Q3 2018 Earnings Call

Company Participants

- Bette Jo Rozsa, Managing Director, IR
- Brian Tierney, EVP, CFO
- Nicholas Akins, Chairman, President and CEO

Other Participants

- Ali Agha, analyst, SunTrust
- Christopher Turnure, analyst, JPMorgan
- Greg Gordon, analyst, Evercore ISI
- Jonathan Philip Arnold, Deutsche Bank
- Julien Dumoulin-Smith, Analyst, Bank of America Merrill Lynch
- Paul Patterson, analyst, Glenrock Associates
- Praful Mehta, Citigroup
- Stephen Byrd
- Steve Fleishman, Wolfe Research

Presentation

Operator

Ladies and gentlemen, thank you for standing by. And welcome to the American Electric Power Third Quarter 2018 Earnings Call. (Operator Instructions) And as a reminder, today's conference call is being recorded.

I would now like to turn the conference over to Bette Jo Rozsa. Please go ahead.

Bette Jo Rozsa {BIO 16484334 <GO>}

Thank you, Cynthia. Good morning, everyone and welcome to the third quarter 2018 earnings call for American Electric Power. Thank you for taking the time to join us today. Our earnings release, presentation slides and related financial information are available on our website at aep.com.

Today, we will be making forward-looking statements during the call. There are many factors that may cause future results to differ materially from these statements. Please refer to our SEC filings for a discussion of these factors. Our presentation also includes references to non-GAAP financial information. Please refer to the reconciliation of the applicable GAAP measures provided in the appendix of today's presentation.

Joining me this morning for opening remarks are Nick Akins, our Chairman, President and CEO; and Brian Tierney, our CFO. We will take your questions following their remarks.

I will now turn the call over to Nick.

Nicholas Akins {BIO 15090780 <GO>}

Thanks, Bette Jo. Good morning, everyone, and welcome again to AEP's third quarter 2018 earnings Call. We just completed another financially strong quarter given positive weather results, continued economic growth albeit moderated in most sectors of the economy and continue resolution of regulatory related matters. The headlines for this quarter are not only that our Board decided to raise (ph) the quarterly dividend by 8.1% to $0.67 a share earlier this week, we're also adjusting our 2018 guidance range upward from from $3.75 to $3.95 per share to $3.88 to $3.98 per share.

The economy in our service territory continues to grow mainly in oil and gas-related industries but others such as chemical industries, primary metals, et cetera are tampering because of tariffs and a strengthening US dollar. Ron will cover that in more detail, but overall AEP continues to deliver on its commitment of providing steady consistent dividend growth commensurate with the long-term earnings growth expectation of 5% to 7%. As with the specifics for the quarter and the year-to-date, GAAP and operating earnings for third quarter 2018 came in at $1.17 per share and $1.26 per share respectively versus third quarter 2017 GAAP and operating earnings of $1.11 and $1.10 per share, respectively.

This brings 2018 year-to-date GAAP and operating earnings to $3.17 per share and $3.23 per share respectively versus 2017 GAAP and operating earnings of $3.07 per share and $2.82 per share, respectively. The difference between GAAP and operating for the quarter and for year-to-date 2018 are primarily due to an impairment taken related to the Racine hydroelectric plant, severance charges taken in response to announce plant closures and economic hedging activities. This has been another very positive quarter financially and operationally, that should bode well for ending the year in a positive fashion.

Because of our belief that we are, and continue to be on a firm 5% to 7% our earnings trajectory void by strong base planning in the future. Our Board was very comfortable increasing the dividend by 8.1%, well within our 60% to 70% targeted payout ratio. Moving to the regulatory activity, at this point, the notable rate case activity really includes Oklahoma and APCo West Virginia. In late September, we filed another base case in Oklahoma PSO our third try to correct the chronic under earning situation in Oklahoma. This case has a requested net increase of $68 million with an ROE of 10.3%.

We have proposed to perform base -- performance-based rate mechanism that adjust for certain customer satisfaction and quality of service metrics with the intend of reducing the regulatory lag while ensuring our positive customer experience. The proposed procedural schedule has now been set that provides for interim rate subject to refund going to effect in April of 2019. We're certainly hoping for a better outcome based upon the operational performance of PSO over the years that financially healthy PSO would be well deserved.

Regarding the West Virginia case that was filed back in early May, we received staff and other intervenor testimony that while disappointing regarding adjustments such as a lower ROE, exclusion of certain known reasonable expenses after the test year and lower depreciation rates, we still believe there is an opportunity to enter into constructive settlement discussions to achieve a more reasonable outcome. Procedural schedules have been set in this case with an expected order in late February with rates going into effect in March 2019. So now, I will move to the equalizer chart. I'm going to hold off on discussion of the Premier regulated energy company to -- little bit later, but as we look at the equalizer chart, I call it that, because it sort of looks like it with the balls of different size of the companies. Overall, we're seeing a 10.1% ROE. We generally project the ROE for our regulated segments combined to be at or near the 10% range. Given our geographic diversity, some companies will be up and others down. But as we have demonstrated by our historical performance, we are generally in that 9.5% to 10% range.

We currently have six rate cases either recently completed or in process and I talked about a couple of those that are in process, which will help some of the underperforming companies. I will remind you, the ROEs are not weather-normalized, so generally across these companies weather benefited the results.

It's interesting to note, though, when you look at the size of the bubbles and how they're changing with the passage of time, our Transco is now the second largest operating utility of AEP. And as you look at the diversity of the service territory, these balls are becoming more or less the same size, six of them in the various jurisdictions are approximately the same size. So it bodes well for the diversity of the area. And then as well, I sort of separated out APCo into West Virginia, Virginia. So if you look at the jurisdictions, with the exception of PSO in Kentucky, they are around that $2.1 billion, $2.2 billion of average equity. So, really a good diverse footprint.

But obviously, AEP, Transco continues to grow considerably and we'll be talking more about that at the -- EEI as well. Regarding AEP Ohio, same thing, we talked about last time. We have a green bubble and a grey bubble, and actually the, the gray one is the one to really look at here. The green includes some global settlement items such as the RSR payments, the fuel, the PER (ph) and the 2014 SEET refund. So it shows a return on equity of 14.1%. The actual ROE for AEP Ohio is 12.5%. So most of these legacy items will roll off by the end of the year with a small portion going into next year.

APCo, the ROE for APCo at the end of third quarter was 9.9%. APCo's improvement in ROE over second quarter 2018 is primarily attributable to weather. APCo West Virginia, as I mentioned earlier, we filed a rate case there. And in Virginia, we still have the tri-annual rate reviews and APCo's Virginia first tri-annual review will be in 2020. And it will cover the 2017 to 2019 period, so we continue to make progress with that.

Kentucky, the ROE for Kentucky is continuing to grow. It's up to 9.2%. The January 2018 rate case is complete, helping drive the turnaround of the ROE, the change in rates during the year, along with better than expected weather contributed to that as well. And also, the economic development activity, we had a two prong approach. Obviously, the rate-making aspects in Kentucky, but the second part was associated with economic development and we continue to do very well in terms, of having jobs -- construction jobs, permanent jobs being created in our service territory in that region. It's called our Appalachian SKA (ph) process but -- but it continues to advance, obviously it helps when the denominator grows as well from a kilowatt hour perspective.

I&M achieved an ROE of 12% at the end of third quarter 2018, and it continues to perform well in 2018, primarily driven by strong sales in all segments, favorable weather, disciplined O&M spending and favorable onetime trueups associated with the regulatory items. I&M is continuing its capital investment program in the nuclear distribution and transmission business units with positive regulatory structures in place for all programs. So really doing well from an I&M perspective.

PSO, I talked earlier about PSO. It's now at 7.7% versus 6.5% at the end of second quarter. So weather is really reflected in there. We still have the considerable regulatory lag and also as you know, we filed an application for rate-making there in Oklahoma. So more to come on that.

SWEPCo, the ROE for SWEPCo at the end of third quarter was 7.4% and -- the primary reason for the increase in ROE, which it was at 6.8% is weather and the results also reflect a full quarter of rate relief implemented last year in May, in our Louisiana and Texas jurisdictions and also Turk -- the 88 megawatts of Turk that was originally attributable to Arkansas, is the issue around the ROE for SWEPCo. So we'll continue to monitor that situation.

AEP Texas, the ROE for AEP Texas at the end of third quarter 2018 was 8.8% versus 9.5% at the end of second quarter and while, earnings have grown year-over-year, the reason for the declining ROE is primarily, due to the timing of -- not only the annual filings that we make relative to capital investments, but also we have a lot of intensive capital investments going on in that territory. So lag has become somewhat of a factor there, but we fully intend on catching up with the construction activity out there.

AEP Transmission Holdco, the ROE for AEP Transmission, at the end of third quarter, was 10.4% and that obviously, reflects the ROE being lower mainly due to reclassification of certain transmission assets in July and August. And in addition, the East Transco's equity percentage of total capital is higher than followed due to the recent changes in equity percent cap, so it drives a higher equity balance but unchanged revenue. So we continue to do very well from the transmission perspective, and we continue to -- to invest heavily in that area as well.

So that -- ends that part of it. And so, in a couple of weeks. I will have been the CEO of this Company for seven years, working with the management team and the Board that takes great pride in our track record of providing our shareholders consistent earnings and dividend growth, while derisking the Company and taking advantage of our industry-leading businesses such as, transmission. There has been a lot of talk externally, that post Wind Catcher, we would be tracking towards the lower end of the 5% to 7% growth rate. Frankly, I don't know where that comes from and I just want to reiterate our 5% to 7% growth rate was not predicated on Wind Catcher and remains unchanged. That is exactly why our Board approved an 8.1% dividend increase.

As a premium regulated utility, we like to keep our dividend well within the 60% to 70% range. And as you can see, the adjustment puts us firmly in that range at 65%. And additionally, we're always trying to do better. So I guess I'm left with -- and last night, I was thinking about this, what sets AEP apart from our peers in the industry.

Well, first of all, there's no overhang of large intensive risky capital projects. We just don't have that going on. Strong financials that support a robust capital and operating plan, we have thousands of smaller capital projects that -- they are well within our control to execute and get recovery of. There is focused on deployment of capital and process efficiencies to bend the O&M curve and we'll be talking about some of those examples of what we're doing at EEI.

Diversity in our operating companies, which I mentioned earlier with the regions of the country, diversity and customer makeup, we're about a third, third, third, industrial commercial, industrial and diversity and capital deployed in the various business units to mitigate risk. So we have the optionality that others may not have. Largest transmission provider by far and you can see the continued and we'll talk about that at EEI -- the continued growth of transmission with over half of our capital budget deployed on this business with a long runway, ahead of us.

And growing distribution companies with infrastructure replacement, resiliency and revitalization through technology, that's going to be a continue to growing wedge of the capital that we can deploy.

And then also selective contracted renewables based upon credit quality, contract terms and financial construction risk minimization. We have a real opportunity to invest as we see fit, but it also fits within the general framework of our overall, capital strategy around the regulated T&D business. But we can be selective around contracted renewables and we do that.

Then and finally, a culture of innovation ingenuity get things done through operational excellence and disciplined execution. That's what we've done year-in and year out, and you can look at the dividends, the last seven years, the way they've moved, you can look at the earnings and it shows the consistency of this Company.

So as we move into the rest of the year and into next year with more detail at EEI to confirm our strong position going forward. I want to leave you all with one of our last favorites. You play this 45 singles, some of you may not know what a 45 is, but is a single that happens to be on the ballet. But this year's Rock and Roll Hall of Fame Induction, Chaka Khan, and the lyrics from I Feel for You that says -- Baby, baby when I look at you I get a warm feeling inside. There's something about the things you do that keeps me satisfied. I feel that way about AEP. I bet Chaka Khan never thought this would be used in our earnings call. But AEP's clear intent over the years has been to be that dependable year in and year out investment that keeps our investors and customers satisfied, the premium regulated utility -- more to come at EEI. Brian?

Brian Tierney {BIO 15917272 <GO>}

Thank you, Nick and good morning, everyone. I will take us through the third quarter and year-to-date financial results, provide some insight on load in the economy, review our balance sheet and liquidity and finish with a preview of what we will present at the EEI conference. Let's begin on Slide 6, which shows that operating earnings for the third quarter were $1.26 per share or $619 million compared to $1.10 per share or $543 million in 2017. Most of this year-over-year growth came from weather and recovery of incremental investment to serve our customers.

Looking at the drivers by segment, earning for Vertically Integrated Utilities were $0.71 per share, up $0.13. Rate changes were favorable by $0.09 per share. Weather was also a large driver this quarter with the $0.08 increase driven by warmer-than-normal temperatures this summer compared to cooler-than-normal temperatures last summer.

These were partially offset by higher O&M of $0.06 per share. Reductions in wholesale load and a reduction in the non-service component of pension cost offset one another. The Transmission and Distribution Utilities segment earned $0.30 per share, up a penny from last year, primarily due to recover of incremental investment in Texas. The AEP Transmission Holdco segment was comparable to the third quarter of last year due to prior period accounting adjustments, which offset earnings from increased investment. Net plant grew by $1.6 billion or 26% since last September. Generation and marketing and corporate and other were each up a penny from last year.

Let's turn to Slide 7 and review our year-to-date results. Operating earnings through September, were $3.23 per share or $1.6 billion compared to $2.82 per share or $1.4 billion in 2017. Our regulated segments experienced growth for the year and as expected, our competitive generation and marketing business was down due to last year's asset sales. Looking at the drivers by segment, operating earnings per Vertically Integrated Utilities were $1.74 per share, up $0.47 with the single largest driver being weather which added $0.32. The dramatic change in weather year-over-year was the largest swing in over 40 years.

Successful implementation of rate changes, added another $0.23. Other favorable items included higher transmission revenues and normalized load, as well as lower non-service pension costs in Texas. Offsetting these drivers were anticipated decreases in wholesale load, as well as increased O&M and depreciation expenses. Through September, the Transmission and Distribution Utilities segment earned $0.78 per share, up $0.02 from last year. Favorable drivers included higher rate changes, weather and normalized load, which were partially offset by higher depreciation.

The AEP Transmission Holdco segment contributed $0.57 per share, up a penny from last year. This growth in earnings reflected our return on incremental rate base, which was mostly offset by minimal formula rate true ups this year compared to the larger one in 2017. This was expected due to the change in methodology to forward-looking test years, last year. Generation and marketing produced earnings of $0.21 per share, down $0.04 from last year, mostly due to the sale of assets. Finally, corporate and other was down $0.05 per share from last year due to higher interest expense and prior year investment gains. We are pleased with our results and are confident in raising and narrowing our 2018 annual operating earnings guidance range to $3.88 per share to $3.98 per share.

Now let's turn to Slide 8 for an update on normalized load growth. Starting in the lower right chart, normalized retail sales increased by three tenths of a percent (ph) for the quarter and were up 1.2% year-to-date. Even though the growth moderated in the third quarter. The year-to-date load performance is still 1% above expectations for the year. In fact, every operating company experienced normalized load growth in retail sales this year with the exception of Kentucky Power. Moving clockwise, industrial sales increased by 2.4% for the quarter and were up 2.6% year-to-date. Industrial sales growth has been strong for over a year now. However, the mix of growth across industrial sectors has started to shift. Through the first half of the year, growth was balanced across most industries and operating companies. In the third quarter, growth was dominated by the oil and gas sectors while the remaining sectors moderated. The shift in industrial sales growth was driven by higher energy prices, the impact of metals tariffs and a stronger dollar.

In the upper left chart, normalized residential sales declined by eight tenths of a percent for the quarter, but remain up seven tenths of a percent for the year. For the year-to-date comparison normalized usage per customer was two tenths of a percent higher than last year. Finally in the upper right chart, commercial sales decreased by 0.5% in the third quarter, but are up two tenths of a percent for the year. Commercial sales were up in the T&D Utility segment but down in Vertically Integrated Utilities.

Now let's move to Slide 9 and review the status of our regional economies. As shown in the upper left chart, GDP growth in AEP service territory was 2.6% for the quarter, which is four tenths of a percent below the US. Within the last six months, the US economy has eclipsed that of AEP service territory. The upper right chart shows the gap in employment growth is narrowing between AEP service territory and the US. While the US has experienced stable job growth over the past year, the job market within AEP's footprint has continued to improve. For the quarter, job growth in AEP's territory was 1.2% with higher growth in the West. The sectors that added the most jobs this quarter were professional and business services, education and health services and leisure and hospitality.

The final chart at the bottom shows that income growth within AEP footprint has not kept pace with the US in recent months. For the quarter, personal income growth for AEP was 1.5% below the US. Income growth is a key driver for residential and commercial sales growth. Overall, 2018 has been a strong year for the economy in AEP service territory. The boost to incomes from tax reform and a robust job market create a momentum through the first nine months of the year, and will cause our load to finish above-forecast for 2018.

Now let's move on to Slide 10 and review the Company's capitalization and liquidity. Our debt to total capital ratio remain flat during the quarter at 56.8%. Our FFO to debt ratio was solidly in the Baa1 range at 19.2% and our revolving credit facilitynet liquidity stood at about $2.3 billion, supported by our revolving credit facility. Net liquidity increased from the prior quarter due to less commercial paper outstanding and recent proceeds from a long-term debt issuance. Last week, we amended and upsized AEP's quarter revolving credit facility from $3 to $4 billion and extended it by one year to June 2022 to increase in size supports our robust capital program. Our qualified pension funding improved 104% and our OPEB funding improved 135%. For both plans the funded status improved due a rising discount rate that led to a decrease in liabilities, which more than offset flat asset returns benefit payments and other administrative costs. Let's try and wrap this up on slide 11 and get to your questions. The strong results we have delivered year-to-date and our confidence in our plan for the remainder of the year. Allow us to raise a mirror the operating earnings guidance range to $3.88 per share to $3.98 per share.

Our message at EEI will be that we are a premium regulated annulated utility delivering 5% to 7% earnings growth and dividends growing in line with earnings our plan has line of sight transparency to growth and has greatly reduced, regulatory and execution risk. We will provide detailed drivers for earnings by segment and updates to our capital expenditure and financing plans, we look forward to seeing many of you in San Francisco in a couple of weeks. With that I will turn the call over to the operator for your questions.

Questions And Answers

Operator

Thank you. (Operator Instructions) Stephen Byrd, Morgan Stanley

Q - Stephen Byrd {BIO 15172739 <GO>}

So Nick, I love the Chaka Khan reference. (multiple speakers). Tell me something good.

A - Nicholas Akins {BIO 15090780 <GO>}

Yeah, yeah

Q - Stephen Byrd {BIO 15172739 <GO>}

So I guess the -- the wind investment opportunity in your geographies appear to be very good. And I was just curious, at a high level, sort of how should we think about the evolution of the potential for additional wind opportunities that might be smaller than Wind Catcher, but still very large. What kind of steps or what kind of cadence should we think about in terms of incremental wind opportunities?

A - Nicholas Akins {BIO 15090780 <GO>}

Yeah, so actually that's probably one of the lessons learned from Wind Catcher being so intensive and the transmission being pretty intensive as well. We're looking at obviously smaller segments -- smaller wind farms, with smaller transmission, multiple areas. We've already started that process. We're also in parallel with that doing really refocusing our integrated resource plans we filed in the various jurisdictions the support that approach. Most of it, you're going to find and we will show more about that at EEI. But basically it's showing renewables, but we also have to be mindful of the political situation and in each of our state jurisdictions and the resources that they are looking for. So you're going to see resource plans develop around wind resources, solar resources, perhaps some storage but also some natural gas. So you'll continue to see that kind of development and as I said, it will be smaller capacity segments focused on various jurisdictions, and we've already started that process.

Q - Stephen Byrd {BIO 15172739 <GO>}

That's great. That makes sense. And then just switching over to transmission. Just want to make sure I was clear, given the FERC announcement last week, I guess I didn't see any significant impact to you all from the FERC activity on transmission, but just wanted to make sure I wasn't missing the nuance or how you all thought about that?

A - Nicholas Akins {BIO 15090780 <GO>}

No, you're not missing anything. The settlement that was done in the East is pretty consistent with the range that that came out of those cases and -- and I really believe even there is some discussion of incentives. Incentives are being dealt with the same fashion. I mean -- the only one we get is the RTO incentive. So I really believe that discussion, while still initial, I still think it will be supportive of transmission investments. So we see no change.

Operator

Praful Mehta, Citigroup

Q - Praful Mehta {BIO 19410175 <GO>}

So I guess, maybe we start with the transmission side and CapEx on the transmission side, given the support that you probably get with the ROEs and clearly there has been some change on the leadership at FERC side but just wanted to understand what do you see in terms of the opportunity set on the transmission side. You've clearly and I had a huge impact on that opportunity but is there incremental opportunity you see there and how do you see that progressing?

A - Nicholas Akins {BIO 15090780 <GO>}

Well certainly transmission. I mean, we're already tracking over $3 billion a year in capital investment in transmission and certainly with transorst (ph) and other opportunities out there, you may see other projects come into play that are incremental but, but obviously won't be very mindful of where we are investing. We have plant retirements that are occurring. They will encourage more transmission investment. We're going to continue to push the organization, the transmission organization to do as much as we possibly can around capital deployment. So there is always opportunities and also it has to be in the context of the distribution sides growing as well. And certainly, we want to make sure that -- that we're doing the right thing there too. But as far as transmission concern, as I said, really no end in sight in terms of our ability to invest in transmission and actually the reasons for transmission investment continue to change all the time. We are seeing further retirements, obviously some of those are ours, but also with I think there is no doubt, even when you think about the climate change aspects, the ESG activity all those types of things that are occurring is going to -- going to continue to push for clean-energy resources and -- and that means transmission as well. We have a lot of resources that are attached and that we enable through transmission and that will continue to grow. So we will have more discussion on that at EEI as well.

Q - Praful Mehta {BIO 19410175 <GO>}

And would love to hear little bit more in terms of how to quantify that that opportunity set as well at EEI, I am sure. So we'll come to that. And then I guess secondly in terms of contracted renewables, just wanted to get a sense for how that is going. We're seeing a number of players continue to invest in renewables. The returns probably continue to get competitive. Where do you see that opportunity set on the unregulated renewable investment side.

A - Nicholas Akins {BIO 15090780 <GO>}

Yes. So we look at that a little differently than -- than others perhaps, because we are accentuated by transmission and because you know largest transmission, by far , that's where our investment -- a lot of our investment goes, but also the regulated operating companies, continuing to grow as well. We can afford to be very selective about these projects. There is a lot of projects out there. Some of them have shorter duration 5 year, 10 years. That's not what we are really interested in. When we look at our tenor of these contracts, we are looking for long-term contracts with credit-worthy counterparties particularly utilities, which we -- which we've done across the country. We're in 32 states now and also with contract, the actual development and construction risk versus financial risk. We're mostly in the financial risk category at this point in time. And that's pretty meaningful in terms of mitigation of risk. So I would say -- we are fully prepared to go as deep as we want to go in that, but we don't have a requirement to be out there, everywhere trying to soak up every every deal that regardless of what it may mean from a risk profile perspective. So Chuck is -- I think it's $750 million (ph) of the billion that we had allocated before and -- and we'll have more on that at EEI as well.

Operator

Steve Fleishman, Wolfe Research

A - Nicholas Akins {BIO 15090780 <GO>}

Morning, Steve.

Q - Steve Fleishman {BIO 1512318 <GO>}

Hey, good morning. Still getting over the Chaka Khan.

A - Nicholas Akins {BIO 15090780 <GO>}

Another person who want me is Backstreet Boys. Not -- I couldn't get there.

Q - Steve Fleishman {BIO 1512318 <GO>}

Yeah . Okay. The Ohio tax order yesterday. It seemed to be relatively flexible. Just, I think you'd already resolved, but could you just give any thoughts on your color on that?

A - Brian Tierney {BIO 15917272 <GO>}

It's very much in line with what we had anticipated . So like -- like so many of the other orders we put -- we have some detail on this in the appendix of the -- of the release. It's going very smoothly wherever we've had these occasions and the range of flow backs that we have -- have also been very reasonable. You know, when we talk to you early in the year, we kind of assumed flow backs happening very quickly. But I think just about everywhere we've been, the ranges to like 18 years with most of it being in the 10 year to 15 year range. It's been very -- people are being reasonable and Ohio's order was just another instance of that.

Q - Steve Fleishman {BIO 1512318 <GO>}

Okay. And then just in terms of the EEI disclosures, on the CapEx and the financing plan that will be out for the kind of 4 year to 5 year period, not just for 2019, right.

A - Brian Tierney {BIO 15917272 <GO>}

The CapEx plan will be out for 5 years and I think the financing plan, we're going to go out 3 years.

Q - Steve Fleishman {BIO 1512318 <GO>}

Okay. And then just on the dividend, which was great. Just in terms of from here, we should probably assume that now that you're at the midpoint of your payout range, you will kind of grow it in line with earnings growth from here?

A - Brian Tierney {BIO 15917272 <GO>}

Yes, that's correct.

Operator

Jonathan Arnold, Deutsche Bank

Q - Jonathan Philip Arnold {BIO 1505843 <GO>}

Nick, I am recovering from learning with -- I am one of the only people on my team who knows what a 45 is.

A - Nicholas Akins {BIO 15090780 <GO>}

Yes, I know.

Q - Jonathan Philip Arnold {BIO 1505843 <GO>}

That's little sad this morning. Could I just -- back just to where Steven was going, you talked about needing to kind of revise IRPs in the states, before you can kind of come with the sort of post Wind Catcher smaller, smaller footprint, smaller transmission type deals . And what's the time frame for that? Is this something you see playing out? Yeah, we'll have some more clarity in the next couple of quarters or is it going to go deeper into 2019 before you really flush that out.

A - Nicholas Akins {BIO 15090780 <GO>}

You'll see more clarity soon. I just want to make clear to you that we already have resource plans filed in the jurisdictions that have renewables in them. I think you're going to see more definition and more focus around what the alternatives are and also being respectful to what the individual states want to see. Those will start coming out as early as December and -- and then they'll continue to flow out during 2019. So you're going to see -- several first passes here probably within the first quarter of '19 and toward the end of this year.

Q - Jonathan Philip Arnold {BIO 1505843 <GO>}

Can you give us a sense of where you'll start in terms -- is there an order to how these teed up from a regulatory schedule standpoint?

A - Nicholas Akins {BIO 15090780 <GO>}

Yeah. Each state is different, but I think the first one to come up is Arkansas, and then Louisiana and obviously, they were supportive of Wind Catcher. So there is some real opportunity there to really fashion it to what they're looking for. But each one is different from a scheduling perspective. And each one will have -- have different views of what resources are applied. And so, we're going to have to make sure that it's met toward that.

Q - Jonathan Philip Arnold {BIO 1505843 <GO>}

Okay. But we're not talking about a sort of IRP do over type thing?

A - Nicholas Akins {BIO 15090780 <GO>}

No, I think, it's more of a refinement. But also there's things we know today that we didn't know even before Wind Catcher and certainly that forecast will change and those types of things. And the way we present things is likely to change as well to where we're being much more of a partner with our commissions and the states in terms of what they're looking for.

Operator

Julien Dumoulin-Smith, Bank of America Merrill Lynch

A - Nicholas Akins {BIO 15090780 <GO>}

Good morning, Julien.

Q - Julien Dumoulin-Smith {BIO 15955666 <GO>}

Hey, good morning. Can you hear me?

A - Nicholas Akins {BIO 15090780 <GO>}

Yes. I can hear you, fine.

Q - Julien Dumoulin-Smith {BIO 15955666 <GO>}

Excellent. Hey, thank you. So I wanted to go back a little bit to some of the updates expected here at EEI, as you've think about CapEx and kind of reconcile that with the cash flows. Obviously, you've had a few updates through the course of the year. Can you give us a little bit of the sense or maybe a little bit of a preview on how you're thinking about cash flows, given some of the updates year-to-date on tax reform and some of the excess refunds. If you think about that. I know you have a little table there and the -- even in the latest deck here.

A - Brian Tierney {BIO 15917272 <GO>}

Yes, Julien. So we showed at last year's EEI for 2020 needing an incremental about $400 million in equity over the dividend reinvestment program. If we were to show another year, I would anticipate showing another need just like that in '21.

Q - Julien Dumoulin-Smith {BIO 15955666 <GO>}

Got it, okay. And that is inclusive of the latest tax reform refunds et cetera that you've been able to secure for this year. Right ?

A - Brian Tierney {BIO 15917272 <GO>}

That's correct.

Q - Julien Dumoulin-Smith {BIO 15955666 <GO>}

Got it. Okay, excellent. Then secondly, turning over to Oklahoma here. Obviously you filed the PSO case and you've talked a little bit about some of the levers you might have over time, as you think about that situation in your ownership or not. Is there potential where you split it apart transmission versus distribution when you think about ownership in the different jurisdictions here. I mean, maybe can you talk a little bit to the jurisdictional issues too just, as you think about your desire to be involved in Oklahoma?

A - Nicholas Akins {BIO 15090780 <GO>}

Yeah. So, well, first of all, I certainly -- certainly I'm looking toward a positive outcome in Oklahoma. I think, there is some confusion that we have the Oklahoma Transco and certainly PSO, they are two separate utilities. But at the same time, I think it would be somewhat difficult to think of them independently, because certainly PSO and the transmission -- in the Transco -- Transco's new transmission but is transmission that's within the PSO customer side of things. And it's not all that way, and I think there's lot of confusion even from the maybe the commission perspective and others, from what I've read from the investment analyst reports.

The Transco at PSO, it is an Oklahoma Transco, but it invest in transmission, based on what SPP requirements are and in terms of what the customer load requirements are for PSO. Only, the cost in the Transco that go to Oklahoma customers are actually ascribed to Oklahoma customers, and there is this view that we can short-change PSO because we get higher ROEs in the Oklahoma Transco -- well -- that is really very, very small. It's -- I mean if you were to take the Oklahoma Transco along with PSO and look at the rate structures associated with that, the impact of the Transco is really only like 28 basis points.

So, and I think some people think that we can have 6.5% ROE at PSO and we're getting 11% at -- 10.5% to 11% in Transco that -- okay, that's fine, overall, but it's not. Because the rate base is much bigger from a PSO perspective and the only incremental transmission is in the Transco. And when you account for that, it's not like we are taken earnings and softened them off to the corporate parent, it's that the investment made in the Transco in earnest of the benefit of AEP shareholders, but also the PSO returns an investment made within PSO, it's also regulated, goes to the AEP shareholders as well, any earnings and returns associated with that.

So this notion that we can average it out and everything is fine, doesn't make sense. And so, I think, we've got to get sort of past that. As far as PSO's future is concerned, we obviously have been -- and we've said time and time again, that we can't have a chronic under recovery for years and years, because, obviously our shareholders are expecting investments to be made in places where we can get positive, very positive returns. And the other state jurisdictions that's possible even in Kentucky is come up considerably. PSO in Oklahoma remains that single situation that we have that needs -- that really needs to be corrected. And we, I think we presented a very positive case to say that, okay, we're going to provide great quality service to our customers and we're committed to that.

But obviously on the other side, we need to be able to invest and investing get a decent recovery for it and that's what performance-based rate making does for you. Also in terms of bringing that investment closer to when -- the recovery closer to when the investments made. That's a natural occurrence. And I think, we've got to get that message across in all of these rate filings, but it would be hard to separate the two and do something different, and I really don't want to go there. At this point, I want to get through this case and then we look at the situation of the tax basis and leakage and everything else, associated with issues of sales and do we actually have a use.

So, and you're going to see more at EEI. I think it is -- one of the slides about sources and uses that sort of gives our thinking in terms of, in terms of what we're looking at. So I'd rather reserve a lot of that discussion for EEI but also as far as PSO is concerned, reserve that discussion to later -- certainly after the rate case.

And keep in mind too, that we have a second corporate headquarters there in Oklahoma. Tulsa has about 618 employees there that are not PSO employees. They are AEP corporate employees. And so that would also have to be managed in the context of whatever the disposition of PSO would be going forward. So there's a lot of things to think about from that perspective, but I really don't want to go there until -- until we fully understand what our role is in Oklahoma. And I think the commission is going to make a definitive statement on that this time around.

Q - Julien Dumoulin-Smith {BIO 15955666 <GO>}

(Multiple Speakers) Excellent.

A - Nicholas Akins {BIO 15090780 <GO>}

I think, we answered than what you probably asked for, but.

Q - Julien Dumoulin-Smith {BIO 15955666 <GO>}

Indeed, quick follow-up on the renewable piece, just real quickly. How do you see the approval process and demonstration need for the RFP filing in Ohio? Specifically, how do you think about this given potential changes in PUCHA and (inaudible) ?

A - Nicholas Akins {BIO 15090780 <GO>}

Yeah. So, I would suspect, we are following what the framework has been setup to get these approvals for the -- for the renewables, and certainly a change in administration could have an impact. But I think the path is already set. It really is up to the Commission now. We've gone out for bid. We've done what we need to do and that's at least for 400 megawatts. You are still 500 megawatts to go. And that's probably wind related resources. So we still have an opportunity to continue to progress along that path. And I don't really see -- I don't really see an impact in terms of or a change in the thought process of the Commission itself, but I -- we've got credible projects out there. You know, we presented a filing that did not have us participating in those two projects of PPAs . But given the use of our balance sheet, certainly there is a factor that we applied to it that included provisions from our financial perspective to ensure that we remain neutral from a capital structure standpoint. So -- and we made that decision and we'll make that decision on any future PPAs and whether we're actually investing or not investing, I think that goes to -- it goes to the capital discipline that we have of our threshold of returns and risk associated with any capital investment we make. So I think we manage it pretty well from that perspective . So we'll wait and see what the Commission thinks about the two that have been filed.

Operator

Greg Gordon, Evercore ISI

A - Nicholas Akins {BIO 15090780 <GO>}

Good morning, Greg.

Q - Greg Gordon {BIO 1506687 <GO>}

Thanks. Good morning. You are in my era with Chaka Khan for sure.

A - Nicholas Akins {BIO 15090780 <GO>}

Yes. Unfortunately, we are all in the same era just about.

Q - Greg Gordon {BIO 1506687 <GO>}

Yeah, well they don't make any good music anymore, do they?

A - Nicholas Akins {BIO 15090780 <GO>}

No , they don't.

Q - Greg Gordon {BIO 1506687 <GO>}

Miss (ph) the old days. But the question on the dividend that Steve asked. So just want to be clear because I had asked this question to you guys maybe one year or two year ago. You move your balance sheet into a really pristine position. And you've indicated to Steve that sort of this 8% move was not indicative of a desire to consistently grow the dividend nudge ahead of the earnings guidance. So as you think about that, is it, is it won and done for any good reason other than, I mean, could you theoretically -- could grow at 8% and be in a strong balance sheet position or is the cash flow profile as you move out three years, four years , five years, you know, in a place where you sort of meet at a place where you're -- you really would be penny-wise pound foolish to nudge ahead of the earnings growth.

A - Nicholas Akins {BIO 15090780 <GO>}

Yeah, I would. Well, I would say it a little differently. I mean, obviously, we've been consistent about the message that our dividends grow commensurate with our earnings. And I think, we got. And we really also feel very strongly that a regulated utility should be in a healthy range within that 60% to 70%, and it started to lag a little bit and we really felt like a -- some of it was catch-up but also some of it was confidence. And I think whereas the Board looked at the dividend policy in the future. We're going to continue to to focus on what the earnings profile of the Company looks like going forward and we'll be very transparent about that at the EEI. And it will give you some sense of where the dividend will go as well.

A - Brian Tierney {BIO 15917272 <GO>}

Greg, we had previously announced guidance for 2019 for operating earnings of $4 to $4.20 per share and the move that the Board made earlier this week, puts our dividend payout ratio squarely in the middle of what we previously announced of 60% to 70% and the move that they made puts it exactly at 65%. And I think as Nick said, that's just the Board expressing its confidence in our ability to grow earnings over time.

Q - Greg Gordon {BIO 1506687 <GO>}

So I get that, guys. I guess what I'm asking is a little bit more nuance perhaps , in that, given how strong the balance sheet is and how good you've been in terms of being Stuarts of that balance sheet.

A - Brian Tierney {BIO 15917272 <GO>}

Yeah.

Q - Greg Gordon {BIO 1506687 <GO>}

If you continue to raise it you know a nudge faster than the midpoint of your earnings growth target, you might be at the higher end of the payout ratio target in several years but you'd still be comfortably in your credit metric profile. So is that outside of the realm of possible?

A - Nicholas Akins {BIO 15090780 <GO>}

I think, our -- our policy has been from a Board perspective. And it comes from the Board obviously that that we'll grow commensurate with our earnings. Now, okay. So, and you also have to look at the use of capital. We have plenty of places to put capital. And I think there is probably going to be more definition around that because Brian has just mentioned that will be showing five years of capital going forward. That will give you some insight in terms of what the earnings capability of the Company is going forward, and then you can take from that earnings where the dividend policy will be.

Q - Greg Gordon {BIO 1506687 <GO>}

Okay, one last question. And perhaps , you'll veer to -- we get to San Francisco but when we look out five years from now, is your generation fleet based on your -- your plan is going to be substantially incrementally decarbonized from where it is today?

A - Brian Tierney {BIO 15917272 <GO>}

Yeah, actually I think we get as far as coal-fired generation, we're in the 30 something percent range. We've already gone from 65% to I think it's 51% and it's going to go even further, because we've already announced closures of local (ph) union in Conesville. And as you move forward, you're going to see continued activity in that regard, but also at the same time, our fleet itself is continuing to grow from a clean energy perspective. That's added on to it as well. So, that's really what we are looking at in the future. So as we transform our generation fleet, we're going to be in the range of 36% coal. At least down 36% from a coal perspective, up 2% on natural gas. No change on nuclear, up 29% on solar and hydro, wind and then energy efficiency up 5%. So you're seeing a very different view of what really is changing from a generation fleet to resources and those resources including transmission and they also include the efficiencies within the grid itself that have yet to really been -- you haven't seen that capital picture yet. So it's going to continue to change dramatically.

Q - Greg Gordon {BIO 1506687 <GO>}

That's even without Wind Catcher, that's impressive.

A - Brian Tierney {BIO 15917272 <GO>}

Yes.

Operator

Christopher Turnure, JPMorgan

A - Nicholas Akins {BIO 15090780 <GO>}

Good morning, Christopher

Q - Christopher Turnure {BIO 17426636 <GO>}

Good morning, guys. Could you talk a little bit about the O&M trajectory year-to-date versus your original plan and any of the drivers that might be underlying that?

A - Brian Tierney {BIO 15917272 <GO>}

Yes, so we are going to be up a little bit as we were out with the weather being what it's coming at. Last year, we significantly throttled back O&M in the fourth quarter. This year, given where we've gotten ahead with weather, we've been able to move some things into 2018 from 2019 and so between shifting employee-related expenses, some things we've taken on forestry, we're going to be up versus what we had previously announced at EEI for last year.

Q - Christopher Turnure {BIO 17426636 <GO>}

Okay. And can you give us a sense as to how much of that differential versus your original plan was due to pulling forward O&M from '19?

A - Brian Tierney {BIO 15917272 <GO>}

A relatively small portion. Less than $0.10 per share.

Q - Christopher Turnure {BIO 17426636 <GO>}

Okay . And then my second question is as you look out over the next five years and think about your tax appetite and level of just cash taxes in general, kind of, how do you think about that and does that position you well versus your competitors for renewable projects and position you well even within any regulated renewable projects that you'd like to do in terms of the cost that you can offer your customers

A - Brian Tierney {BIO 15917272 <GO>}

Yeah. So we do have tax appetite for both the regulated side of the business and the competitive side of the business and we anticipate utilizing that tax appetite to the point where we anticipate having a cash effective tax rate on a Federal basis of about 5% for the foreseeable future.

Operator

Paul Patterson, Glenrock Associates

A - Nicholas Akins {BIO 15090780 <GO>}

Good morning, Paul.

Q - Paul Patterson {BIO 1821718 <GO>}

How are you, how're you doing?

A - Brian Tierney {BIO 15917272 <GO>}

Just fine.

Q - Paul Patterson {BIO 1821718 <GO>}

Really, just sort of one question here I have left and that is the, -- the ROE case in New England. I was wondering, how you guys were looking at that in the context of the FERC ROE settlement that you guys came up with. And just any thoughts you have about the, I guess it's kind of a proposal, but whatever, there -- what they're proposing in New England, which seems to be a new policy in general and just how you see that in the context of what you guys settled on?

A - Brian Tierney {BIO 15917272 <GO>}

So Paul, when we take that methodology and apply it to our facts, we come up with an ROE that is very, very similar to what we settled at. One of the other benefits that we got from the settlement was the opportunity to increase our equity layer from 50% to 55%. And so even though the ROE is right on top of where we would calculate it given the New England transmission orders, we think we end up even better than that given the increase in the equity layer. And then, of course, on top of that we have as Nick was talking about earlier, the incentive for being in an RTO.

Q - Paul Patterson {BIO 1821718 <GO>}

So when you look at it just to make sure I understand, you see your base ROE -- you think that the new proposed numbers apply to your situation would have come in pretty close to where you are (multiple speakers)

A - Brian Tierney {BIO 15917272 <GO>}

Yes. Very similar.

Operator

Ali Agha, SunTrust

A - Nicholas Akins {BIO 15090780 <GO>}

Almost missed you, Ali.

Q - Ali Agha {BIO 1509168 <GO>}

Yes, good morning. One thing I wanted to clarify, Brian, back on the second quarter call you had laid out your '21 CapEx. And now if I'm hearing you right, at EEI, you will lay out a five-year look, so presumably that gets us to 2023. One, I wanted to confirm that. And then secondly, should we also expect that your transmission earnings outlook which currently is out till 2020 that you'll also extend that out to 2023 as well?

A - Brian Tierney {BIO 15917272 <GO>}

No -- we are going to add a year to that. So let me confirm that we are going to show five years of CapEx and we'll show an additional year on the transmission outlook.

Q - Ali Agha {BIO 1509168 <GO>}

I got you. Okay. And then secondly, Nick, you talk about having your sort of blended portfolio ROE somewhere in the 10% range, which is obviously where you're tracking right now. But in actuality, I also wanted to confirm, when you look at what your authorized ROEs are across your jurisdictions and you compare that to the 10.1 (ph) -- the LTM ROE that you're earning. Is there any regulatory lag in the system? And some of it may just be fictional and historical. But just to get a sense of the difference in authorized and actual earned?

A - Brian Tierney {BIO 15917272 <GO>}

Yeah, there is regulatory lag. But also there's -- and we sort of position our cases where they need to be done. In some cases, I mean, like AEP Texas, it's a lower ROE because we're investing heavily. But it's a -- really a good recovery mechanism in Texas. The same is true with the transmission, and then we have the formula-based rates in various jurisdictions and where Arkansas has formula-based rates now and certainly, we're trying to get that PSO to bring that more concurrent. But there is regulatory lag in there and we're trying to minimize that as much as possible to bring up the effective ROEs. That's a critical component of what we're working with our regulators on.

And as far as looking into the future, you're going to have AEP Ohio, that portion drop-off. So the legacy parts of AEP Ohio, the RSR and the PER (ph) and all that kind of stuff that's going to drop off. But at the same time, we expect other jurisdictions to be picking up, so, including PSO, and so that's part of it as well.

So it's -- it's probably more convoluted then -- you can't look at each one of them deterministically because we invest differently in each company, a different times and timing has lot to do with it, and the O&M spend for various activities. So -- but generally speaking, across the Board, we always try to get to that 10%.

Q - Ali Agha {BIO 1509168 <GO>}

Got you. Last question also wanted to just clarify, at EEI in addition to extending the time period. Did I hear you folks right that given the opportunities that you're seeing whether it's renewables or transmission, et cetera that there is also an opportunity, an expectation that the absolute amounts of investment also likely goes up as well. Just clarifying, if I heard that right?

A - Brian Tierney {BIO 15917272 <GO>}

So we're going to talk about that at EEI.

Q - Ali Agha {BIO 1509168 <GO>}

Okay. But that was not what you had signaled in your comments, currently.

A - Nicholas Akins {BIO 15090780 <GO>}

We'll give you the full update at EEI, Ali.

Operator

Thank you. And speakers, I'd like to turn it back over to you for any closing comments.

A - Bette Jo Rozsa {BIO 16484334 <GO>}

Thank you for joining us on today's call everyone. And as always, the IR team will be available to answer any additional questions you may have. Cynthia, would you please give the replay information.

Operator

Thank you, and ladies and gentlemen, today's conference call will be available for replay after 11.15 AM today until midnight November 1st. You may access the AT&T Teleconference replay system by dialing 1-800-475-6701 and entering the access code of 455386. International participants may dial 320-365-3844. Those numbers once again 1-800-475-6701 or 320-365-3844 and enter the access code of 455386.

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