American Electric Power (AEP)

Updated August 20th, 2024 by Samuel Smith

Key Metrics

Current Price:	$98.1	**5 Year CAGR Estimate:**	5.8%	**Market Cap:**	$52 B
Fair Value Price:	$83.9	**5 Year Growth Estimate:**	5.5%	**Ex-Dividend Date:**	11/9/24[1]
% Fair Value:	117%	**5 Year Valuation Multiple Estimate:**	-3.1%	**Dividend Payment Date:**	12/8/24[2]
Dividend Yield:	3.6%	**5 Year Price Target**	$110	**Years Of Dividend Growth:**	19
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.

In the second quarter of 2024, American Electric Power (AEP) reported GAAP earnings of $0.64 per share and operating earnings of $1.25 per share. The company reaffirmed its 2024 operating earnings guidance of $5.53 to $5.73 per share and a long-term growth rate of 6% to 7%. Revenue for the quarter was $4.6 billion, an increase from $4.4 billion in the same period last year. GAAP earnings were $340.3 million, down from $521.2 million in the second quarter of 2023, while operating earnings were $662 million, up from $582.2 million the previous year. The difference between GAAP and operating earnings was primarily due to a revenue refund provision associated with the Turk Plant, impacts of the EPA's revised Coal Combustion Residuals Rule, and severance expenses related to AEP's workforce reduction. AEP reported strong commercial customer class growth, particularly in data processing load, positioning the company for further growth supported by its industry-leading transmission system. Commercial load increased by 12.4% over the same quarter last year, with significant gains at Transmission & Distribution companies. The company has commitments for over 15 gigawatts of incremental load by the end of the decade, driven by strong interest from customers in Ohio and Texas, and other vertically integrated states for new data processing facilities. AEP continues to progress on transforming its generation fleet with plans to add over 20 gigawatts of new resources over the next decade. The company announced plans to seek regulatory approval for purchasing the 795-megawatt Green Country natural gas generation facility, which will serve as a reliable and affordable local energy resource for customers.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	$3.34	$4.17	$1.24	$3.88	$3.97	$4.19	$4.44	$4.74	$5.09	$5.25	***$5.59***	***$7.30***
DPS	$2.03	$2.15	$2.27	$2.39	$2.48	$2.74	$2.84	$3.00	$3.17	$3.37	***$3.52***	***$4.55***
Shares[3]	489.4	491.1	491.7	492.0	493.2	494.2	496.6	504.2	513.9	526.2	***532.1***	***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 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

[1] Estimated
[2] Estimated
[3] In millions

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and grow considerably. 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 5.5% annualized growth.

Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Avg. P/E	18.1	14.8	50	17.9	18.6	20.5	19.6	18.1	17.5	14.2	***17.5***	***15.0***
Avg. Yld.	3.40%	3.50%	3.70%	3.40%	3.40%	3.20%	3.30%	3.50%	3.60%	4.70%	***3.6%***	***4.2%***

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. Given that interest rates are elevated right now, we view it as trading above fair value right now.

Safety, Quality, Competitive Advantage, & Recession Resiliency

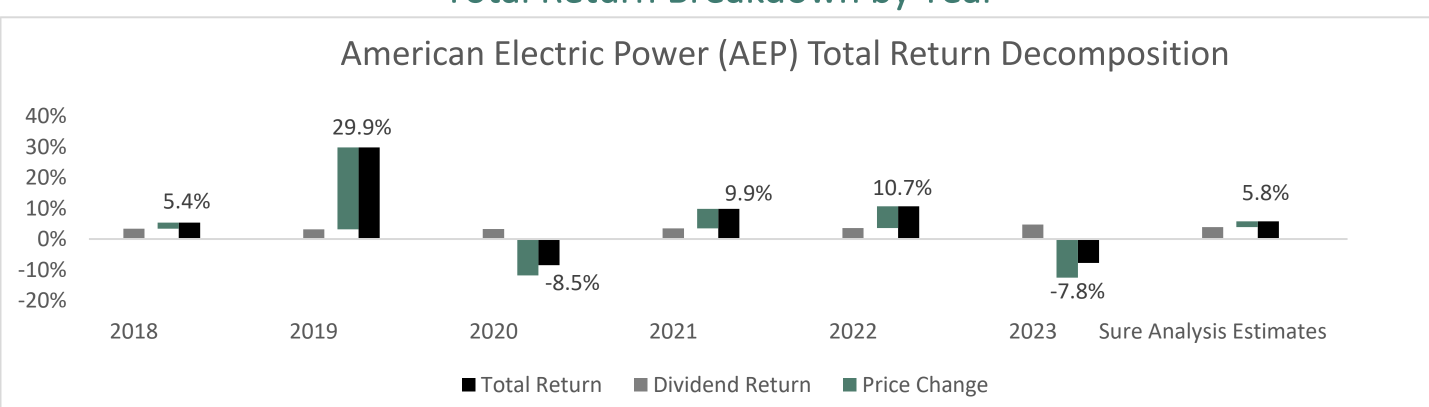
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	61%	52%	183%	62%	62%	65%	64%	63%	62%	64%	***63%***	***62%***

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 3.6% dividend yield and 5.5% expected annualized earnings-per-share growth rate, the stock should produce 5.8% 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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	16,379	16,453	16,380	15,425	16,196	15,561	14,919	16,792	19,640	18,982
Gross Profit	8,693	9,020	9,408	8,968	9,162	9,241	9,538	10,204	11,292	11,128
Gross Margin	53.1%	54.8%	57.4%	58.1%	56.6%	59.4%	63.9%	60.8%	57.5%	58.6%
D&A Exp.	2,042	2,155	2,091	2,126	2,400	2,740	2,907	3,046	3,286	3,187
Operating Profit	3,127	3,334	3,432	3,386	2,753	2,749	2,988	3,423	3,779	3,642
Operating Margin	19.1%	20.3%	21.0%	21.9%	17.0%	17.7%	20.0%	20.4%	19.2%	19.2%
Net Profit	1,634	2,047	611	1,913	1,924	1,921	2,200	2,488	2,307	2,208
Net Margin	10.0%	12.4%	3.7%	12.4%	11.9%	12.3%	14.7%	14.8%	11.7%	11.6%
Free Cash Flow	367	219	(390)	(1,529)	(1,134)	(1,874)	(2,483)	(1,924)	(1,484)	(2,494)
Income Tax	903	920	(74)	970	115	(13)	41	116	5	55

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	59,545	61,683	63,468	64,729	68,803	75,892	80,757	87,669	93,403	96,684
Cash & Equivalents	163	176	211	215	234	247	393	403	509	330
Accounts Receivable	637	616	705	644	699	625	614	721	1,145	1,030
Inventories	1,317	1,339	967	953	921	1,169	1,310	989	1,350	1,880
Goodwill & Int. Ass.	53	53	53	53	53	53	53	53	53	53
Total Liabilities	42,720	43,778	46,048	46,416	49,743	55,979	59,983	64,989	69,281	71,398
Accounts Payable	1,258	1,418	1,689	2,065	1,874	2,086	1,710	2,055	2,671	2,033
Long-Term Debt	19,858	20,373	21,969	22,812	25,257	29,564	33,552	36,069	40,913	42,973
Shareholder's Equity	16,820	17,892	17,397	18,287	19,028	19,632	20,551	22,433	23,893	25,247
LTD/E Ratio	1.18	1.14	1.26	1.25	1.33	1.51	1.63	1.61	1.71	1.70

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	2.8%	3.4%	1.0%	3.0%	2.9%	2.7%	2.8%	3.0%	2.5%	2.3%
Return on Equity	9.9%	11.8%	3.5%	10.7%	10.3%	9.9%	10.8%	11.5%	9.9%	8.9%
ROIC	4.5%	5.5%	1.6%	4.8%	4.5%	4.1%	4.2%	4.4%	3.7%	3.3%
Shares Out.	489.4	491.1	491.7	492.0	493.2	494.2	496.6	504.2	513.9	526.2
Revenue/Share	33.50	33.54	33.32	31.31	32.80	31.42	30.00	33.46	38.25	36.49
FCF/Share	0.75	0.45	(0.79)	(3.10)	(2.30)	(3.78)	(4.99)	(3.83)	(2.89)	(4.79)

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