

## American Electric(AEP)

**\$93.46** (As of 01/02/20)

Price Target (6-12 Months): **\$99.00**

Long Term: 6-12 Months

**Zacks Recommendation:**

**Neutral**

(Since: 01/27/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

**Zacks Rank:** (1-5)

**2-Buy**

Zacks Style Scores:

VGM:C

Value: C

Growth: C

Momentum: B

## Summary

American Electric's strategy includes incremental investment in renewable generation projects throughout the United States. This provides stability to its revenue stream and insulates it from lower sales in any particular service area. Its geographically-diversified operations allow it to avail transmission opportunities with better returns, compared with its single-state utility peers. In the past year, shares of American Electric outperformed its industry's growth. However, the company is exposed to environmental risks, since its power plants produce large quantities of nitrogen, sulfur, mercury and carbon dioxide. Investments required to meet proposed environmental regulations for its Welsh Plant through 2025 can cost an additional \$550 million. These additional investments could weigh on the company's finances, going ahead.

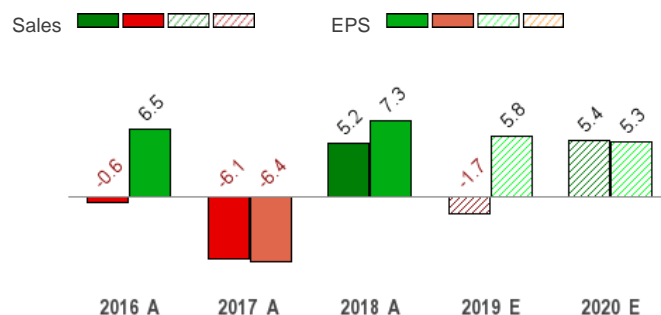
## Price, Consensus & Surprise



## Data Overview

52 Week High-Low	\$96.22 - \$72.26
20 Day Average Volume (sh)	1,791,685
Market Cap	\$46.2 B
YTD Price Change	-1.1%
Beta	0.07
Dividend / Div Yld	\$2.80 / 3.0%
Industry	<a href="#">Utility - Electric Power</a>
Zacks Industry Rank	Bottom 27% (185 out of 253)

## Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	9.8%
Last Sales Surprise	-15.4%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	01/23/2020
Earnings ESP	2.8%
P/E TTM	21.4
P/E F1	21.2
PEG F1	3.8
P/S TTM	2.9

## Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020					16,771 E
2019	4,057 A	3,600 A	4,300 A	4,085 E	15,917 E
2018	4,048 A	4,000 A	4,300 A	3,800 A	16,200 A

## EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$1.22 E	\$0.98 E	\$1.46 E	\$0.74 E	\$4.40 E
2019	\$1.19 A	\$1.00 A	\$1.46 A	\$0.62 E	\$4.18 E
2018	\$0.96 A	\$1.01 A	\$1.25 A	\$0.72 A	\$3.95 A

\*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/02/2020. The reports text is as of 01/03/2020.

## Overview

Columbus, OH-based **American Electric Power Company, Inc.** is a public utility holding company, which, through directly and indirectly owned subsidiaries, generates, transmits and distributes electricity, natural gas and other commodities. The company was incorporated in 1906. It is one of the largest integrated utilities in the United States, serving more than 5.4 million customers in 11 states. It has roughly 25,400 MW of generating capacity, of which almost 52% are coal-fired as of Sep 30 and nearly 40,000 miles of electricity transmission system network. Its service area covers Arkansas, Indiana, Kentucky, Louisiana, Michigan, Ohio, Oklahoma, Tennessee, Texas, Virginia and West Virginia. Approximately 70% of the company's power is generated from coal and lignite, 17% from nuclear energy, 12% from natural gas and oil, and the remaining 1% from wind, water, pumped storage and other sources. The company mainly operates under the following business segments:

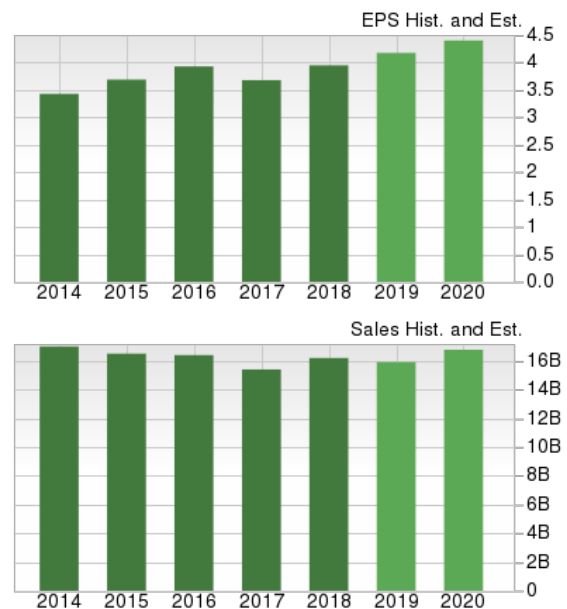
**Vertically Integrated Utility Operations:** Revenues during 2018 came in at \$9,645.5 million, contributing 56.6% to the company's total revenues.

**Transmission & Distribution Utilities:** Revenues during 2018 came in at \$4,653.1 million, contributing 27.3% to the company's total revenues.

**AEP Transmission Holdco:** Revenues during 2018 came in at \$804.1 million, contributing 4.7% to the company's total revenues.

**Generation and Marketing:** Revenues during 2018 came in at \$1,940.3 million, contributing 11.4% to the company's total revenues.

Its public utility subsidiaries are Appalachian Power Company (APCo), Indiana Michigan Power Company (I&M), Kentucky Power Company (KPCo), Kingsport Power Company (KGPCo), Ohio Power Company (OPCo), Public Service Company of Oklahoma (PSO), Southwestern Electric Power Company (SWEPCo), AEP Texas Central Company (TCC), AEP Texas North Company (TNC), Wheeling Power Company (WPCo), AEP Generating Company (AEGCo) and AEP Transmission Holding.



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## Reasons To Buy:

▲ In the past year, shares of American Electric surged 32.6%, which outperformed its industry's growth of 27.3%. The company had a strong liquidity position of \$2.6 billion as of Sep 30, supported by its revolving credit facility, which further enables it to finance future endeavors. Such a solid financial position also allows the company to reward its shareholders via dividends, which it has been paying since July 1910. Its regulated business investment strategy supports dividend growth consistent with earnings.

Ongoing investments in transmission projects and expanding renewable portfolio bode well for its earnings in the future.

▲ American Electric has a stable earnings base of approximately 5.4 million customers spread over 11 states. This provides stability to the company's revenue stream and insulates it from lower sales in any particular service area. Also, the company owns the nation's largest electricity transmission system and over 224,000-miles of distribution lines. With focus on augmenting its earnings base, American Electric has directed its capital expenditure toward regulated businesses. Notably, to drive earnings, it plans to invest approximately \$33 billion over the 2019–2023 period in its core regulated operations, contracted renewables and wires. This indicates 37.5% improvement from the company's prior capital expenditure strategy, which should enable American Electric to achieve long-term organic growth of 5-7%.

▲ The company's geographically-diversified operations allow it to avail transmission opportunities with better returns, compared with its single-state utility peers. In this context, American Electric's strategy will allow it to invest approximately \$16.6 billion in its transmission and distribution business over the next four years, reflecting 50% of its total capital investment forecast, to enhance customer reliability. Such investments should enable the company to make infrastructural upgrades in its transmission and distribution of utility services, thereby weathering adverse climate and offering better facilities.

▲ American Electric's investment strategy also includes incremental investments in renewable generation projects across United States. In sync with this, the company has been making substantial investments. Evidently, the company's latest plan includes a capital expenditure of \$2.2 billion in contracted renewables over the 2019-2023 period, of which \$1.5 billion has already been spent.

During the second quarter of 2019, American Electric acquired Sempra Renewables LLC, which has 724 MWs of wind generation and battery assets, for approximately \$1.05 billion. With this acquisition, its competitive renewable generation portfolio has reached 1,075 MW of renewable generation in 11 states. The addition of these high-quality renewable assets will support the company's long-term strategy to diversify its generation fleet. The long-term contracts and attractive returns associated with these existing assets will be immediately accretive to earnings and further solidify the company's projected 5-7% earnings growth rate.

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## Reasons To Sell:

- ▼ American Electric is exposed to environmental risks since its power plants produce large quantities of nitrogen, sulfur, mercury and carbon dioxide. Historically, the company has consumed approximately 77 million tons of coal every year. Moreover, though the company aims to gradually reduce its dependence on coal, it will remain mostly a coal-fired power generator for many years to come. In order to meet the environmental regulations, the company invested \$8.5 billion between 2000 and 2016. American Electric projects an investment of \$1.05-\$2.2 billion in the 2019–2025 time period. This additional investment could weigh on the company's finances, going ahead.
- ▼ Management currently estimates that the investment necessary to meet proposed environmental regulations through 2025 for its Welsh Plant, Units 1 and 3 could be worth approximately \$550 million, excluding allowance for funds used during construction (AFUDC). As of Sep 30, SWEPCo incurred costs of \$399 million, including AFUDC, related to these projects. Management continues to evaluate the impact of environmental rules and related project cost estimates. If the company fails to recover any of these costs, future net income and cash flows of American Electric could get reduced, thereby hampering its financial condition.
- ▼ American Electric collects its revenues from the distribution of electricity in the ERCOT area of Texas from Retail Electric Providers (REPs), which supply the electricity that American Electric distributes to REP customers. The company depends on these REPs for timely remittance of payments. As of Dec 31, 2018, American Electric did business with approximately 124 REPs. In 2018, AEP Texas' largest REP accounted for 19% of its operating revenues and its second largest REP accounted for 15% of the same. Any delay or default in payment could reduce future cash flows and negatively impact financial condition. Adverse economic conditions, structural problems in the Texas market or financial difficulties of one or more REPs could also impair the ability of these REPs to pay for services or cause them to delay such payments.
- ▼ Although the company's shares outperformed its industry, a comparative analysis of its historical P/E ratio reflects a relatively gloomy picture that might be a cause for investors' concern. The stock currently has a trailing 12-month P/E ratio of 21.39. This level compares unfavorably with what the stock saw in the past 12 months and is near the higher end of 22.74. The ratio is higher than the industry's average of 18.34.

Stringent environmental regulations and dependence on regulatory commissions for rate relief at regular intervals are major headwinds.

## Last Earnings Report

### American Electric Q3 Earnings Beat, Ups '19 EPS View

American Electric Power Co., Inc. reported third-quarter 2019 adjusted earnings per share (EPS) of \$1.46, surpassing the Zacks Consensus Estimate of \$1.30 by 12.3%.

Moreover, the bottom line also increased 15.9% from \$1.26 per share in the year-ago quarter.

The company reported GAAP earnings of \$1.49 per share compared with the year-ago quarter's \$1.17 per share.

Quarter Ending **09/2019**

Report Date	<b>Oct 24, 2019</b>
Sales Surprise	<b>-15.41%</b>
EPS Surprise	<b>9.77%</b>
Quarterly EPS	<b>1.46</b>
Annual EPS (TTM)	<b>4.37</b>

### Total Revenues

American Electric's third-quarter revenues of \$4.30 billion, missed the Zacks Consensus Estimate of \$4.86 billion by 11.4%. The reported figure also declined 0.6% from the year-ago quarter's revenues of \$4.32 billion.

### Quarterly Highlights

Operating expenses in the reported quarter were \$1,941.1 million compared with \$1,978.8 million a year ago.

Operating income in the quarter was \$944 million, up 30.8% from \$721.5 million in the year-ago quarter.

### Segmental Performance

**Vertically Integrated Utility Operations:** Operating earnings in the quarter increased to \$437.9 million from \$347.3 million a year ago.

**Transmission & Distribution Utilities:** Operating earnings were \$133.9 million in the quarter, down from \$147.2 million a year ago.

**AEP Transmission Holdco:** This segment generated operating income of \$126.1 million, up from \$73.7 million reported in the third quarter of 2018.

**Generation and Marketing:** Operating earnings were \$78.3 million, up from \$41.1 million in the year-ago quarter.

**Corporate & Other:** Operating losses were \$53.9 million against the operating earnings of \$9.8 million in the year-ago quarter.

### Financial Update

As of Sep 30, 2019, American Electric had cash and cash equivalents of \$348.8 million compared with \$234.1 million as of Dec 31, 2018.

Long-term debt was \$24.55 billion as of Sep 30, 2019, compared with \$21.65 billion as of Dec 31, 2018.

Cash flow from operations was \$1,549.1 million during the first nine months of 2019 compared with \$1,925.8 million in the first nine months of 2018.

### 2019 Guidance

American Electric has raised its 2019 operating earnings guidance of \$4.14-\$4.24 per share, from the previous earnings guidance of \$4.00-\$4.20 per share. The Zacks Consensus Estimate for the company's 2019 earnings, pegged at \$4.17, lies below the mid-point of the company's guidance.

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## Recent News

On **Dec 10, 2019**, American Electric announced that Public Service Company of Oklahoma (PSO) has reached a settlement agreement with the Public Utility Division Staff of the Oklahoma Corporation Commission (OCC), Oklahoma Attorney General's Office, customer groups and other parties on the company's proposal to add 675 megawatts (MW) of wind energy to serve customers. The settlement agreement seeks approval of terms for PSO's purchase of the North Central Energy Facilities.

Notably, PSO's proposed North Central Energy Facilities plan includes American Electric's partial ownership in three Oklahoma wind generation facilities located in seven counties in north central Oklahoma – Alfalfa, Blaine, Custer, Garfield, Kingfisher, Major and Woods. The three wind farms represent a nearly \$2 billion investment in Oklahoma.

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## Valuation

American Electric Power's shares are up 5.3% in the past six months and 31.3% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Utilities sector are up 7.6% and 5% in the six months period, respectively. Over the past year, the Zacks sub-industry is up 25.6% whereas the sector is up 7.2%.

The S&P 500 index is up 9.4% in the six months period and 29% in the past year.

The stock is currently trading at 22.36X of forward 12-month earnings, which compares to 14.68X for the Zacks sub-industry, 13.61X for the Zacks sector and 19.06X for the S&P 500 index.

Over the past five years, the stock has traded as high as 22.62X and as low as 14.27X, with a 5-year median of 17.63X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$99 price target reflects 23.68X forward 12-month earnings.

The table below shows summary valuation data for AEP

Valuation Multiples - AEP					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	22.36	14.68	13.61	19.06
	5-Year High	22.62	14.68	15.33	19.34
	5-Year Low	14.27	11.19	13.69	15.17
	5-Year Median	17.63	13.02	13.61	17.44
P/S F12M	Current	2.9	2.25	2.9	3.46
	5-Year High	2.93	2.25	3.26	3.48
	5-Year Low	1.42	1.5	1.7	2.54
	5-Year Median	2.14	1.83	1.95	3
P/B TTM	Current	2.31	1.76	3.97	4.41
	5-Year High	2.41	1.86	3.97	4.42
	5-Year Low	1.48	1.32	2.01	2.85
	5-Year Median	1.84	1.54	2.55	3.6

As of 01/02/2020

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## Industry Analysis Zacks Industry Rank: Bottom 27% (185 out of 253)



## Top Peers

Dominion Energy Inc. (D)	Neutral
DTE Energy Company (DTE)	Neutral
Duke Energy Corporation (DUK)	Neutral
Consolidated Edison Inc (ED)	Neutral
Public Service Enterprise Group Incorporated (PEG)	Neutral
Southern Company (The) (SO)	Neutral
Sempra Energy (SRE)	Neutral
Xcel Energy Inc. (XEL)	Neutral

Industry Comparison Industry: Utility - Electric Power				Industry Peers		
	AEP Neutral	X Industry	S&P 500	DUK Neutral	PEG Neutral	XEL Neutral
<b>VGM Score</b>	<b>C</b>	-	-	<b>C</b>	<b>C</b>	<b>B</b>
Market Cap	46.16 B	9.29 B	23.76 B	65.86 B	29.69 B	32.71 B
# of Analysts	6	2	13	6	4	6
Dividend Yield	3.00%	2.81%	1.78%	4.18%	3.20%	2.60%
<b>Value Score</b>	<b>C</b>	-	-	<b>C</b>	<b>C</b>	<b>C</b>
Cash/Price	0.01	0.04	0.04	0.01	0.00	0.03
EV/EBITDA	13.22	11.30	13.97	12.54	11.74	12.41
PEG Ratio	3.76	3.67	2.02	3.65	4.72	4.13
Price/Book (P/B)	2.31	1.76	3.38	1.45	1.99	2.49
Price/Cash Flow (P/CF)	10.61	9.08	13.70	8.02	9.81	10.54
P/E (F1)	21.24	19.60	18.83	17.68	17.41	22.39
Price/Sales (P/S)	2.93	2.22	2.68	2.62	2.95	2.82
Earnings Yield	4.71%	5.08%	5.30%	5.66%	5.74%	4.47%
Debt/Equity	1.27	1.06	0.72	1.24	0.99	1.28
Cash Flow (\$/share)	8.81	4.03	6.94	11.27	5.98	5.92
<b>Growth Score</b>	<b>C</b>	-	-	<b>C</b>	<b>D</b>	<b>C</b>
Hist. EPS Growth (3-5 yrs)	3.65%	4.40%	10.56%	1.57%	3.00%	5.63%
Proj. EPS Growth (F1/F0)	5.38%	5.68%	7.41%	1.79%	4.09%	6.57%
Curr. Cash Flow Growth	10.45%	7.23%	14.83%	10.90%	-19.92%	9.42%
Hist. Cash Flow Growth (3-5 yrs)	4.93%	4.95%	9.00%	4.96%	2.45%	8.08%
Current Ratio	0.48	0.81	1.23	0.72	0.75	0.72
Debt/Capital	55.97%	51.35%	42.92%	54.28%	49.66%	56.14%
Net Margin	13.52%	9.70%	11.08%	14.10%	14.45%	11.15%
Return on Equity	11.09%	9.47%	17.10%	8.24%	11.01%	10.35%
Sales/Assets	0.22	0.24	0.55	0.17	0.22	0.24
Proj. Sales Growth (F1/F0)	5.36%	3.15%	4.20%	2.80%	-0.27%	6.22%
<b>Momentum Score</b>	<b>B</b>	-	-	<b>D</b>	<b>B</b>	<b>A</b>
Daily Price Chg	-1.11%	-0.60%	0.33%	-0.95%	-0.58%	-1.75%
1 Week Price Chg	-0.75%	-0.15%	0.13%	0.39%	-0.15%	-1.61%
4 Week Price Chg	1.08%	1.97%	3.31%	1.18%	-0.05%	0.39%
12 Week Price Chg	0.92%	0.26%	9.70%	-6.18%	-4.55%	-2.46%
52 Week Price Chg	28.43%	19.41%	30.28%	6.70%	15.52%	29.88%
20 Day Average Volume	1,791,685	262,578	1,603,615	3,423,481	2,737,992	2,518,952
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	-0.16%	0.00%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	0.00%	-0.16%	0.22%	0.00%
(F1) EPS Est 12 week change	-0.09%	-0.12%	-0.57%	-0.52%	-0.59%	-0.12%
(Q1) EPS Est Mthly Chg	0.41%	0.00%	0.00%	0.00%	2.88%	0.00%

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## Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

### Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

### Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

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### Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	C
Growth Score	C
Momentum Score	B
VGM Score	C

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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