more of flight to quality. People see us as an A+ rated company and a counter party they feel more comfortable doing business with. Certainly we’re in competition with all of the major trading companies that do origination, but we think that we’re bringing a lot to the table and our customers believe that too. We have physical assets to back up our position, so we’re not strictly providing financial products. Customers like the assurance of having physical power plants behind the sales – behind their purchases and so we see a lot of opportunity with respect to length of contracts. Talking about some of these are multi-year contracts, certainly there was a concern initially that we would see fundamental changes in the length and duration of term transactions, but we’re not seeing that. We’re seeing a good mix of excellent transactions and some of them long term and companies who want to do business with Duke because we have the financial wherewithal and the physical assets to back up our obligations.

**David Fleischer:**

Can you tell me if you’re seeing a greater requirement or request for credit by the customers – credit wraps – are they just as happy to do business with you today on the same terms as they were in the past. We saw with Williams that deal they were trying to do with Nevada Power, but they had to bring an insurance company to put up the credit basically?

**Robert Brace:**

Well, for us, of course that’s not an issue for us, but the issue for Duke Energy is to make sure that the customers and the people we do business with have solid credit and we’ve established some very stringent policies around how we qualify credit and what kind of margining agreements we have to assure that when we enter into



transactions with customers and counter parties that they can stand behind their obligations just as well as we can stand behind ours.

**David Fleischer:** Are there investment banks giving you competition here – are they your competition doing the originations?

**Robert Brace:** No, we're not seeing them in the physical markets and since most of our transactions have physical settlement versus financial settlement we don't see them as a major competitive force in the market.

**Winfred Frehauf - National Bank Financial:**

**Winfred Frehauf:** Thank you, good morning. First question I have is if you will still have to continue to amortize goodwill in the first quarter, which of course, you were not required to do, what would have been the EPS?

**Robert Brace:** It would have been one and a half cents lower.

**Winfred Frehauf:** Okay. Next question I have is what impact from inventory valuation of natural gas stored in underground storage have affected your numbers and what's the impact?

**Robert Brace:** I don't think there's anything significant there at all.

**Dorothy Ables:** No, there was no impact from that in our numbers.

**Winfred Frehauf:** Okay, the other question I have is dealing with origination and I'm wondering of that \$.23 year over year reduction, how much is attributable to decreased earnings from origination as compared to your trading activities?

**Robert Brace:** We haven't split that out, I mean, it's probably is a mix but the trading is the heaviest element.

**Winfred Frehauf:** Oh, I would actually think that the impact of lower earnings from origination ought to be fairly small so that by far the lion's share has to be related to your trading activity.

**Robert Brace:** I think that's a reasonable deduction.

**Winfred Frehauf:** And, are you still maintaining your expectations with respect to the EPS contribution of west coast for 2002/2003 that you had shared with us a few months ago?



**Robert Brace:**

What we said for this year, you know, the ten months we issued the full 49.9 million shares - the upper end of the range of shares and so that didn't help but we think this year we'll be about three cents. I think for 2003/2004, I think we're in the range that we said before, say six cents for '03 and nine cents for '04, I mean, we're really pleased with what we've got. We're very pleased with the quality of the people and the way that the whole deal has gone so far and so we're pretty bullish and think with the cost savings we'll achieve will hopefully allow us to beat that target that we laid out.

**Winfred Frehauf:**

Last question is on currency translations in the first quarter, I was wondering if you could share with us the positive or negative impact of currency translations.

**Robert Brace:**

It wasn't significant. Off the top of my head it's about \$100 million at your OCI. Currencies jumped around a lot, we're not terribly exposed to Argentina and in the past we've had bigger movements on Brazil, they went up and they went down and then they went up again.

**Raymond Niles - Solomon Smith Barney:**

**Raymond Niles:**

Good morning. Well, I just have a couple of follow-up questions, a number of mine have been asked, but in terms of trading and marketing I'm just wondering if you could give a little bit of color in terms of in the U.S. power versus gas, I understand volatility was down significantly both categories and you mentioned the efforts in Europe where I take it you're experiencing a start up loss, I do think it's an important market to be in, but can you maybe characterize performance in those three segments?

**Harvey Padewer:**

We've actually started up our European trading operation approximately 24 months ago through the acquisition of Me-Gas. We're continuing to grow that business and we've actually seen pretty good results in the start up, but we certainly think there's more opportunity in Europe to take advantage of and we're going to do that. In the North American business we've seen a significant change, obviously year on year, because of volatility in the west has gone down dramatically and so the opportunities that we had in the western region have gone down, but I will say that in the eastern region - eastern part of the United States - we've seen plenty of good opportunities and we feel pretty good about how our trading is going in North America and the prognosis for the year.



**Raymond Niles:** Are you making money in Europe at this stage of the game?

**Harvey Padewer:** Yes, we make money in Europe.

**Raymond Niles:** Okay. Finally, just in terms of understanding the mark to market – change in the unrealized mark to market margin, first of all, I guess, this is an income statement item – would it be fair to say that then you had a \$68 million loss in trading and marketing segment versus a \$560 million earnings benefit last year or is there a piece – an additional piece that needs to be considered there?

**Robert Brace:** Well, what we're characterizing there is the unrealized portion, so 68 million is a margin and there are some expenses against that. We've said to people 15% to 20% variable cost associated with it both on the up side and the down side, so the 68 million is a debit to the P & L at the gross margin level, the net charge is going to be slightly lower than that after the variable cost and similarly the 500 million last year was a positive. The other bit of information is that the mark to market amount at the end of the period is the amount of profit that we've taken in, in prior periods on a mark to market basis was a billion – rounded to billion – it was one billion one at the end of December.

**Raymond Niles:** Would it be a profit posted in prior periods?

**Robert Brace:** In all prior periods up to and including the 31<sup>st</sup> of March, we have recognized one billion dollars worth of earnings, that's where the contracts are still running. So, if you move between December and March where you've had some contracts maturing and any additional profits related to those would have fallen into income. That's an extra piece but what we were trying to give people a handle because you told us you were concerned about which was the unrealized portion. So we've given you the duration of the underlying contracts in the mark to market with a half life of our books is around two years. So half the contracts mature within the two year period and the 68 million is the movement within the quarter so that became a charge to the P & L in the quarter, but it wasn't the only thing that was hit the P & L in the quarter.

**Raymond Niles:** Okay and just one last question. You have a fair amount of generating capacity coming on line this year and it's well-hedged, can you just characterize it all, who your counter parties are for the bulk of that?

**Harvey Padewer:** Well, they're all over the map, Ray, I mean we've got financial counter parties, we've got physical counter parties, we have end use



wholesalers, we have producers on the gas side, it's really the entire spectrum of wholesale counter parties out there.

**Raymond Niles:** Okay, that you very much.

**Sue Becht:** We are now in the end of our hour, why don't we hear from one more caller.

**Will Maze – Bank of America:**

**Will Maze:** Thank you and good afternoon. Just wanted to ask some follow up questions on the hedging. Harvey you mentioned that these are not financial hedges, if I understood you correctly and I'm wondering, therefore, are you selling these – are these more origination deals or how exactly are you hedging – ?

**Harvey Padewer:** I didn't say they weren't financial, that was an answer to a question about our origination activities, which are large part physical. With respect to our hedges, it's a combination of financial and physical and so you have a combination that makes up our hedge pool.

**Will Maze:** I understand that you don't want to talk about absolute numbers as far as the amount of the hedge here in '02, but I'm guessing that it's less than 92%?

**Harvey Padewer:** Well, I'll say this, to kind of restate a little of what Robert said before, once we get to the current year – the prompt year for those hedges, those are turned over to the trading operation who dynamically trade around those hedge positions to create extrinsic value. So, the hedge percentages do change. The fact that we don't reveal them is simply a commercial decision because if we tell you what our current percentage is then you'll understand our market bias, but so will our competition and we don't like to reveal market bias with respect to our trading operations.

**Will Maze:** That's fair enough, just the amount of reduction; again I'm assuming it's a reduction – would that be reflected in first quarter numbers?

**Robert Brace:** In the first quarter numbers is three months of that 2002, so whatever contract matured in the first quarter those would have been realized in that number. When you move forward into the eight to nine months that are left that hasn't happened yet.

**Harvey Padewer:** Two things are going on, those contracts are realized, you peel off the hedges, you take an income, but the second thing that's happening is



we're actively trading and those two are two of the variable that's considered in the hedge percentages.

**Will Maze:** Sure and then just on the remainder on that, whenever you talk about hedges are you talking about margin hedge locked into the gas as well.

**Harvey Padewer:** Yes we lock in the spread – the spark spread.

**Will Maze:** Okay and so it is earnings essentially.

**Robert Brace:** The way that we calculate the hedge is that we take the expected output from our plant and we look at what volume we think – what volume has been sold compared with the normalized running at the plant and the fuel is purchased as the same time.

**Will Maze:** You know you have brought up '03 from 62 to what I've written down up to 74. Does that imply you're not very bullish on '03 prices.

**Robert Brace:** I don't think you should deduce too much other than that we're giving you some facts about what our position is at this point in time. In three months time it could be quite different. It could be quite different today from the end of March to today's call. All we're doing is we're giving you factual information where over time you'll see a trend and, hopefully, our other competitors will provide similar information to give you a comfort as well.

**Operator:** And that concludes our question and answer session. I'll turn it back over to you for any closing remarks.

**Robert Brace:** Thank you and good-bye