American Electric Power (AEP)

Updated March 24th, 2020 by Samuel Smith

Key Metrics

Current Price:	$70	**5 Year CAGR Estimate:**	8.4%	**Market Cap:**	$35.4B
Fair Value Price:	$71	**5 Year Growth Estimate:**	4.5%	**Ex-Dividend Date:**	5/7/20[1]
% Fair Value:	98%	**5 Year Valuation Multiple Estimate:**	0.4%	**Dividend Payment Date:**	6/10/20[2]
Dividend Yield:	4.0%	**5 Year Price Target**	$89	**Years Of Dividend Growth:**	10
Dividend Risk Score:	D	**Retirement Suitability Score:**	F	**Last Dividend Increase:**	4.5%

Overview & Current Events

American Electric Power (AEP) was founded in 1906, and has evolved its business model along with changing technologies in order to offer customers safe, reliable, and affordable energy. It is one of the largest regulated utilities in the United States and offers electricity generation, transmission, and distribution services in 11 states.

Its energy sources are coal, natural gas, renewables, nuclear, and demand response. Its income sources are integrated utilities, transmission and distribution, competitive transmission, and unregulated generation and marketing. AEP's sound business model has enabled it to outperform the broader stock market, as well as the utility sector, by a significant margin over the past five years while also sustaining or raising its dividend every year for the past 16 years.

AEP recently reported (2/20/2020) Q4 results. Revenue declined by 5% to $3.6 billion while unadjusted Q4 profit fell by over 50% year-over-year to $153.3 million due to expensing coal generation assets, a court case settlement, and an impairment of a plant in Conesville. Even on an adjusted basis, the company expects that results will improve in 2020 due to several new industrial expansions coming online.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$2.53	$4.02	$2.60	$3.04	$3.34	$4.17	$1.24	$3.88	$3.97	$4.19	***$4.19***	***$5.23***
DPS	$1.71	$1.85	$1.88	$1.95	$2.03	$2.15	$2.27	$2.39	$2.48	$2.74	***$2.78***	***$3.42***
Shares[3]	480	482	485	487	489	491	492	493	493	493	***493***	***497***

One of AEP's major growth drivers moving forward will be its ambitious plans for its renewable power business, as it plans to install 3.9 GW of solar and 4.4 GW of wind power by 2030. A significant sign of its intent to become a major player in the renewable space was its recent acquisition of Sempra Energy's renewable business, which includes joint ownership of 7 wind farms and 1 battery installation. This deal, combined with the Santa Rita wind project in Texas, will nearly quadruple AEP's renewable portfolio from its current size, with plans to grow it by another four times of its pro-rata size (nearly 16 times its current size) by 2030. The other major growth driver for the company will be its transmission business. Given its large footprint and execution experience, AEP should be well positioned to capitalize on the aging infrastructure in this space and grow considerably.

Management is guiding for a long-term growth rate target of 5%-7% and just raised its dividend by 4.5%, projecting its confidence in executing on its growth initiatives. While its renewables and transmission programs do seem ambitious, the company's low ROIC has led to a 10-year earnings-per-share compound annual growth rate of only ~3.5%. As a result, we will assume that AEP will hit the rate of its dividend-per-share growth target range at a 4.5% CAGR until 2025. Since the current dividend payout ratio is in the company's long-term payout ratio target range, we assume the dividend will continue to grow at the same pace as well. For 2020, we expect flattish performance year-over-year due to some light disruption from the coronavirus outbreak.

---

[1] Estimate

[2] Estimate

[3] In millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

American Electric Power (AEP)

Updated March 24th, 2020 by Samuel Smith

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	14.2	11	16.4	19.6	16.6	16.2	70	19.2	18.8	21.6	***16.7***	***17.0***
Avg. Yld.	4.3%	4.1%	4.1%	3.7%	3.3%	3.1%	3.1%	2.9%	3.1%	3.0%	***4.0%***	***3.9%***

Given the choppiness of AEP's earnings, and in particular, the abnormal results in 2016, the ten-year average price-to-earnings ratio is not necessarily a good indicator of fair value for this company. However, other than the 2016 outlier, we can see that its current multiple is right in the middle of its historical valuation range, which is somewhat justified given that current economic turmoil is offset by its fairly strong growth pipeline and record low interest rates. Therefore, we view shares as fairly valued at present.

Safety, Quality, Competitive Advantage, & Recession Resiliency

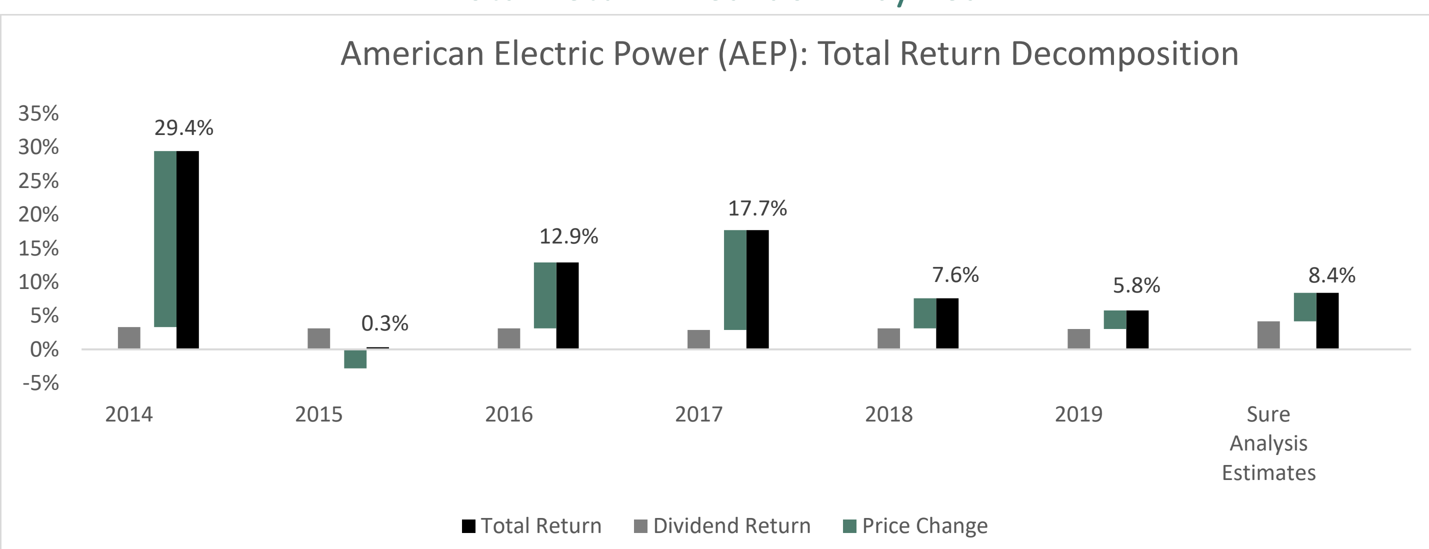
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	55.2%	67.6%	48.9%	72.3%	80.7%	54.6%	58.9%	248.9%	61.6%	65.4%	***66.3%***	***65.4%***

AEP benefits from government-granted exclusive rights and rates that give them service-territory monopolies. AEP also benefits from large scale, which increases its efficiency as its network grows larger. The main risks and catalysts for AEP involve weather, the timeliness and outcomes of regulatory rate decisions, and development execution uncertainty. The good news is that AEP has diversification across 11 states, somewhat mitigating its weather and regulatory risks. Additionally, its aggressive expansion into green energy projects helps offset some of the potential regulatory risks to its traditional energy businesses, such as coal. Another positive is that the business is quite recession resistant. While revenues and profits dipped from 2008-2009, the dividend was maintained comfortably, and the company's results rebounded strongly in 2010. The balance sheet may not look pretty based on traditional metrics, but the steady cash flow of the business is such that it is quite resilient.

Final Thoughts & Recommendation

AEP is a solid dividend growth stock with a recession-resistant business model. It can serve as a nice portfolio diversifier, especially for those trying to be more defensive with all the uncertainty from the coronavirus. Given its 4.0% dividend yield and 4.5% expected annual earnings-per-share growth rate, the stock should produce 8.4% annualized total returns over the next decade. As a result, we think it is fairly valued, making it a hold.

Total Return Breakdown by Year



Click here to rate and review this research report. Your feedback is important to us.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

American Electric Power (AEP)

Updated March 24th, 2020 by Samuel Smith

Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	13489	14427	15116	14945	14814	16379	16453	16380	15425	15,561
Gross Profit	8958	5124	5400	5588	5643	5926	6316	6455	6488	6,498
Gross Margin	66.4%	35.5%	35.7%	37.4%	38.1%	36.2%	38.4%	39.4%	42.1%	41.8%
SG&A Exp.										
D&A Exp.	1,780	1,792	1,918	1,843	2,042	2,155	2,091	2,126	2,400	2,740
Operating Profit	2,663	2,921	2,956	3,049	3,127	3,334	3,432	3,386	2,753	2,749
Operating Margin	18.5%	19.3%	19.8%	20.6%	19.1%	20.3%	21.0%	21.9%	17.0%	17.7%
Net Profit	1,214	1,946	1,259	1,481	1,634	2,047	611	1,913	1,924	1,921
Net Margin	8.4%	12.9%	8.4%	10.0%	10.0%	12.4%	3.7%	12.4%	11.9%	12.3%
Free Cash Flow	226	1,013	672	336	367	219	(390)	(1,529)	(1,134)	(1,874)
Income Tax	643	818	604	678	903	920	(74)	970	115	(13)

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	48348	50455	52223	54367	56414	59545	61683	63468	64729	75892
Cash & Equivalents	490	294	221	279	118	163	176	211	215	247
Accounts Receivable	584	1769	1728	1676	1703	1689	1609	1758	1661	625
Inventories	1661	1448	1292	1519	1423	1317	1339	967	953	1,169
Goodwill & Int. Ass.	76	76	76	91	91	53	53	53	53	53
Total Liabilities	35208	36833	37558	39130	40328	42720	43778	46048	46416	55979
Accounts Payable	1158	1061	1095	1169	1266	1258	1418	1689	2065	2,086
Long-Term Debt	17624	18157	18166	18738	19134	19858	20373	21969	22812	29564
Shareholder's Equity	13140	13622	14664	15237	16085	16820	17892	17397	18287	19632
D/E Ratio	1.34	1.33	1.24	1.23	1.19	1.18	1.14	1.26	1.25	1.51

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	2.9%	2.5%	3.8%	2.4%	2.7%	2.8%	3.4%	1.0%	3.0%	2.7%
Return on Equity	11.4%	9.1%	13.8%	8.4%	9.5%	9.9%	11.8%	3.5%	10.7%	9.9%
ROIC	4.6%	3.9%	6.0%	3.8%	4.3%	4.5%	5.5%	1.6%	4.8%	4.1%
Shares Out.	480	482	485	487	489	491	492	493	493	493
Revenue/Share	29.39	30.08	31.33	30.81	30.42	33.50	33.54	33.32	31.31	31.42
FCF/Share	-1.06	0.47	2.10	1.39	0.69	0.75	0.45	-0.79	-3.10	(3.78)

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.