American Electric Power (AEP)

Updated November 7th, 2022 by Samuel Smith

Key Metrics

Current Price:	$88.0	**5 Year CAGR Estimate:**	7.6%	**Market Cap:**	$45 B
Fair Value Price:	$85.3	**5 Year Growth Estimate:**	4.9%	**Ex-Dividend Date:**	11/9/22
% Fair Value:	103%	**5 Year Valuation Multiple Estimate:**	-0.6%	**Dividend Payment Date:**	12/9/22
Dividend Yield:	3.8%	**5 Year Price Target**	$109	**Years Of Dividend Growth:**	18
Dividend Risk Score:	B	**Retirement Suitability Score:**	B	**Rating:**	Hold

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.

On October 27th, American Electric Power reported Q3 results. Non-GAAP EPS of $1.62 beat analyst consensus estimates by $0.06. Revenue of $5.5B (+19.6% Y/Y) beat analyst consensus estimates by $750M. The Company reaffirmed narrowed 2022 operating earnings (non-GAAP) guidance range of $4.97 to $5.07 vs consensus of $5.01, raised its midpoint of $5.02, and estimates 6% to 7% long-term growth rate. The company's $40 billion, five-year capex plan focuses on robust pipeline of wires investments and renewable generation to drive the clean energy transition.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	$2.60	$3.04	$3.34	$4.17	$1.24	$3.88	$3.97	$4.19	$4.44	$4.74	***$5.02***	***$6.39***
DPS	$1.88	$1.95	$2.03	$2.15	$2.27	$2.39	$2.48	$2.74	$2.84	$3.00	***$3.32***	***$3.86***
Shares[1]	485.7	487.8	489.4	491.1	491.7	492.0	493.2	494.2	496.6	503.7	***513.9***	***510.0***

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 4.9% annualized growth.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Avg. P/E	18.1	15.3	18.1	14.8	50	17.9	18.6	20.5	19.6	18.1	***17.5***	***17.0***
Avg. Yld.	4.0%	4.2%	3.4%	3.5%	3.7%	3.4%	3.4%	3.2%	3.3%	3.7%	***3.8%***	***3.6%***

[1] In millions

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

Safety, Quality, Competitive Advantage, & Recession Resiliency

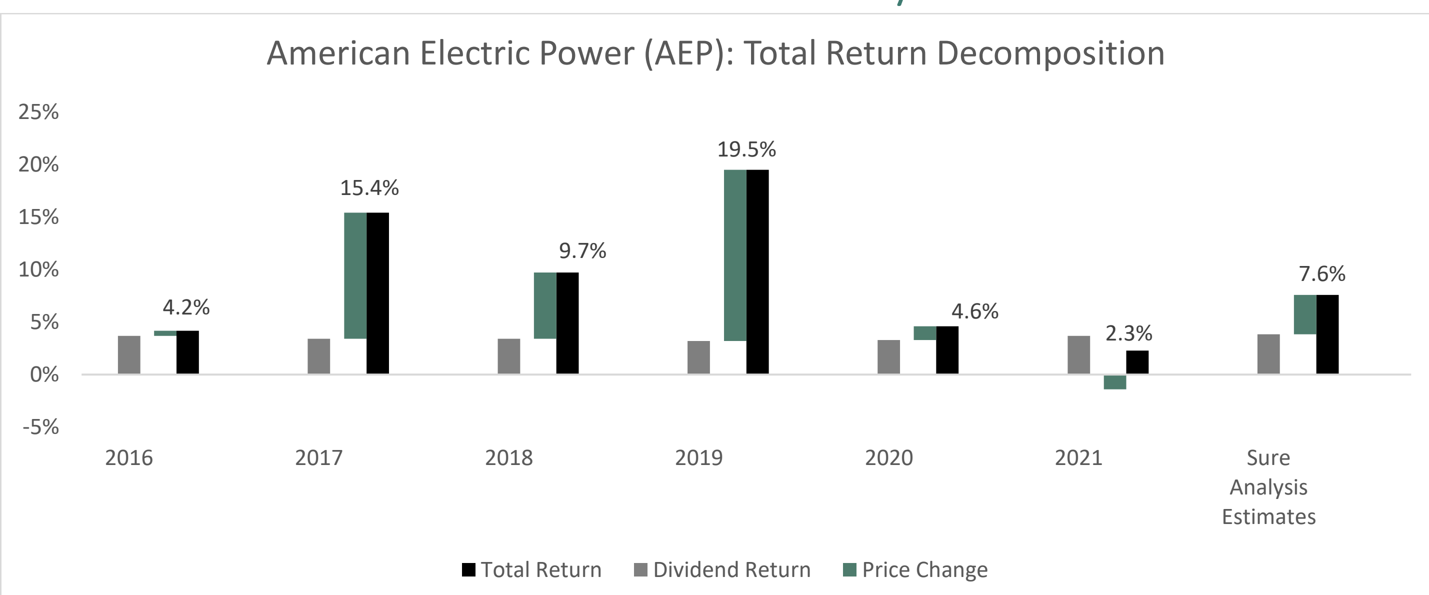
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	72%	64%	61%	52%	183%	62%	62%	65%	64%	63%	***66%***	***60%***

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 3.8% dividend yield and 4.9% expected annualized earnings-per-share growth rate offset partially by expected multiple contraction headwinds, the stock should produce 7.6% annualized total returns over the next half decade. As a result, we rate it a Hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	14,945	14,814	16,379	16,453	16,380	15,425	16,196	15,561	14,919	16,792
Gross Profit	8,550	8,091	8,693	9,020	9,408	8,968	9,162	9,241	9,538	10,204
Gross Margin	57.2%	54.6%	53.1%	54.8%	57.4%	58.1%	56.6%	59.4%	63.9%	60.8%
D&A Exp.	1,918	1,843	2,042	2,155	2,091	2,126	2,400	2,740	2,907	3,046
Operating Profit	2,956	3,049	3,127	3,334	3,432	3,386	2,753	2,749	2,988	3,423
Operating Margin	19.8%	20.6%	19.1%	20.3%	21.0%	21.9%	17.0%	17.7%	20.0%	20.4%
Net Profit	1,259	1,481	1,634	2,047	611	1,913	1,924	1,921	2,200	2,488
Net Margin	8.4%	10.0%	10.0%	12.4%	3.7%	12.4%	11.9%	12.3%	14.7%	14.8%
Free Cash Flow	672	336	367	219	(390)	(1,529)	(1,134)	(1,874)	(2,483)	(1,924)
Income Tax	604	678	903	920	(74)	970	115	(13)	41	116

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	54,367	56,414	59,545	61,683	63,468	64,729	68,803	75,892	80,757	87,669
Cash & Equivalents	279	118	163	176	211	215	234	247	393	403
Accounts Receivable	685	746	637	616	705	644	699	625	614	721
Inventories	1,519	1,423	1,317	1,339	967	953	921	1,169	1,310	989
Goodwill & Int. Ass.	91	91	53	53	53	53	53	53	53	53
Total Liabilities	39,130	40,328	42,720	43,778	46,048	46,416	49,743	55,979	59,983	64,989
Accounts Payable	1,169	1,266	1,258	1,418	1,689	2,065	1,874	2,086	1,710	2,055
Long-Term Debt	18,738	19,134	19,858	20,373	21,969	22,812	25,257	29,564	33,552	36,069
Shareholder's Equity	15,237	16,085	16,820	17,892	17,397	18,287	19,028	19,632	20,551	22,433
LTD/E Ratio	1.23	1.19	1.18	1.14	1.26	1.25	1.33	1.51	1.63	1.61

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	2.4%	2.7%	2.8%	3.4%	1.0%	3.0%	2.9%	2.7%	2.8%	3.0%
Return on Equity	8.4%	9.5%	9.9%	11.8%	3.5%	10.7%	10.3%	9.9%	11.0%	11.6%
ROIC	3.8%	4.3%	4.5%	5.5%	1.6%	4.8%	4.5%	4.1%	4.2%	4.4%
Shares Out.	485.7	487.8	489.4	491.1	491.7	492.0	493.2	494.2	496.6	503.7
Revenue/Share	30.81	30.42	33.50	33.54	33.32	31.31	32.80	31.42	30.00	33.46
FCF/Share	1.39	0.69	0.75	0.45	(0.79)	(3.10)	(2.30)	(3.78)	(4.99)	(3.83)

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