Q2 2013 Earnings Call

Company Participants

- Brian Tierny, CFO
- Julie Sherwood, Director, IR
- Nick Akins, President, CEO

Other Participants

- Anthony Cordell, Analyst, Jeffries & Company
- Dan Eggers, Analyst, Credit Suisse
- Greg Gordon, Analyst, ISI Group
- Jonathan Arnold, Analyst, Deutche Bank
- Steven Fleishman, Analyst, Wolfe Research

Presentation

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Second Quarter 2013 conference call. (Operator Instructions) I will turn the conference over to our host, Miss Julie Sherwood. Please go ahead.

Julie Sherwood {BIO 16873529 <GO>}

Thank you, Ernie. Good morning, and welcome to the Second Quarter 2013 earnings webcast of American Electric Power. Our earnings release, presentation slides, and financial information are available on our website, aep.com. Today we will be making forward-looking statements during the call.

There are many factors that may cause results to differ materially from the statements. Please refer to FCC filings.

Joining me this morning for opening remarks are Nick Akins president and Chief Executive Officer and Brian Tierney, our Chief Financial Officer. We will take your questions following their remarks. And now I'd like to turn the call over to Nick.

Nick Akins {BIO 15090780 <GO>}

Thanks, Julie. Thanks to everyone for joining us today. The Second Quarter, while in space may seem uneventful, there have some been significant developments that warrant further discussion and define the milepost for future actions.

The challenges we face with the economy, capacity markets and an industry in transition pro provide the functions forcing functions for change that is exactly what our management team in this company intends to do, face these challenges head on and provide the tools for our employees to be agile and adapt to an ever-changing environment.

From the outset, financial measures for the quarter were on track and respectable, and have not changed our plans for the year or our guidance that has been previously provided. Second Quarter GAAP earnings per share were $0.69 per share and $0.73 per share from an operating earnings perspective, which was slightly less than the $0.77 per share for Second Quarter 2012.

Year-to-date puts us at $1.44 per share GAAP earnings and $1.53 operating is slightly less than last year.

The difference in GAAP versus operating earnings primarily is the net of an impairment related to Muskingum River 5, which is not clear the PJN capacity market and the benefit of a Supreme Court ruling regarding the tax benefits related to a UK windfall profits tax. Our Board yesterday did approve the quarterly payment of a dividend to investors of record of $0.49 per share which AEP's is 413th consecutive quarter of paying a dividend, so steady as she goes from a Board perspective.

With the basic financial members for the quarter out of the way, I want to give you my perspective on the challenges we face and what we are doing about them. But first let me cut to the chase.

We are reaffirming our guidance range for 2013 of $3.05 to $3.25 per share and despite the challenges before us we still maintain expected long-term earnings growth rate of between 4% and 6%.

Albeit the results of the 2016-2017 PJM capacity auction that has tested our business case for the upside beyond this range, through capital allocation, particularly the transmission, regulatory recovery support and performance improvement that benefit our customers, operations and bottom line performance, our management team is committed to living up to the 46% expectation.

Too many times we equate only load growth with earnings expectations. While that equation may still be partially true, our business has changed. It is more about optimization, performance improvement, and disciplined capital and operating expense management that is driven by culture of optimism and expectation that we can get the job done and we will.

So let me discuss some of the challenges I see. An economy that continues to be tenuous at best, I think you are seeing this all across the country and for the past quarter industrial loads in our footprint has continued to be down.

Commercial load was down slightly and residential loads held flat. Brian will discuss the numbers in detail, but because margins are different by rate class, financially the impact was only $0.02 per share year-on-year if you look at those traditional retail footprints.

But with the addition of generational marketing adding $0.04 per share, which includes our retail earnings, actually the financial of performance of serving load is up. Now let's take a look at the regulatory recovery support.

The asset transfer cases in Kentucky, Virginia and West Virginia are moving along. In Kentucky, a non-unanimous settlement was filed that provides for the transfers of Mitchell, as planned with Big Sandy-related conversion costs.

In Virginia, we have made the case of the Wheeling merger along with the Mitchell transfers in the public interest, as well as the transfer of Amos. And in West Virginia we just concluded hearings that we feel confident demonstrate our case for the transfer of Amos and Mitchell along with the Wheeling merger that is in the best interest of customers.

Why do we believe we just put on excellent cases in these jurisdictions? These are fully controlled units that are least-cost options that provide secure supply to customers for the future in lieu of the capacity payments that were paid through the American Electric pool to other operating companies.

We believe we have strong cases, and will soon find out the outcomes, with the first order expected in Virginia by Wednesday, followed by West Virginia and Kentucky in the Third Quarter. The SWEPCO Texas rate case related to Turk is expected in Third Quarter that will be retroactive to late January 2013, and Brian will discuss this timing issue in our Second Quarter reporting on this subject.

We are hopeful the PUCT, the Public Utility Commission of Texas, will see beyond the short sightedness of the ALJ decision in this case, particularly as it relates to the notion we should have stopped construction of Turk late in the game. This is tantamount to hindsight regulation and should be rejected by the Texas commissioners.

The PUCT commissioners need to send a strong message that Texas jurisdictional capacity can get built in recovery in a state that desperately needs capacity. Customers are benefiting from an exceptional generating unit that is 15% more efficient than any supercritical unit in the country and thereby saving customers considerable fuel costs.

This is a win for Texas customers and should be afforded the recovery in the ROE and that is deserved for this major investment, and sub 10% isn't reasonable. In Indiana, two positive developments have occurred that further improved the recovery of the life cycle management program at Cook and Dry-sorbent Injection equipment at Rockport.

The $1.69 billion less, about $23 million of incremental upsides in costs, were approved for recovery which was $741 million jurisdictional to Indiana and allowed the deferral of other project-related costs for future recovery related to the lifecycle management program, so very good outcome in Indiana on this regard.

Regarding the Rockport DSI projects, just yesterday a settlement agreement was filed to allow the full recovery of the Dry-sorbent injection systems, 80% would be through a tracker and 20%

deferred for the next case, so another great outcome. Also, at Flint Creek, we received an order earlier this month to allow recovery of the scrubber installation and Arkansas Public Service Commission approved that. Now let's talk about performance improvement. I'm

CEO of AEP but many of you may know I'm also a rock drummer. One of the biggest challenges, I know that's hard to believe, for a beginning drummer is to separate the movement of the right hand and right foot. At first, it's not natural, but after practice it becomes second nature to react to play and different times of music.

I tell you that because too many times we assume that work has to be performed one way or even the old way only to find out better and more efficient ways of improving processes and while reducing operating expenses. This is what we are doing at AEP.

Too many we assume performance improvement is only about cost-cutting, therefore we think expense reductions are not sustaining. This is just not true. I've been involved in every operational business function in this company and what employs are doing to reinvent this company is truly phenomenal.

I have decided to give you a little insight to help you understand our sustainability initiative and what we are doing relative to our ability to adjust to this changing environment we operate in, particularly in line with the questions about capacity markets, load forecast and so forth.

We estimate that we'll exceed our expense reduction revenue enhancement targets for 2013 through our repositioning Engage to Gain employee programs while increasing O&M spends in specific areas of prioritization such as transmissions, cyber, retail and other things.

So it's important to note that we are being mindful that we need to add O&M in certain places and prioritize the areas and at the same time achieve the O&M objectives we set out for ourselves for the year. So far as well our free plants who have gone through the lien processes are transformational for these generating plants.

We have achieved between $5 million and $10 million of savings per plant in this analysis and this process hasn't ended. The third plant is only in eighth week of doing these lean initiatives and amazing the things they come up with.

And, oh, by the way, next year we'll have six to eight about this time plants going through the same process and we have between 15 and 20 plants to go through this process, so it's important to note that we are far from done. And a lot more work to do but a lot more savings will inure benefit as we go forward.

We've executed supply chain RFB and tens of millions of dollars going out for bid with our repositioning programs standardized some equipment speck and enabled us to do that kind of buying. Typically we haven't done that in years but we've now done that and it will provide tremendous benefits. We've also done things like changing limestone specks and suppliers, lowering our auxiliary loads minimum loads at power plants and the list goes on and on but it's also a work in process and many savings initiatives yet to follow.

We would not have increased O&M in some areas if we believed that Second Quarter O&M timing issues were a problem. We are putting a culture continuous improvement in place that will achieve savings this year and, yes, help mitigate the impact of the 2016 to 2017 capacity auction results.

Chuck Zebula will also be looking at this business like a private equity investor with the help of generation employees and corporate to reduce expenses commensurate with what the capacity market dictates. AEP has issues with this regulatory construct we sometimes call the capacity market in PJM. This version of socialism that equates DSM and non-firm transmission with reliable capital-intensives still in the ground is really just capitalism in a sand box.

The rules seem to penalize long-term investors. This has change or we'll eventually have a doughnut with PJM being the empty middle, and reliability will suffer. PJM is fully aware of our concerns and, hopefully, will react accordingly because change is desperately needed.

Regarding President Obama's speech I refer to page five of the presentation. In that you'll see, I was actually when I heard the President's speech, it was different than what the write-up of what the initiative was.

In the write up it talked about things like clean coal, natural gas, nuclear, renewables, electric vehicles with the e-gallon approach, which I find pretty intriguing to talk about the dollar per gallon equivalent for the electricity side of things. And transmission was discussed. From that perspective, it was a balanced approach.

I guess the proof comes with what the administration will do and what the EPA will do as a result of some of the activities they are going through. It's certainly clear that they need to be consistent and reasonable in their approach.

I think that as you can see from the page five, our 2015 estimate shows that we'll exceed even the Waxman Markey litigation targets of 17% by 2020 because of coal retirements, coal to gas switching and energy efficiency and renewable resources, as well as transmission optimization.

The industry itself has already achieved 16% reduction because of these activities so not a time to really impair the economy even further. The mercury rules and the natural gas revolution has already achieved the objectives we set out to make consistent progress commensurate with Waxman Markey limitations before.

There is no reason to further cripple economic recovery of this nation by adding or even adding a larger burden of onerous greenhouse gas requirements that further jeopardize the economic recovery and even the electric grid itself. I believe that Gina McCarthy at EPA will be more responsible and reasonable, particularly with what has already been achieved with the mercury rules. Certainly we are seeing more retirements related to that, much more than even the EPA had anticipated.

Hopefully we'll wind up with a reasonable solution we can work forward with particularly as it relates to existing units. We have proposed an efficiency type of requirement and certainly we have striven with our plants to find more efficiency gains and we continue to do that.

Lastly, I'll point to my favorite graph, which is back on page four. I know there have been some comments earlier this morning about this but this is a 12-month ROE view. As we look at this thing, APCo is continuing to improve. We expect that to continue to improve.

I&M has a rate case that was completed that is not fully reflected in these numbers. Its ROE will certainly improve upwards toward 10% in the coming year and as we look at SWEPCO, the SWEPCO rate case in Texas, its retroactive back to the end of January. Brian will talk about this, AFUDC, part of the analysis versus what is actually going to happen back to that point.

We would expect SWEPCO to move up to the 9, 9-plus range. We continue to see improvement and it's because of the capital intensiveness, but also the cases have been completed waiting for an order from the commissions or haven't been fully reflected in these numbers. So we continue to be optimistic about how this chart will look as we go forward in the year.

So with that I would have to say that overall the Second Quarter has been a typical Second Quarter. Weather dependent, load dependent, but as you know, the third and Fourth Quarter is where AEP certainly sees the benefits not only the timing related to O&M but also, from earning standpoint that occurs during the rest of the year during the hot season and the cold season. Again, thank you very much for attending and I'll turn it over to Brian.

Brian Tierny

Thank you, Nick. Good morning, everyone. I'll start on slide six with the reconciliation of this Second Quarter to last year's.

As you can see, American Electric Power's operating earnings $0.73 for the Second Quarter compared to $0.77 per share last year. As I will discuss this decline of $0.04 is explained by the affect of certain Ohio transition is reflect of certain items.

The largest item adversely affecting the quarter-over-quarter includes a combination of certain unfavorable $0.09 per share. This effect on earnings includes a reversal of a fuel provision last year worth $0.05 per share last year and lower capacity payments from competitive suppliers totaling $0.04 per share. Operations and maintenance expenses net of offsets increased slightly adversely affecting earnings by $0.05 per share. The higher expense levels were driven primarily by additional spending associated with storm restoration and incremental planned outage work performed in 2013.

We continue to focus on controlling our expenses across all functions particularly overhead costs and expect to see this impact back end loaded in 2013. We anticipate that O&M net of offsets will be close to flat when compared to 2012 on an annual basis. We will discuss this more later. Weather played an unfavorable role in our quarterly earnings comparison. Temperatures were milder across all of our jurisdictions, adversely affecting results by $0.04 per share was $0.02

However, weather was $0.02 per share favorable versus normal. Allowance for funds used during construction, or AFUDC, was off $0.03 per share in 2013 versus 2012, due primarily to the start-up of the Turk plant in December of 2012.

With the inclusion of Turk in Louisiana and the anticipated rate order in Texas this item will be offset in rate relief as the year progresses. Other items in total were unfavorable by $0.03 per share and include lower results from river operations segment due to weaker market conditions and challenging operating results.

Regulated retail load was down from the prior period adversely affecting the quarterly comparison by $0.02 per share. This decline is being driven by lower commercial and industrial sales and we'll talk about this more later as well. Items positively affecting the quarter over quarter comparison include continued growth in our transmissions operations business by $0.02 per share and by $0.06 per share.

This latter item is largely the interest income component of the favorable Supreme Court ruling associated with the windfall profit tax treatment. The operating income treatment here is consistent with how we previously treated this component of the case. The benefit of the tax treatment is treated as non-operating and consistent with prior period treatment.

Finally, rate treatment was favorable by $0.14 per share in 2013 another result of activity across a multiple of our jurisdictions. Turning our attention to the year-to-date comparison on slide seven, you can see that the Company's operating earnings for this year were $1.53 per share compared to $1.57 per share last year.

I'll focus my works on the significant differences from the quarterly explanation. Adverse year-to-date comparisons include the Ohio transition items that were unfavorable, $0.20 per share, O&M expenses net of offset, and river operations were negative to year-to-date, reasons similar to the quarterly comparison.

And the effective tax rate was negative by $0.05 per share. The tax rate difference was driven by positive prior year tax adjustments as well as unfavorable book-to- tax differences, which are accounted for in a flow through basis. ton he positive side of the ledger, the significant contributor of the other category, which was up $0.03 per share, was the generation of marketing segment which Nick has mentioned earlier.

Transmission operations and interest income were up a combined $0.09 per share for reasons similar to the quarterly comparison and in contrast to the Second Quarter results, weather through June was favorable year-to-date in 2012 by $0.07 per share. Weather was favorable by $0.04 per share relative to normal.

Finally, rate changes were favorable by $0.21 per share in the first half of 2013 versus 2012 with the improvement, again, coming from multiple or our jurisdictions.

In summary, we continue to face the challenge of off setting the unfavorable affect of Ohio transmission items but remain on track to achieve our guidance range for 2013. I'll remind you that the Ohio transition items were included in our guidance for the year. We are clearly challenged in the area of regulated load but expect to exceed our forecast in other areas. As we always do, we continue to manage our businesses and adjust accordingly as we work through the year.

We are confident we are on track to deliver results and discuss this again in more detail later. As I mentioned earlier I'd like to spend some time looking at our regulated load so far this year. Turning to slide eight you can see in the lower right-had quadrant that weather-normalized load was down 2.7% for the quarter and 2.1% for the year-to-date period. The decline for the both periods was driven by lower industrial sales.

Residential sales were close to flat for the quarter but the year-to-date results driven by strong results in the First Quarter. The residential class, shown in the upper left quadrant, was comparable to last year's Second Quarter, down 0.1%. Year to date residential sales show a favorable 0.7% increase as compared to the same period last year. We continue to see some modest customer growth of 0.7% in our western service territory but none to speak of in our eastern areas. In the upper right hand quadrant, you can see the 2.1% decline in commercial sales for the quarter. Year-to-date commercial sales were down 0.9%aided by stronger results in the First Quarter.

Our sales to commercial customers have been the strongest in Texas and Ohio, where growth is being driven by stronger employment growth. Finally, in the lower left quadrant you can see declines I mentioned earlier where industrial sales were down 5.3% fort he quarter and 5.7% year-to-date.

If you exclude the effect of our largest customer, which has been operating at reduced levels the declines would have been 3.1% and 3.3% for the quarter in year-to-date periods respectively. While not minimizing the importance of these declines, it is important to note the affect on gross margin associated with the declines in industrial class is less than other classes.

The average realization from industrial customers is less than half that of residential customers. And a larger portion of the rate is driven by demand charges that adjust to lower levels on a lagging basis. Because of this we are not alarmed on an earnings standpoint by overall load being down relative to forecast.

As Nick alluded to earlier, the mix of load and margin differences resulted in overall year-to-date earnings only being off $0.02 per share despite a year-to-date normalized load decrease of 2.1%. As I have done on previous calls, I'll pause here to share economic indicators for AEP.

The service territory continues to experience stronger growth than the United States in terms of GDP although the growth is not evenly distributed. For the quarter, GDP growth in AEP's western footprint was 2.7% compared to 1.8% growth in the eastern part of AEP's territory. That's compared to an estimated 1.9% growth for the US in aggregate.

Unemployment rate for AEP's total service territory at 7.1% is still lower than it for the US as a whole at 7.6%. Employment growth for the US has finally caught up within AEP's territory after having lagged behind since the start of the recession.

Job growth in AEP's western footprint of 1.5% is identical to that for the US as a whole. Estimates for job growth in our eastern service territory moderated this quarter to an increase of 0.8%

Let's turn to slide nine where you'll find load trends for the quarter from our five largest industrial sectors. Our largest sector, primary metals, was down 16% from last year's Second Quarter.

As I mentioned earlier, the curtailed production at our largest customer and excluding that affect, this sector would have been down closer 8%. We are seeing other customers reducing other until market conditions improve and some are taking advantage of the situation to retool their operations and add efficiencies for their ultimate return to operation.

Chemical manufacturing was down 2.6% for the quarter. This decline was widespread across our service area with the exception of Texas. Even with low natural gas prices market demand remained soft. Petroleum and coal products were up 1.2% for the quarter versus the same period last year, reflecting a new refinery in Texas that reached full capacity in June of 2012.

Two refineries were down for maintenance in the First Quarter. Excluding those customers, this sector would be up 3.5% for the year. The mining sector, excluding oil and gas, was down 1.2% for the quarter. This continuing decline reflects the effect of recent mild winters, low natural gas prices, and low utility demand.

Approximately 90% of AEP's mining load is located in our eastern foot print. Paper manufacturing was up 2.5% for the quarter, driven by higher demand in Ohio that more than offset demand in the west. Although not in our top five sectors, we also continue to see growing sales in the oil and gas extraction and the pipeline transportation sectors, driven by continued expansion related to shale gas activity.

Slide ten provides an opportunity to update you on the financial health of American Electric Power. Our debt to total capitalization remains very healthy at 55.2%. This ranks among the lowest levels for the Company in recent history. Our credit metrics FFO interest coverage, and FFO to total debt are solidly BBB and BAA2 at 4.5 times and 19.1% respectively.

Our net available liquidity stands at nearly $3.5 million and is underpinned by our two resolving credit facilities and our parent term loan credit facility. In order to be able to obtain a private letter ruling on the tax-free nature of our pending corporate separation, we terminated that parent company term loan facility and reinstated the same program at the subsidiary level.

Now Ohio power, AEP Generation Resources, Appalachian Power, and Kentucky Power will be the direct borrowers of the facility. The size and tenor remain unchanged and due to the subsidiary transaction costs should be recovered by reduced borrowing costs.

On the bottom left side of the slide you will see that our pension liability is nearly fully funded at 97%. This is the result of aggressive funding over the last three years and this year's higher discount rate. In addition, due to the changes that were made last year in our post-retirement medical plans for future retirees, as well as higher discount rates, our other post-employment benefit liability is now fully funded.

And finally, this week we priced our inaugural securitization for American Electric Power in Ohio. Specifically $267 million of securitization bonds comprised of $165 million with the weighted average life of 2.25 years and $102 million with the weighted average of just over five years were priced at a duration weighted yield of approximately 1.59%.

The closing date for the issuance is scheduled for August 1. This marks additional progress in our 2013 financing plan and is particularly beneficial to AEP for two reasons. First, we strengthened our balance sheet as we transitioned our regulatory asset into cash, and second, we eased the burden on our customers who realized a substantial reduction in the carrying charge on the regulatory assets.

The net present value of the savings to the customers is estimated to be nearly $24 million. The management and Board remain committed to the financial health of the company as exhibited by the items you see on slide ten.

We will continue to demonstrate O&M discipline, careful capital allocation, and thoughtful access of the debt capable markets. Let me spend time on slide 11 talking about our recent success in reducing the baseline utility operations and maintenance expenses in recent years.

We focus on the base spend because we have been successful at getting certain O&M items placed into trackers with contemporaneous revenue increases for rate making purposes. From 2010 through estimated year end 2013, the compounded annual growth rate for the Company's base O&M spend has been negative 2.9%.

This spending discipline does not happen by accident. The employees of AEP have hard at work on repositioning the Company for the competitive environment we are facing.

In 2013 we formalized the program and engaged our employees to focus on five distinct areas of efficiency improvements, cost saving initiatives and revenue enhancement programs. In addition to the examples Nick provided earlier in the call, another example of the progress we made is in the procurement organization.

At the beginning of the year we asked Craig Rhodes to take the role of Chief Procurement Officer. Among the initiatives that Craig and his team have undertaken was to select the single integrated maintenance repair and operations supplier for all of AEP.

This selection will allow AEP to take advantage of its buying power on behalf of its customers and allow us to reap significant back office and process savings. Recognizing the competitive forces facing our business and the challenges posed by low capacity pricing in coming years, our employees have chosen to continue and expand the continuous improvement programs into 2014. Specific targeted and employee-generated continuous improvement is becoming part of our culture at AEP.

We have come to realize that it works, it makes our operations more efficient, engages and energizes our employees and provides a mechanism for wringing activities and costs out of our operations. Those savings can be channeled back into operations and some can flow to the bottom line. Nick mentioned some of the challenges posed by the capacity auction pricing in PJM.

Expense savings through continuous improvement will help us build a gap created by increased revenues. So will capital rotation into faster growth areas of our business like transmission operations. This is the same capital rotation that has allowed us to grow earnings in this segment of our operations from $0.02 per share in 2010 to a forecasted $0.14 per share this year.

It would be a leap of faith to believe we could be successful in these endeavors if our recent track record did not demonstrate our employees' ability to successfully deliver these positive results. I would never bet against the dedication, ingenuity, and hard work of the American Electric Power employee. On slide 12, I would like to point out some earnings contributors for the balance of 2013.

Many of you have looked at the first-half 2013, added second half earnings and expressed concerns of year end results. Those are concerns I don't share due to number of the balance the balance of year differences reflected on the slide. First we are awaiting an order in Texas as Nick indicated, placing the Turk power plant into rates.

We anticipate an order shortly with those rates to be effective to January 29 of this year. Second, in the Fourth Quarter of last year, we had a significant charge associated with refinancing of our parent company debt. That charge will not recur this year.

In addition, we had some significant expenses in the Third Quarter last year associated with the Derecho windstorm in the eastern part of our service territory. While we expect some continued storm activity, we do not anticipate a large storm of that magnitude. We believe the base utility O&M will be approximately flat to last year's level.

We are anticipating better river conditions and grain export shipments this year in our river operations business as compared to the dismal conditions from last year. Finally, we expect decreased depreciation expenses associated with the recent write-up with Muskingum River 5 unit in the second half of this year. Given where we are in the year, and how we are tracking to our plan, we are confident of our ability to meet our operating guidance range of $3.05 to $3.25 per share for 2013. Thank you for your time this morning and with that I will turn the call back to the operator for your questions..

Questions And Answers

Operator

Thank you. (Operator Instructions) we'll go to the line of Greg Gordon with ISI Group. The line is open.

Q - Greg Gordon {BIO 1506687 <GO>}

Thanks, good morning, guys.

A - Nick Akins {BIO 15090780 <GO>}

How are you.

Q - Greg Gordon {BIO 1506687 <GO>}

I'm good. I hear your enthusiasm and optimism about the ongoing ability of the Company to improve ROE in states where you're underearning and control costs, but there's still a lot of skepticism about very significant headwind from 2015 and 2017 coming from the most recent PJM capacity result as pertains to your ability to sustain 4% to 6% growth rate.

Will you just talk a little bit more about your planning horizon and what you think the tools are in your tool box to plow through that headwind?

A - Nick Akins {BIO 15090780 <GO>}

Yes, Greg, we learned this early on in my tenure we had a $250 million problem with Ohio and now this time around we have 2.5 to three years to get this fully resolved from a sustainability fashion.

As I mentioned early from the O&M issues and the revenue enhancements that we have going on, it's crescendoing over time. The plant ideas were an example of that. Six to eight plants going through it this next year and the rest of the plants going through the following year.

And then we also have the buying measures, the differences in the way they operate the plant. Certainly the unregulated plants are now looking at -- they can look across the board at areas of fuel. Fuel as part of the business case for some of the things they do, which typically is hard to do in a regulated environment because of the different capital versus fuel decisions. But also, Chuck is looking deeply at that team to figure out what the overhead costs look like.

We have to address that because it's in a competitive environment. These plants are focused on making sure they survive and they intend on doing that. So I think, and really, I guess the optimism is coming from the fact that our employees have already come together to find objectives in terms of savings and revenue enhancements for the year that are in excess of the targets that we had in place. And that's confirming this year but also it's setting the track record for the future years because we're only getting partial benefits from some of these in 2013.

Some of these things are starting to kick in now and will kick in later in the year and we'll get the full year benefits in 2014 and then with the additional ideas and things that we are doing, particularly lean wires, those types of activities will continue and we'll see those benefits going in the future years.

So and I guess another issue with that is mid-2014 there will be another capacity auction for the future year, so that will give us insight in terms of how we deal with in that specific year of late 2016 and early 2017, which straddles two years, but as well, we have to decide how much of this is one time adjustments where we can move around outages and those types of things versus how much is actually sustaining into the future.

But it really goes to the question of the volatility of that business and what that means to our planning associated with that. We're not wasting any time, obviously. We are acting like we are going to have to have sustainable savings going forward that compensates for the crafty [ph] auction in late 2016, early 2017, but if it winds up being a capacity market moving up in the future then that could be a different thing.

I think we certainly are in a position now, though, to where we are confident that we are changing a culture that focuses on our ability to address these types of issues. We have to and that's what we are paid to do. And that's something I think our employees are certainly energized around to achieve.

As I said earlier in the discussion, I had it probably, I was thinking originally, we may be able to exceed 6% if we had more transmission spending and those types of things. Well, the more transmission spending we have our eye on is going to fortify that 4% to 6% and it would be silly for us to sit here and say it hasn't had any impact because it has had an impact. I think it has had an impact on our ability to exceed the 6% as opposed to be that 4% to 6% range.

Q - Greg Gordon {BIO 1506687 <GO>}

Thanks very much.

Operator

Next we go to the line of Dan Eggers with Credit Suisse. Please go ahead. Your line is open.

Q - Dan Eggers {BIO 3764121 <GO>}

Good morning. I'm going to carry on with Greg's question. You gave a very thorough answer. Maybe

A little more simply when you look at the Ohio generation and the uncertainty that RPM's are created around economic viability and visibility to the business. How are you guys seeing that fit within AEP and was RPM a point where you were pushed to make a more drastic decision than you were hoping?

A - Nick Akins {BIO 15090780 <GO>}

Yes, certainly if capacity prices had stayed in there at a reasonable level, it probably wouldn't have had everyone questioning the 4% to 6% or our ability to get the cost savings that we need to make sure we were sustainable in the future. I think it raises a lot of questions and we are addressing those questions.

But it also puts us even more focused on how we adjust that particular business, and we talk about minimum load adjustments, for example. The Amos plant reduced its minimal load by over 1,000-megawatts. That's a big change and takes a lot of cost out of the way we operate in relation to the market.

Our people have a very, and I'm not going to say what it is, but certainly they have a very aggressive measure on what they are trying to achieve in terms of a clearing price for capacity that they operate under. But we have a lot of work to do, and I can say that business, if it remains as volatile as it is, if we don't get this capacity construct working where it should, where it respects the long-term investments made by steeling the ground investors in the territory, then that's not something we are very interested in.

It doesn't fit what we believe our investors are looking for and we'll need to make adjustments.

A - Brian Tierny

Dan, I know you talked about this in the past. We were very aggressive on moving on Muskingum River 5 as we saw the results of this and recognized the capacity environment didn't lend itself to further investment in that unit.

And we're going to be very disciplined in terms of the capital that we put to work in that regard and right now not an area that's attracting a lot of capital from us, as compared lower volatility, higher growth areas like our transmission business.

We have been disciplined in the past and we're going to demonstrate that discipline as we work our way through this capacity pricing issue.

A - Nick Akins {BIO 15090780 <GO>}

I don't know that the generation function itself can make up that difference. If you are thinking about what energy prices can be in the future, we don't want to bank on what energy prices will be in the future, we just assume they're going to be low.

We have to adjust accordingly, and it's not just a matter of looking at the unregulated generation business itself. It's also a matter of looking at the overhead that's charged that generation business. If there's less units running, if they're running in different ways, and you're compartmentalizing the profit /loss picture of each unit, then it drives a very different supporting structure from Corporate that supports it. So there's a lot of work to be done and we'll be doing it.

Q - Dan Eggers {BIO 3764121 <GO>}

And one other question looking at the load trends, and obviously the bankruptcies [ph] kind of skew the industrial number, made it a little bit worse than it otherwise would be. Usage trends haven't been great. You've seen unemployment fall. You've seen economic growth in the region. What is the prognosis, do you think, for power demand growth for your territories going forward and is there something bigger structural happening from usage that will really limit future demand growth?

A - Nick Akins {BIO 15090780 <GO>}

I think we continue to see soft load because and it's probably two things, energy efficiency is part of it.

Also, it's an area where the economy through the entire country but certainly in our area as well, there's been a lasting impact of that at the first of the year, economists were saying by the Third Quarter things would pick up.

We were always saying, and have been saying for several quarters now, since the Third Quarter of last year, the industrials were tenuous as best and that continues to be the case. I think there are some structural changes that are occurring. We'll continue to have energy efficiency in play.

The question is can the electrification of the economy outstrip the energy efficiency piece of the business that enables us to continue to grow. But you can't bank on that and that's why I say our business is going to be more about optimization and providing services to customers as well that provide additional benefits beyond what you see just strictly in the low numbers.

But I also believe that, and, as Brian pointed out, the oil and gas activity in our footprint is prevalent with the (inaudible) shell and others, those are wet gas. We have a lot of dry gas top formations.

If we ever get to a point where the economy starts to pick up like the economists keep projecting at some point, we'll benefit probably more than others because of that indigenous growth associated with the shale gas footprint and the production capability associated with it. And that's actually been our saving grace on the other primary metals industrial losses that have occurred. So I'd say certainly with a growing economy but also with the intensive focus on energy-related infrastructure, particularly in our service territory, that could be a benefit. And I'm probably more optimistic. I guess I'm probably if its pessimism, is where is it going to happen.

We've all been waiting for an economic recovery and you hear a lot about housing construction. I see a lot of commercial and housing construction in our service territory and I also see the top of the, all the corn in the fields are still green so that's a good sign. But we really do need an emphasis placed on how to move this economy forward.

Q - Dan Eggers {BIO 3764121 <GO>}

Great, thank you.

Operator

Thank you. Next we'll go to the line of Anthony Cordell with Jefferies & Company. Please go ahead. Your line is open.

Q - Anthony Cordell

Good morning. Two quick questions. One is that it seems everyone is focused on the 2016 and beyond. How could you help us forecast transmission earning? You guys have a great trajectory of transmission earnings, roughly $0.35 you are from projecting in 2015.

What is the best way to forecast it going forward? And the second question. You mentioned during your opening remarks with RPM, and it seems like it's all over the map. It's just kind of throwing numbers out of a hat. What does AEP think the reserve margin is? Actually steel in the ground versus when you're adding in all the demand response and everything else.

A - Nick Akins {BIO 15090780 <GO>}

What steel you put in the ground that's important. We've already finished our build cycle related to generations. Operational, we bought natural gas, that's all done in our eastern footprint and so we're at a point where we can decide probably for the first time in a long time where our capital is deployed.

Much of it was driven by environmental spend, it was driven by new generation spend. Now it's driven by block and tackle infrastructure spending that typically commissions don't have an issue with. As a matter of fact they support it.

And they should because we're at a stage where there's a rehabilitation of the grid that needs to occur. What we are trying to focus on is whether those no regrets types of activities and optimization of transmission is no regrets.

Infrastructure build related to distribution is no regret. Certainly, the investment we are making from an environmental standpoint we have about $4 billion to $5 billion left to spend associated with the particular plants that with we have. But we're doing it in a very different way.

We're not going out and building and then asking for recovery of it. We are going in at the beginning and saying, okay, before we start construction on this thing in a big way we need to know are we going to be able to recover it and in the case of Kentucky we haven't. In the case of Arkansas, we have because there's different set of circumstances and we're more than willing to do that.

In fact, we want to move more of our capital to those infrastructure areas. And that's the kind of steel in the ground that makes sense. With demand side resources, certainly I'm all for demand side resources but not to the point of really jeopardizing the reliability of the grid by depending on those kinds of resources for only a specific set of hours during the year as opposed to the things that we run into in the real world from an operational perspective.

I started out as an electric system dispatcher and my experience was in interconnected power system operations. And I can tell you what's going on now is wrong and it needs to be fixed. But that said demand side resources certainly generation with firm transmission coming into the area is a benefit and we should be mindful of that because we are optimizing resources and defining a new set of resources that includes new technologies as well. So my view is we stay with optionality around the resource side of things but focus on those enabling areas where we can accommodate those resources and provide better services to our customers.

A - Brian Tierny

Anthony, we hope to have more detail for you on the growth trajectory of transmission about the EEI conference time frame. We are working on that capital rotation now. And one thing we've never done is show you earnings we hope to get or think we might get or projects that may come together. We've really tried to show projects that are either approved or don't need further approval and that's why we're reluctant to go out too far in terms of transmission growth rate beyond areas where we've been through the planning process of the RTO's.

A - Nick Akins {BIO 15090780 <GO>}

Anthony, I'll add on to that.

We are already looking at additional transmission projects that can be put in place and addressed more quickly because frankly that's part of the revenue stream and the additional earnings that would partially fill the gap for this capacity issue that we had. So we have every motivation to continue with our transmission investment and every motivation to find and release every bit of capital.

One thing that gets forgotten in all this, the performance management side of things also produces capital alleviation benefits that can be redeployed to other areas including transmissions. Sp we're not just about O&M changes, we're about capital changes as well to accommodate that and fuel that future growth. So as Brian said at EEI we'll have more information on that.

Q - Anthony Cordell

Great. Thank you.

Operator

Next we go to the line of Jonathan Arnold of Deutsche Bank. Thank you, your line is open.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Good morning, guys.

A - Nick Akins {BIO 15090780 <GO>}

How are you.

Q - Jonathan Arnold {BIO 1505843 <GO>}

A quick one on just the quarterly sales and commercial. You mentioned, Brian, I think that you were strong still in Texas and Ohio but you didn't say very much about what had underpinned the big drop. Was it a couple of specific items or something more broad, can you give us more color and what suddenly turned so negative there?

A - Nick Akins {BIO 15090780 <GO>}

And it was largely broader-based across the area. The place where we saw the increase was associated with shale gas plays and growth in employment and the other areas we just weren't seeing that growth in employment as much as we were and it was pretty much broad-based across the sector.

The one thing, Jonathan, that I'll say and we look at these monthly we look at, we discuss with you quarterly weather normalized sales. You really need to look at I think the trend over time to try and understand what's happening with load and can't take it quarter to quarter.

Up modestly in the First Quarter this year down greater than 2% in the Second Quarter. You need to kind of look at a trend line for the quarterlies for a sense of what you think is going on. With the exception of Texas and Ohio the decrease was pretty broadly based.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Thank you. Secondly, on just to understand this interest comma item, so there was like $0.06 of benefit relating to reversing previous negative related to the UK windfall tax. Is that correct?

A - Nick Akins {BIO 15090780 <GO>}

So it's separated in two categories. One is the interest income component of it and the other is the tax component. Interest income we always reflect on ongoing earnings.

To the point where, specifically associated with this item, we had a negative in the Fourth Quarter of last year as we thought the case was going against us and then PPNL won their case at the US Supreme Court. And since we had previously adjusted for this in operating earnings, the interest income component reflecting the same treatment that we always had for interest income.

Q - Jonathan Arnold {BIO 1505843 <GO>}

The negative was booked Q4 last year. This reverses that effectively.

A - Nick Akins {BIO 15090780 <GO>}

It doesn't entirely reverse it. We took a partial write-down of that in the Fourth Quarter of last year where we had previously accounted for the interest income and then we had the full reversal this year. But the full treatment of this issue has always been in ongoing earnings.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Any ongoing beyond this quarter, do we have any continued impact from this item?

A - Nick Akins {BIO 15090780 <GO>}

Very a little bit.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Okay. Just in Q3?

A - Nick Akins {BIO 15090780 <GO>}

It will be true up as we work our way through the balance of the year. But very little.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Okay. And Could I squeeze in one other thing?

A - Nick Akins {BIO 15090780 <GO>}

Sure.

Q - Jonathan Arnold {BIO 1505843 <GO>}

The whole conversation going on with the Commission around trying to reduce tariff. How should we -- is there any kind of guidance exposure to that? Or how should we be thinking about that as we watch it play out.

A - Nick Akins {BIO 15090780 <GO>}

You know, so I wouldn't want to talk specifically about the discussions with the commission that we are having. There are issues as to whether or not Ormat stays in business or not altogether and those items are fairly small for us. If Ormat were to stop operations altogether, the pre-tax would be about $2.8 million per month. So for the balance of the year maybe $0.025 for all of 2014, maybe $0.045 per share.

Q - Jonathan Arnold {BIO 1505843 <GO>}

And that would be incremental would be the difference.

A - Nick Akins {BIO 15090780 <GO>}

That would be, that's right. And that would be if they ceased operations altogether. But remember, Jonathan, there would be some offset for that as well in sales as we have incremental energy to take after the market.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Thank you, very much, guys.

A - Brian Tierny

A large load like many of these industrials but that one in particularly. We don't hardly make any money off it to begin with. But then if it did go away, then we'd be selling to market.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Thanks. For the color.

Operator

Thank you, and our final question from the line of Steven Fleischmann with Wolfe Research. Please go ahead. Your line is open.

Q - Steven Fleishman {BIO 1512318 <GO>}

Good morning, guys. On the PGM outcome and implications, does it have any change besides Muskingum 5 to your co plans or shutdown plans or EPA spend. Are those under any kind of review because of that?

A - Brian Tierny

No, not at this point obviously. We've addressed Muskingum River 5. That was the one issue where we had an incremental investment that would have to be made and related to natural gas.

If the market didn't support making that investment then we retire it. The others plan to be retired anyway which we've already written those off in terms of an impairment.

So the others are fully controlled units that operate well in the market but we are certainly focused on that year and ensure that we are driving costs out and efficiencies that we can draw through the market and make sure they continue to operate. So we don't see anything else at this point.

A - Nick Akins {BIO 15090780 <GO>}

Steve, we've been proactive in getting out in front of this, as Nick mentioned. We had those units we knew we were going to retire in 2015 and the Ohio components of them we wrote off late last year. And then we had bubble units and Muskingum River 5 is one where we thought we were going to be able to retrofit it and run it on gas through 2028. And the capacity results just made that not a prudent investment for us. So it went from being on the bubble to being a unit that makes sense for us not to operate after 2015.

Q - Steven Fleishman {BIO 1512318 <GO>}

Thank you.

A - Julie Sherwood {BIO 16873529 <GO>}

Thank you for joining us on today's call. As always our team will be available to answer any additional questions you might have. Ernie, can you please give the replay information.

Operator

Thank you, very much. Ladies and gentlemen, this conference will be available for replay after 11 AM today until August 1, 2013 at midnight. You (Operator Instructions)

This does conclude our conference for today. Thank you, again for your participation and using AT&T Executive Teleconference service. You may now disconnect.