American Electric Power (AEP)

Updated November 13th, 2023 by Samuel Smith

Key Metrics

Current Price:	$75.0	**5 Year CAGR Estimate:**	10.7%	**Market Cap:**	$41 B
Fair Value Price:	$79.2	**5 Year Growth Estimate:**	5.8%	**Ex-Dividend Date:**	2/9/24[1]
% Fair Value:	95%	**5 Year Valuation Multiple Estimate:**	1.1%	**Dividend Payment Date:**	3/8/24[2]
Dividend Yield:	4.7%	**5 Year Price Target**	$105	**Years Of Dividend Growth:**	18
Dividend Risk Score:	B	**Retirement Suitability Score:**	B	**Rating:**	Buy

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 November 2, 2023, American Electric Power (AEP) reported its third-quarter earnings for 2023. The company announced GAAP earnings of $954 million, or $1.83 per share, compared to $684 million, or $1.33 per share in the third quarter of 2022. Operating earnings for the third quarter of 2023 were $924 million or $1.77 per share, an increase from $831 million or $1.62 per share in the same period last year. AEP's CEO, Julie Sloat, attributed the earnings growth to the company's long-term strategy of investing in a modern, reliable energy system that meets customer needs while maintaining affordable electricity rates. This achievement was realized despite challenges such as high interest rates, inflation, and unfavorable weather conditions.

The company also reported a significant increase in commercial load, which rose by 7.5% year over year. This growth was driven by AEP's focus on economic development in the communities it serves. Additionally, AEP added nearly 30,000 new residential customers over the year, helping to offset lower average usage in the residential segment. Despite a softening in industrial load due to higher interest rates, AEP expects overall retail load to grow in 2024. Furthermore, AEP narrowed its 2023 operating earnings guidance range to $5.24 to $5.34 per share, maintaining the midpoint at $5.29. The company also reaffirmed its long-term growth rate of 6% to 7% and a Funds From Operations (FFO)/Debt target of 14% to 15%.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	$3.04	$3.34	$4.17	$1.24	$3.88	$3.97	$4.19	$4.44	$4.74	$5.09	***$5.28***	***$7.00***
DPS	$1.95	$2.03	$2.15	$2.27	$2.39	$2.48	$2.74	$2.84	$3.00	$3.17	***$3.52***	***$4.15***
Shares[3]	487.8	489.4	491.1	491.7	492.0	493.2	494.2	496.6	504.2	513.9	***525.9***	***520.0***

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.

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[1] Estimated

[2] Estimated

[3] In millions

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Management is guiding for a long-term growth rate target of 5%-7%, 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 5.8% annualized growth.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Avg. P/E	15.3	18.1	14.8	50	17.9	18.6	20.5	19.6	18.1	17.5	***14.2***	***15.0***
Avg. Yld.	4.2%	3.4%	3.5%	3.7%	3.4%	3.4%	3.2%	3.3%	3.5%	3.6%	***4.7%***	***4.0%***

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 low end of its historical valuation range. Therefore, we view shares as slightly undervalued at present.

Safety, Quality, Competitive Advantage, & Recession Resiliency

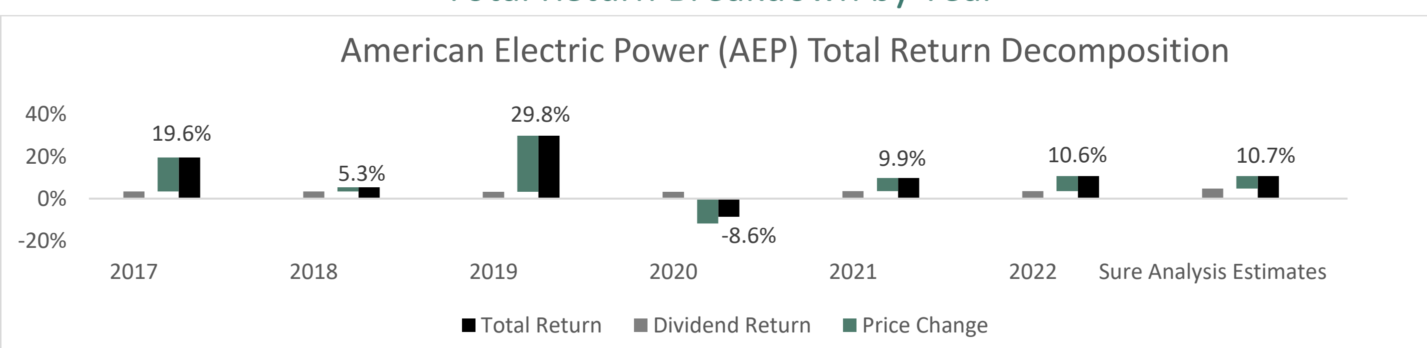
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	64%	61%	52%	183%	62%	62%	65%	64%	63%	62%	***67%***	***59%***

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 4.7% dividend yield and 5.8% expected annualized earnings-per-share growth rate along with slight expected multiple expansion tailwinds, the stock should produce 10.7% annualized total returns over the next half decade. As a result, we rate it a Buy.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	14,814	16,379	16,453	16,380	15,425	16,196	15,561	14,919	16,792	19,640
Gross Profit	8,091	8,693	9,020	9,408	8,968	9,162	9,241	9,538	10,204	11,292
Gross Margin	54.6%	53.1%	54.8%	57.4%	58.1%	56.6%	59.4%	63.9%	60.8%	57.5%
D&A Exp.	1,843	2,042	2,155	2,091	2,126	2,400	2,740	2,907	3,046	3,286
Operating Profit	3,049	3,127	3,334	3,432	3,386	2,753	2,749	2,988	3,423	3,779
Operating Margin	20.6%	19.1%	20.3%	21.0%	21.9%	17.0%	17.7%	20.0%	20.4%	19.2%
Net Profit	1,481	1,634	2,047	611	1,913	1,924	1,921	2,200	2,488	2,307
Net Margin	10.0%	10.0%	12.4%	3.7%	12.4%	11.9%	12.3%	14.7%	14.8%	11.7%
Free Cash Flow	336	367	219	(390)	(1,529)	(1,134)	(1,874)	(2,483)	(1,924)	(1,484)
Income Tax	678	903	920	(74)	970	115	(13)	41	116	5

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	56,414	59,545	61,683	63,468	64,729	68,803	75,892	80,757	87,669	93,469
Cash & Equivalents	118	163	176	211	215	234	247	393	403	509
Accounts Receivable	746	637	616	705	644	699	625	614	721	1,082
Inventories	1,423	1,317	1,339	967	953	921	1,169	1,310	989	1,302
Goodwill & Int. Ass.	91	53	53	53	53	53	53	53	53	53
Total Liabilities	40,328	42,720	43,778	46,048	46,416	49,743	55,979	59,983	64,989	69,347
Accounts Payable	1,266	1,258	1,418	1,689	2,065	1,874	2,086	1,710	2,055	2,613
Long-Term Debt	19,134	19,858	20,373	21,969	22,812	25,257	29,564	33,552	36,069	39,735
Shareholder's Equity	16,085	16,820	17,892	17,397	18,287	19,028	19,632	20,551	22,433	23,893
LTD/E Ratio	1.19	1.18	1.14	1.26	1.25	1.33	1.51	1.63	1.61	1.66

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	2.7%	2.8%	3.4%	1.0%	3.0%	2.9%	2.7%	2.8%	3.0%	2.5%
Return on Equity	9.5%	9.9%	11.8%	3.5%	10.7%	10.3%	9.9%	11.0%	11.6%	10.0%
ROIC	4.3%	4.5%	5.5%	1.6%	4.8%	4.5%	4.1%	4.2%	4.4%	3.8%
Shares Out.	487.8	489.4	491.1	491.7	492.0	493.2	494.2	496.6	503.7	513.9
Revenue/Share	30.42	33.50	33.54	33.32	31.31	32.80	31.42	30.00	33.46	38.25
FCF/Share	0.69	0.75	0.45	(0.79)	(3.10)	(2.30)	(3.78)	(4.99)	(3.83)	(2.89)

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

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