



American Electric Power (AEP)

Updated November 3rd, 2021 by Samuel Smith

Key Metrics

Current Price:	\$84.7	5 Year CAGR Estimate:	6.8%	Market Cap:	\$42.7B
Fair Value Price:	\$79.6	5 Year Growth Estimate:	4.9%	Ex-Dividend Date:	11/9/21
% Fair Value:	106%	5 Year Valuation Multiple Estimate:	-1.2%	Dividend Payment Date:	12/10/21
Dividend Yield:	3.7%	5 Year Price Target	\$101	Years Of Dividend Growth:	16
Dividend Risk Score:	C	Retirement Suitability Score:	B	Last Dividend Increase:	5.7%

Overview & Current Events

American Electric Power was founded in 1906 and has evolved its business model along with changing technologies 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 perform very well in recent years while also sustaining or raising its dividend every year for 16 years.

AEP recently reported (10/28/2021) Q3 results. GAAP earnings per share came in at \$1.59, up from \$1.51 in the year-ago quarter. Operating earnings per share came in at \$1.43, down from \$1.47 in the year-ago quarter. Meanwhile, the company changed its 2021 operating earnings guidance range to between \$4.65 to \$4.75, and GAAP basis earnings of \$4.79 to \$4.89 per share.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	\$4.02	\$2.60	\$3.04	\$3.34	\$4.17	\$1.24	\$3.88	\$3.97	\$4.19	\$4.44	\$4.68	\$5.95
DPS	\$1.85	\$1.88	\$1.95	\$2.03	\$2.15	\$2.27	\$2.39	\$2.48	\$2.74	\$2.84	\$3.12	\$3.42
Shares¹	483.0	485.7	487.8	489.4	491.1	491.7	492.0	493.2	494.2	496.6	500.3	500

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 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 raised its dividend by over 5% last year, 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 in the low single digits. 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. For the next half decade, we expect ~2% annualized growth.

¹ 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.



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Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Avg. P/E	9.5	18.1	15.3	18.1	14.8	50.0	17.9	18.6	20.5	19.6	18.1	17.0
Avg. Yld.	4.8%	4.0%	4.2%	3.4%	3.5%	3.7%	3.4%	3.4%	3.2%	3.3%	3.7%	3.4%

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 on the high end of its historical valuation range. Therefore, we view shares as slightly overvalued at present and expect the company to face multiple contraction headwinds moving forward.

Safety, Quality, Competitive Advantage, & Recession Resiliency

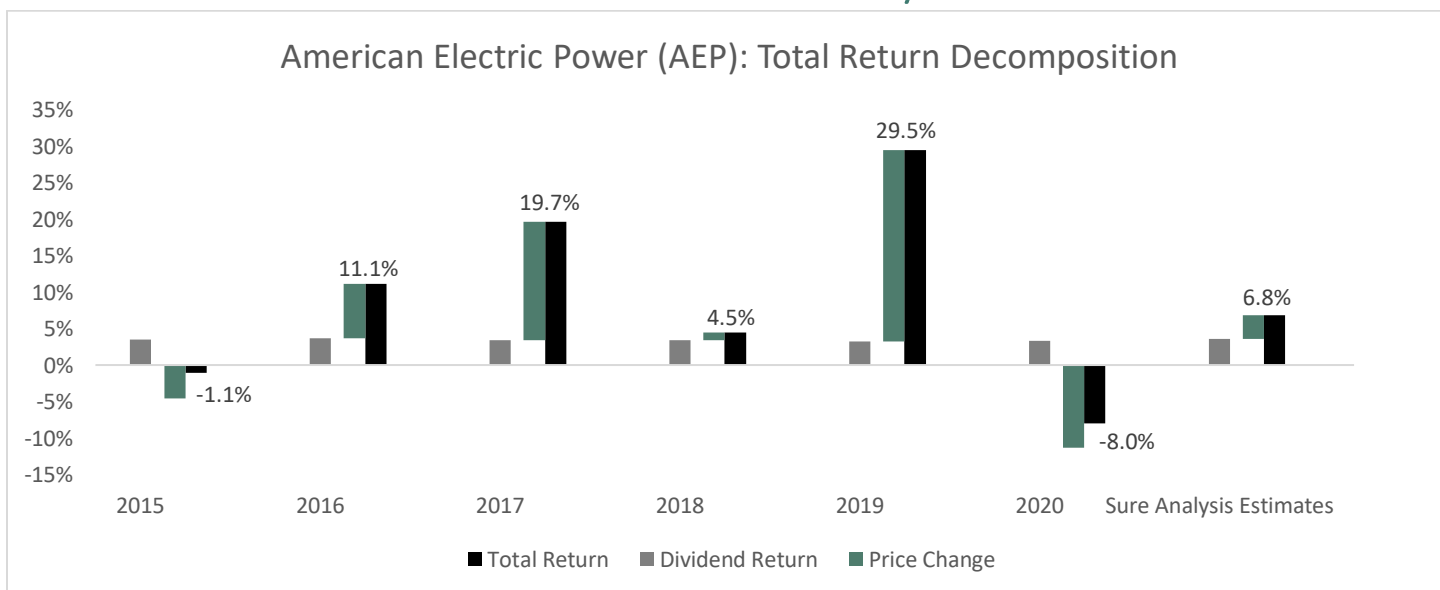
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	46%	72%	64%	61%	52%	183%	62%	62%	65%	64%	67%	57%

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 numerous 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 actually 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. Given its 3.7% dividend yield and 4.9% expected annual earnings-per-share growth rate, the stock should produce 6.8% annualized total returns over the next half decade. As a result, we think it is reasonably priced, making it a Hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	15116	14945	14814	16379	16453	16380	15425	16196	15561	14919
Gross Profit	5,400	5,588	5,643	5,926	6,316	6,412	6,442	6,183	6,498	6,966
Gross Margin	35.7%	37.4%	38.1%	36.2%	38.4%	39.1%	41.8%	38.2%	41.8%	46.7%
SG&A Exp.										
D&A Exp.	1,792	1,918	1,843	2,042	2,155	2,091	2,126	2,400	2,740	2,907
Operating Profit	2,921	2,956	3,049	3,127	3,334	3,432	3,386	2,753	2,749	2,988
Operating Margin	19.3%	19.8%	20.6%	19.1%	20.3%	21.0%	21.9%	17.0%	17.7%	20.0%
Net Profit	1,946	1,259	1,481	1,634	2,047	611	1,913	1,924	1,921	2,200
Net Margin	12.9%	8.4%	10.0%	10.0%	12.4%	3.7%	12.4%	11.9%	12.3%	14.7%
Free Cash Flow	1,013	672	336	367	219	(390)	-1529	(1,134)	(1,874)	(2,483)
Income Tax	818	604	678	903	920	(74)	970	115	(13)	41

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	52223	54367	56414	59545	61683	63468	64729	68803	75892	80757
Cash & Equivalents	221	279	118	163	176	211	215	234	247	393
Accounts Receivable	690	685	746	637	616	705	644	699	625	614
Inventories	1292	1519	1423	1317	1339	967	953	921	1169	1310
Goodwill & Int. Ass.	76	91	91	53	53	53	53	53	53	53
Total Liabilities	37558	39130	40328	42720	43778	46048	46416	49743	55979	59983
Accounts Payable	1095	1169	1266	1258	1418	1689	2065	1874	2086	1710
Long-Term Debt	18166	18738	19134	19858	20373	21969	22812	25257	29564	33552
Shareholder's Equity	14664	15237	16085	16820	17892	17397	18287	19028	19632	20551
D/E Ratio	1.24	1.23	1.19	1.18	1.14	1.26	1.25	1.33	1.51	1.63

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	3.8%	2.4%	2.7%	2.8%	3.4%	1.0%	3.0%	2.9%	2.7%	2.8%
Return on Equity	13.8%	8.4%	9.5%	9.9%	11.8%	3.5%	10.7%	10.3%	9.9%	11.0%
ROIC	6.0%	3.8%	4.3%	4.5%	5.5%	1.6%	4.8%	4.5%	4.1%	4.2%
Shares Out.	482	485	487	489	491	492	493	493	495	497
Revenue/Share	31.33	30.81	30.42	33.50	33.54	33.32	31.31	32.80	31.42	30.00
FCF/Share	2.10	1.39	0.69	0.75	0.45	(0.79)	(3.10)	(2.30)	(3.78)	(4.99)

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

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