Q2 2019 Earnings Call

Company Participants

- Bette Jo Rozsa, Managing Director of Investor Relations
- Brian X. Tierney, Executive Vice President & Chief Financial Officer
- Nicholas K. Akins, Chairman, President and Chief Executive Officer

Other Participants

- Alex Morgan, Analyst, Bank of America Merrill Lynch
- Ali Agha, Analyst, SunTrust Robinson
- Angie Storozynski, Analyst, Macquarie
- Greg Gordon, Analyst, Evercore ISI
- Michael Lapides, Analyst, Goldman Sachs
- Praful Mehta, Analyst, Citi
- Steven I. Fleishman, Analyst, Wolfe Research

Presentation

Operator

Ladies and gentlemen, thank you for standing by and welcome to the American Electric Power Second Quarter 2019 Earnings Call. Now at this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will be given at that time. (Operator Instructions) As a reminder, today's call is being recorded and replay information will be given out in conclusion of the conference.

I will now turn the call over to your host, Bette Jo Rozsa. Please go ahead.

Bette Jo Rozsa {BIO 16484334 <GO>}

Thank you, Kevin. Good morning, everyone and welcome to the Second Quarter 2019 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 our opening remarks are Nick Akins, our Chairman, President and Chief Executive Officer; and Brian Tierney, our Chief Financial Officer. We will take your questions following their remarks. However, before I turn the call over to Nick, I would like to share with you that this will be my last earnings call here at AEP. After 39 years with the Company, including 22 years in IR, I have decided to retire, effective September 30th. While I thoroughly enjoyed my role here at AEP and interacting with all of you, there are other ventures I would like to explore and decided now is the right time.

Nick and Brian have graciously invited me to come to EDI for our conference so that I can say goodbye to you and I look forward to seeing you there. In the meantime, I'm leaving you all in very good hands with Darcy Reese, who most of you already know and our new addition to IR, Tom Scott, who many of you will get to meet in the coming months.

I will now turn the call over to Nick.

Nicholas K. Akins {BIO 15090780 <GO>}

Thanks, Bette Jo. Before I get started with the earnings call, I would like to recognize Bette Jo for the wonderful job she has done representing this Company and our investors. I'm a CEO that has been trained by Bette Jo Rozsa. I have the permanent bruises on my shins to prove it. I've looked to her for guidance, no pun intended, with the message of our Company and we will sorely miss her. She mentioned to me that she actually did our first earnings call and has done all of them since, 114 years of earnings calls is a lot. Just kidding. She has been with the Company 39 years and we have done earnings calls beginning in 2000. So again, Bette Jo, thank you.

Now off to the second quarter. We're doing this little differently this time. I'm deferring the actual discussion of the GAAP and operating financial performance to Brian's part of the presentation other than to say, it was another steady as she goes quarter with financial operating performance consistent with our expectations. So, no surprise there. We continue to confirm our operating guidance for the year of $4 to $4.20 per share for the year and our long-term 5% to 7% growth rate. And of course, our Board earlier this year approved the second quarter dividend consistent with our financial plan, which Brian will also cover in more detail.

While the financials for the quarter met our expectations, there were some important catalysts for future growth that developed during the quarter. I'll continue by covering those as well as other highlights and topics for the quarter that we believe you might all be interested in. First, we made several wind resource filings in Arkansas, Louisiana, Texas, and Oklahoma in our SWEPCo and PSO operating companies consistent with our integrated resource plan expectations. SWEPCo and PSO were seeking regulatory approvals to acquire three wind generation facilities currently under development in North Central Oklahoma that total 1,485 megawatts. Hence, the name, North Central Wind Initiative. These projects are being developed by Invenergy and will be acquired on a fixed price turnkey basis at COD. If approved, 200 megawatts will be acquired by the end of 2020 with the balance being acquired at the end of 2021. This $2 billion investment -- regulated investment opportunity represents a unique win-win for customers and shareholders.

The investment is expected to both lower customer rates and provide a long-term earnings opportunity for shareholders. Customer benefits totaled approximately $3 billion nominal net of cost over the 30-year life of the facilities. The investments produced near-term customer savings and positive customer benefits under a wide array of power, natural gas, and production sensitivities. We are seeking timely regulatory approvals in each state in order to take advantage of the expiring federal PTC. The net value of the PTC is accrued to our customers total approximately at $1.4 billion and offset nearly 70% of the total capital investment over the first 10 years of the project.

The acquisition can be scaled subject to commercial limitations to align with individual state resource needs and approvals. We have the ability to take a minimum of 810 megawatts and then provide states the ability to take more megawatts in another state or states reject our applications and we have designed enough flexibility into our applications to move forward under scenarios where only one, two, three, or four states approve. These highly efficient 44% capacity factor wind investments will serve to further diversify our generation fuel mix and act as a valuable fuel price hedge for our customers over the long term.

You might wonder why we didn't acquire for the full 2,200 megawatts with our SWEPCO and PSO integrated resource plans proposed. Because these projects were competitively bid, we recognized a clear break point between the winning three projects that happen to be Invenergy projects, who we have worked with in the past, and others from a pricing perspective. We wanted to position the best projects first and clear winners from an end of money viewpoint so that our commissions could clearly recognize the value for our customers. We can always come in later to fill in the rest of the resource planning requirements with future bids and we feel good about that from a risk perspective.

By following the normal regulatory processes that exist with projects that clearly benefit our customers and with less risky multiple projects that are already being developed and utilization of existing SVP transmission capacity, we believe that these projects are set up for success with our regulators, our customers, and our shareholders. We learned a lot from the experience of Wind Catcher and these filings prove that. Now on to the next hot issue, the Ohio House Bill 6 legislation. Governor DeWine earlier this week signed a legislation that will provide support for the nuclear units in Ohio as well as support for the OVEC generating units.

While the legislation phases out the RPS mandate after 2026, it still provides benefits for the recovery of existing renewable contracts until 2032 and provides additional support for solar projects that have already received signing approval including our 400 megawatts of proposed solar project, which can also collect from the same Clean Energy Fund as the nuclear units. So to reiterate, as far as AEP is concerned, we see positives from this legislation for us, namely recovery of OVEC collected -- that's collected on a state-wide basis through 2030. Secondly, recovery of our existing renewable contracts entered into to comply with previous legislation approved by the PUCO. The opportunity for AEP Ohio to enter into bilateral contracts with certain customers. This one is an important issue for AEP as we have had specific requests from various customers for AEP Ohio to be the provider of renewable resources in addition to being the largest provider.

And fourth, the ability for solar projects that have siting board approval to access the $20 million of the clean air funds, which includes the 400 megawatts of solar that we now have before the PUCO. The access to these funds make these particular projects even more beneficial for customers and as you recall, the request for these projects include a $6 million per year debt equivalency rider to maintain AEP Ohio's capital structure. And finally, the net impact of HB6 will provide headroom to our ratepayers, which will enable potential additional distribution investments to improve the customer experience and grid reliability. AEP does believe in the importance of nuclear generation as a part of the portfolio of this country and the State of Ohio.

We congratulate speaker householders, the Senate President Obhof, Governor DeWine, Lieutenant Governor Husted, and Chairman Randazzo along with many other members of the Ohio legislature in balancing the interest of the need for a balanced portfolio, employment and economic development issues, and customer benefit. Also do not think we should view this as the end of Energy Policy activities in Ohio. From our perspective, HB 247 that includes provisions for grid modernization and behind the meter technologies is important. This legislation would clarify the ability for AEP Ohio to continue to deliver emerging technologies to our customers that not only improve the customer experience, but enhances grid resiliency and efficiencies.

This is a critical area to provide clarity regarding these types of investments that will define the future of the electric utility. HB 247 will continue review in the house with hearings expected in September and AEP believes this to be the companion bill that will complete the redefinition of Ohio energy policy. Another legislative session that just concluded was in Texas, that provided some important wins for SWEPCo and AEP Texas. SWEPCo can now recover reasonable cost for deployment of advanced metering technologies while providing customer protections.

AMI technology has been implemented in the ERCOT portion of Texas but not in the SWEPCo Texas jurisdiction. So we are pleased that that can proceed.

Also, new legislation allows SWEPCO to obtain approval for a rider from the PECT to recover the investment and power generation facilities outside of a rate case when the generation goes into operation with certain provisions being made for subsequent rate case timing and the size of the investment. Also affecting both SWEPCO and AEP Texas, the legislature passed Senate Bill 1938, a roper [ph] bill that clarifies rules regarding the investment in any new interconnected transmission facilities. Yesterday, we announced the purchase of 227 megawatts, 75% interest in the Santa Rita Wind Farm for approximately $356 million. This is just another example of our continued growth consistent with the capital plan for our contracted renewables business.

We also could not be more pleased with the outcome of the purchase of the Sempra Wind assets. We are already seeing the prospects of this business continue to grow beyond the value of the original deal financial expectations. Not only are earnings so far from the business toward the upper end of our acquisition modeling, but the development projects are moving along nicely as well. AEP Clean Energy Resources is close to completing negotiations related to the construction of one of these development projects that uses the safe harbor equipment.

This project along with others amounting to 1,000 megawatts are in various stages of development. This business now has committed $1.5 billion of the $2.2 billion committed at EEI last November, so very good progress there. Brian will be discussing the economy in load in a few minutes in more detail, but I will say while we have seen areas of load decline, primarily tariff-related, we do expect better performance from our load growth in the second half of the year as a result of a number of new customers for expansions that will come on board primarily in the oil and gas area and data center load areas.

The biggest economic headwind we have at this point is the impact of the trade war on the businesses in AEP's service territory. The increasing number of tariffs on goods beyond steel and aluminum have impacted export manufacturers in our service territory. Certainly, the trade wars have weakened the world economy and caused a strengthening U.S. dollar, which adds even more of a hurdle. Hopefully, all of this can get resolved during the election season, since a strong economy is one of President Trump's major reelection tenets. So we will continue to monitor this closely as we move forward in finalizing our expectations for next year regarding load growth. Because the rate cases I&M, SWEPCo Arkansas and AEP Texas are in their initial stages, I'll cover them as we go through the equalizer chart. So, we'll go through that.

Turning to that chart on Page 5, AEP's overall regulated operations, ROE, is currently 9.7% versus 10.1% last quarter. The primary reason for the decrease in quarter two 2019 versus quarter one 2019 was the significantly unfavorable weather versus the year before and lower normalized load, mainly in our vertically integrated utilities. Looking at the individual companies, the ROE for AEP Ohio at the end of the second quarter was 12.2%. We expect to end 2019 in this 12.5% to 13% range as we continue to invest in the distribution smart grid, partially offset by the legacy fuel carrying charges rolling off.

The ROE for Appalachian Power at the end of the second quarter was 8.9% compared to 9.5% at the end of first-quarter 2019. APCO's change in ROE from the previous quarter is primarily attributable to stronger weather results in second quarter 2018 versus this year. Lower normalized margins also contributed to lower ROE, but this was offset by the payable rate proceeding in West Virginia.

The ROE for Kentucky power at the end of the second quarter 2019 was 7.6% compared to 8.6% at the end of first quarter 2019. Kentucky's second quarter ROE versus the first quarter was down primarily due to unfavorable weather and unfavorable transmission true-up. We are working on optimizing revenue and scrutinizing the OEM and capital to improve ROE by the end of the year.

The ROE for I&M at the end of the second quarter was 11.1%. I&M's positive performance in the second quarter was primarily driven by timing of the expenses and multiple one-time adjustments. I&M expects to end the year with an ROE around 10%, which is in line with the authorized ROEs in Indiana and Michigan. I&M continues to successfully execute its capital programs in generation, transmission and distribution and recently filed future test year rate cases in both Indiana and Michigan to seek timely recovery of the ongoing capital cost.

In Indiana, I&M filed for a $94 million net increase with a 10.5% request at ROE. Intervener testimony is due in August. And hearings are anticipated in October with an expected effective date, March 2020. In Michigan, I&M filed for a net increase of $52 million with a 10.5% ROE. Intervener testimony is due in October, and hearings will occur in November with a commission order expected in April of 2020. The ROE for PSO at the end of the second quarter was 8.4%. PSO received an order on its base case settlement in March 2019, which contained an important provision for a full transmission tracker and a partial distribution tracker.

With the continued implementation of new base rates and tracker, we believe that PSO will earn its authorized ROE by the end of the year. The ROE for SWEPCO at the end of the second quarter was 5.9% versus 7.2% at the end of first quarter 2019. The most recent 12-month ROE decreased primarily due to unfavorable weather, loss of normalized load margins, and the 2018 wholesale formula rate true-up.

However, the PECT approved the Company's TCRF settlement in July, which will produce approximately $11 million of additional annual revenue. Additionally, we filed in Arkansas an Arkansas base rate case in February 2019. SWEPCO's ROE continues to be affected by the Arkansas' share of the Turk Plant that is not in retail rates. And this impacts the ROE by about 125 basis points. SWEPCo filed in Arkansas for a net increase of $34 million, which is $46 million minus $12 million depreciation with 10.5% ROE.

Arkansas Public Service Commission staff recommended a $20 million increase based upon a 9.5% ROE. The filing provides for SWEPCo's movement to an annual, formula-based rate review mechanism. Hearings are expected in October with new rates expected to go in effect in early 2020. The ROE for AEP Texas at the end of the second quarter was 8.5%.

The reason for the increased ROE this quarter is primarily due to a one-time deferral of previously reported interest expense approved for recovery in the AEP Texas Storm Cost Securitization financing order issued in June 2019. We expect the ROE to decline by year-end due to lag associated with the timing of annual filings and our base rate review filed with the PUCT on May 1st, 2019. During a rate review year, there is a lag associated with these filings. Continued high levels of investment will continue to have an impact on the ROE in 2019. Regarding the rate review, we filed a net increase of $35 million with 10.5% ROE.

Intervener testimony is due today, and hearings are set for August with an expected effective date in first quarter 2020. The ROE for AEP Transmission Holdco at the end of the second quarter 2019 was 10.6%. AEP Transmission Holdco quarter two ROE is higher than quarter one due to a favorable change in one-time events such as the prior year true-up in June. Regarding the FERC 206 filings in the AEP east and west territories, we have obtained settlement orders in both cases. In May, the FERC issued a settlement order -- approval order for the east territory of AEP that includes a base ROE of 9.85%, effective January 1st, 2018 with a total ROE of 10.35% including the 50 basis point RTO adder. The settlement includes a cap on the equity portion of the cap structure at 55%.

In the west transmission area, the FERC issued an order at the end of June that includes a base ROE of 10%, effective back to the date of the first complaint. This is a total ROE of 10.5% including the 50 basis point RTO adder. There are no caps on the equity portion of the cap structure, and implementation of the new rates will occur in third quarter.

Refunds for prior periods will be made part of the annual true-ups. And the parties agreed not to seek any change in the ROE prior to January 2021. So all-in-all, another great quarter particularly with the headwinds of tariff-related economic conditions. The second quarter still met expectations financially, but more importantly, the predicate has been set for some important growth opportunities. I would be remiss in not mentioning an evolving side of the earnings growth equation bending the OEM curve. In the face of operational challenges that the industry has recently faced, operational excellence is paramount as the foundation of AEP's ability to advance the creativity and innovation necessary to move our company forward in our transformation to be the premium utility of the future.

Technology innovations through digitization and automation is absolutely required to get us there. There will be more to come in November EEI, but I just want to give you a couple of examples that we have implemented in this phase. One, we call the asset damage assessment tool, ADAT, that digitizes information to more effectively screen facility locates for underground facilities.

We expect to be able to clear a request without sending crews for inspection as we do today, saving time and resources. And two, our breaker shot digital maintenance platform where digitized real-time information will improve efficiency, thereby allowing more preventative maintenance inspections of our over 7,500 generation related breakers to be brought in-house as opposed to more expensive outside contractors being used for the work.

Just a couple of examples, but many others will continue to move the needle on reducing OEM and provide better service to our customers. These efforts remind me of a drummer that creates new rhythms that can only be grounded by the rudiments or fundamentals of drumming.

A lot of practice to develop muscle memory and the creativity to develop new complicated rhythms that redefine the notion of operating rhythm.

As an example, just listen to a famous drummer, Gavin Harrison, who played an unusual 7/4 time signature beat in Sound of Muzak, which M-U-Z-A-K, if you're looking into that, by Porcupine Tree. A great sounding song but very difficult to learn and play. This is what AEP is in the process of doing now, focusing on the fundamentals of operational excellence to provide the muscle memory while establishing the culture of creativity and innovation necessary to define a new operating rhythm of technology deployment to bend the OEM curve and find new avenues for growth.

So, while this quarter is another solid quarter, just know that we are feverishly in the background driving forward and providing future shareholder value and improving our customer's experience. Brian?

Brian X. Tierney {BIO 15917272 <GO>}

Thank you, Nick and good morning, everyone. I will take us through the second quarter and year-to-date financial results, provide some insight on load in the economy, and finish with a review of our balance sheet and liquidity. Let's stop briefly on Slide 6, which shows the comparison of GAAP to operating earnings for the quarter and the year-to-date periods.

GAAP earnings for the second quarter were $0.93 per share compared to $1.07 per share in 2018. GAAP earnings through June were $2.10 per share compared to $2 per share in 2018. There is a reconciliation of GAAP to operating earnings in the appendix. Let's go into the detail on Slide 7 and look at the drivers of quarterly operating earnings by segment.

Operating earnings for the second quarter were $1 per share or $494 million compared to $1.01 per share or $498 million in 2018. Operating earnings for the vertically integrated utilities were $0.38 per share, down $0.18. Weather was the largest driver of the variants this quarter, down $0.13 from last year, driven by the warmer than normal temperatures experienced in the spring of 2018.

Normalized load was also unfavorable with decreases across all classes. We will talk more in detail about our normalized load and regional economies a little bit later. Rate changes helped offset these declines. You can see other smaller impacts for this segment listed on the slide.

The transmission and distribution utility segment earned $0.27 per share, up $0.04 from last year. Favorable items included rate changes and recovery of increased transmission investment in ERCOT as well as favorable carrying charges and taxes.

These favorable items were partially offset by higher depreciation and property taxes on the increased investment and higher O&M due to storms.

The AEP Transmission Holdco segment continued to grow, contributing $0.31 per share, an improvement of $0.10 over last year. This growth reflected the return on incremental rate base as well as the impacts of the annual true-up and a favorable FERC settlement.

Net plant increased by $1.4 billion or 19% since June of last year. Generation and marketing produced earnings of $0.06 per share, up $0.01 from last year, primarily driven by the growing renewables business and the repowering of Trent Mesa and Desert Sky as well as the acquisition of the Sempra Wind assets.

Corporate and other was up $0.02 primarily due to the consolidating tax items that should levelize over the year and will partially offset by higher interest expense and a positive tax adjustment from last year that did not recur.

Let's turn to Slide 8 and review our year-to-date results. Operating earnings through June were $2.19 per share or $1.1 billion, compared to $1.97 per share or $972 million in 2018. Looking at the earning drivers by segment, operating earnings for the vertically integrated utilities were $1.01 per share, down $0.02 with weather subtracting $0.15 compared to last year.

Normalized load was also down for the year across all classes. And depreciation increased due to incremental investment. On the positive side, rate changes added $0.18 per share. Lower O&M added $0.06, and AFUDC and transmission revenue were each favorable by $0.02.

Through June, the transmission and distribution utilities segment earned $0.58 per share, up $0.09 from last year influenced by the reversal of a regulatory provision in Ohio.

Other favorable drivers included higher rate changes and transmission revenue as well as favorable carrying charges and taxes. Partially offsetting these favorable items were higher depreciation and property taxes from increased investment as well as higher O&M and unfavorable weather.

The AEP Transmission Holdco segment contributed $0.57 per share, up $0.15 from last year. This growth in earnings reflected our return on incremental rate base as well as the impact of the annual true-up and a FERC settlement.

Generation and marketing produced $0.14 per share, up $0.01 from last year. Increases in retail margins and the growth in the renewables business were offset by lower generation sales due to plant retirements and outages. Finally, corporate and other was down $0.01, primarily driven by higher interest expense in taxes, which were partially offset by lower O&M.

Overall, we are pleased with our financial results and are confident in reaffirming our annual operating earnings guidance of $4 per share to $4.20 per share.

Now let's turn to Slide 9 and update you on our load performance. Starting in the lower right chart, normalized retail sales decreased by 1.8% for the quarter compared to 2018. This decline is largely responsible for the 1% decrease in the year-to-date comparison.

For both comparisons, normalized retail sales were down across all operating companies and retail classes. We now anticipate 2019 normalized sales to come in 0.2% below 2018.

Moving clockwise, industrial sales decreased by 2.7% for the quarter, which brought the year-to-date comparison down to 1.5% below last year. Sales to the industrial class have been slowing in recent quarters as the impact of the strong dollar and more restrictive trade policy have challenged export manufacturers within AEP's footprint.

For both the quarter and the year-to-date comparison, industrial sales were down across all operating companies with the exception of Public Service Company of Oklahoma, which benefited from increased oil and gas activity in 2019. I will provide more color on our industrial sales on the next slide.

In the upper left chart, normalized residential sales decreased by 1.4%, compared to the second quarter of 2018. As described earlier, the weak second quarter performance erased the positive momentum from earlier this year, making the year-to-date comparison essentially flat. The decline in normalized usage for the quarter more than offset the 0.4% growth in customer accounts.

Finally, in the upper right chart, commercial sales decreased by 0.9% for the quarter and were down 1.3% year-to-date. For both comparisons, commercial sales were down across all operating companies. The tightening labor market and rising interest rates have limited this sector's growth in recent quarters.

Turning to Slide 10, I'll provide more color with respect to our industrial sales growth. This chart shows the disparity in growth between the oil and gas sectors and all other industrial sectors. The oil and gas sector load shown in blue mirrors the pattern for oil prices.

For the quarter, industrial sales in the oil and gas sectors increased by 2.8%. We expect growth in oil and gas to continue throughout 2019 based on a number of new projects identified to come online later this year, primarily in the mid and downstream part of the sector. Focusing on the red bars, the non-oil and gas industrials have struggled since the first tariffs were announced last year.

For the quarter, industrial sales other than oil and gas declined by 4.6% compared to last year. Most of this slowdown can be tracked to the export industries such as chemicals manufacturing, which is down 14% for the quarter.

Ironically, sales to the primary metals sector declined by 1% this quarter despite the tariffs on steel and aluminum. As discussed on previous calls, AEP has a higher exposure to trade policy given the higher concentration of export manufacturers located within the service territory.

Despite these headwinds, we have a number of new industrial expansions, as I said earlier, largely focused on oil and gas. And we expect this to drive industrial sales into the positive territory for the full year. Now let's turn to Slide 11 and review the status of our regional economies.

As shown in the upper left chart, GDP growth in AEP service territory was 1.8% for the quarter, which is 0.8% below the U.S. The strongest growth for the quarter came from the AEP Texas service territory. All of our service territories experienced GDP growth with the exception of Kentucky.

Moving to the upper right chart, you see that employment growth for the AEP service territory improved this quarter to 1% above last year, while US growth moderated slightly in the second quarter. Throughout the AEP footprint, over 18,000 jobs were added in the second quarter with 37% of those coming from the education and healthcare sector.

Other sectors that experienced strong growth and employment in the quarter included construction and natural resources and mining. The final chart at the bottom shows the income growth of AEP's footprint moderated slightly in the second quarter while U.S. income growth accelerated.

For the quarter, personal incomes within AEP's service territory increased by 3.4%, which was 0.7% below the U.S. Income growth is a key driver for residential and commercial sales.

Now let's turn to -- let's move on to Slide 11 -- I'm sorry, -- let's move on to slide 12 and review the Company's capitalization and liquidity. Our debt total capital ratio increased 1% during the quarter to 58.8%. Our FFO to debt ratio was solidly in the BAA1 range at 15.3%, and our net liquidity stood at about $2.6 billion supported by our revolving credit facility.

Our qualified pension funding decreased approximately 2% to 96%, and our OPEB funding decreased approximately 1% to 130%. A drop in interest rates with the largest driver in the decreased funding status with strong equity and fixed income returns helped offset much of the liability increases.

Let's try to wrap this up on Slide 13, so we can get to your questions. We have successfully achieved outcomes in all expected regulatory cases. And we will work with our regulators to obtain approval in the North Central Wind initiative benefiting our PSO and SWEPCo customers.

Our year-to-date performance in the stability of our regulated business model gives us the confidence to reaffirm our operating earnings guidance range of $4 per share to $4.20 per share.

With that, I will turn the call over to the operator for your questions.

Questions And Answers

Operator

Thank you. (Operator Instructions) Our first question is Greg Gordon, Evercore. Please go ahead.

A - Nicholas K. Akins {BIO 15090780 <GO>}

Good morning, Greg.

Q - Greg Gordon {BIO 1506687 <GO>}

Good morning. Bette Jo, like an institution is leaving, it's very -- I'm happy for you, but at the same time sad that we're going to miss you. Looking forward to seeing you. That's my question. That's it. Just kidding. No, my question is with regard...

A - Nicholas K. Akins {BIO 15090780 <GO>}

Ask her if she's going to stay longer.

Q - Greg Gordon {BIO 1506687 <GO>}

My question is with regard, just a little bit more thought perhaps on what's going on on the demand side. I mean, clearly on the industrial side, you've been upfront on saying that things are a little bit behind plan and you point to the sort of trade tensions and other factors. At the same time, it looks like the demand from the oil and gas sectors remain strong except we're seeing signs of significant weakening and activity there in real-time. So, how do you guys manage around the potential volatility in those areas in the economy if they wind up trending weaker than planned over the next several years?

A - Brian X. Tierney {BIO 15917272 <GO>}

Greg, we've always of course monitored load and what's going on with that and we've tried to adjust over time our O&M spend in response to how load is impacted either by trade tariffs, the dollar, or things like weather. And we saw that impact this quarter as well. We -- you mentioned seeing slowdown in oil and gas. We're kind of seeing the opposite of that. We're seeing uptick in oil and gas right now including expansions through the end of the year. And whereas previously we've seen things really on the upstream side, we're now starting to see things on the mid and downstream side as things -- as the infrastructure comes in to fulfill what's been happening in the producing part of that industry. So, we're still seeing uptick in oil and gas and anticipate increases in that throughout the balance of the year. But we are subject as are -- is everyone else to what's happening with the general economy and weather. We've been very successful in responding to that over the last several years and anticipate doing the same going forward.

A - Nicholas K. Akins {BIO 15090780 <GO>}

The interesting thing is, Greg, the oil prices remain at least relatively decent unlike, I guess, natural gas prices continue to be relatively low. But there's a lot of oil field activity. But also, like as Brian said, the infrastructure pipeline activity continues because there's a lot of production that can't -- and that's why prices are so low in live territories. They just can't get the transmission capabilities. So, a lot of work continues in that regard. The other part is even our industrial base is pretty diversified and it's unusual to see several of them line up. Eight out of ten I believe sectors are decreasing. And you can really point to the tariff activity. So if that gets resolved, we should be in much better shape in our territory.

That being said, there is expansion going on. Matter of fact, there was just an announcement in Corpus Christi of a large expansion there. It was announced a couple days ago. So, we continue to see the pipeline of activity. And I think we just need to get past these tariff issues so that people really understand -- the companies understand the rules of the game so they can make investments. And so, we'll get there. But until then, we'll do what we've always done. No matter what's going on with all the fundamentals associated with our business, we pull the levers we need to to make sure externally we provide that consistent quality of earnings going forward. So if the economy is adjusting, we have to adjust.

Q - Greg Gordon {BIO 1506687 <GO>}

Clear. Thank you.

Operator

And our next question is from the line of Julien Dumoulin-Smith, Bank of America. Please go ahead.

A - Nicholas K. Akins {BIO 15090780 <GO>}

Good morning, Julien.

Q - Alex Morgan {BIO 20604015 <GO>}

Good morning. This is Alex calling in for Julien. Congratulations, by the way, Bette Jo.

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

Thank you.

Q - Alex Morgan {BIO 20604015 <GO>}

I have two quick questions. And one is first on Ohio. I was wondering if you have looked into and could detail the impact of decoupling from the Ohio Bill 6. I know that this is something that First Energy is exploring and I was wondering if this could potentially be a positive for you as well.

A - Nicholas K. Akins {BIO 15090780 <GO>}

Well, we're already decoupled in Ohio. So, that really isn't an issue for us.

Q - Alex Morgan {BIO 20604015 <GO>}

Okay, great. And then my second question is plans for AMI in SWEPCO, if this could also be another positive for the Company and if so when we might anticipate future announcements about it?

A - Nicholas K. Akins {BIO 15090780 <GO>}

Yeah. I think it will be positive for SWEPCO, and certainly, we want to go about the process as quickly as possible to get AMI metering put in place as a predicate for many of the technologies that we're working with. So, it's important to do that. I think you're probably going to be seeing a focus on that very soon now that the whole installation is done.

Q - Alex Morgan {BIO 20604015 <GO>}

Okay. Thank you. And also including like Arkansas and states like that rather than just Texas?

A - Nicholas K. Akins {BIO 15090780 <GO>}

Well, certainly we'll install AMI metering wherever we can install it. But -- and I think I'd have to check, but I'm pretty sure we could do that in the other states already. We just haven't gotten to the point of moving that process ahead in those jurisdictions yet, but we're getting there.

Q - Alex Morgan {BIO 20604015 <GO>}

Okay. Thank you so much. Thanks for taking my questions.

A - Nicholas K. Akins {BIO 15090780 <GO>}

We had recently installed some AMR meters in SWEPCO. And so, we're really managing through dealing with the replacement of those at the same time of putting in AMI metering. So, it's one of those areas where timing is going to be really important and certainly the regulatory process will be key in terms of the implementation.

Q - Alex Morgan {BIO 20604015 <GO>}

Okay. Thank you again.

Operator

Next question is Steve Fleishman, Wolfe Research. Please go ahead.

A - Nicholas K. Akins {BIO 15090780 <GO>}

Good morning, Steve.

Q - Steven I. Fleishman {BIO 1512318 <GO>}

Hey. Good morning. Bette Jo, congratulations. Definitely wish you the best.

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

Thank you.

Q - Steven I. Fleishman {BIO 1512318 <GO>}

Just maybe -- I don't know if you have this detail, but out of curiosity, when you talk about the strength in oil and gas, is there a big difference between the AEP east and AEP west businesses? Is it mainly in the west?

A - Brian X. Tierney {BIO 15917272 <GO>}

Yes. Steve, yes. So, we're seeing it in the west, particularly in Texas and Oklahoma.

Q - Steven I. Fleishman {BIO 1512318 <GO>}

Okay. How about the AEP east oil and gas? Is that down or flat or still up?

A - Brian X. Tierney {BIO 15917272 <GO>}

It's still up. But it's not to the degree that the west part is.

Q - Steven I. Fleishman {BIO 1512318 <GO>}

Okay. And then maybe could you just talk about maybe a little more color on the regulatory approval process on North Wind and just kind of timelines and the like?

A - Nicholas K. Akins {BIO 15090780 <GO>}

Yeah. So, I guess the beauty of all this is it's using the standard integrated resource plan processes. And we'll go through the normal hearings, but we're expecting to have an outcome in about a year. The filings have just been made. And obviously, we'll go through the testimony and all that kind of stuff in the meantime.

We'll try to move it as expeditiously as we can to take advantage of the PTCs. But we expect the procedural schedules to come out soon. But our expectation is, it'll take about a year to get those approvals.

Q - Steven I. Fleishman {BIO 1512318 <GO>}

Okay. And do you just -- you just need to prove that -- you don't need to prove need, you just need to prove this is like lease cost or in the public interest?

A - Nicholas K. Akins {BIO 15090780 <GO>}

Well, yeah. That's right. There is capacity needs and TSO. And then SWEPCo has been -- is looking at it from really a customer benefit perspective.

Q - Steven I. Fleishman {BIO 1512318 <GO>}

Got it. Okay. Thank you.

A - Nicholas K. Akins {BIO 15090780 <GO>}

Yeah. Really nothing unusual about these filings. And that's probably the good thing. You know, we went after Wind Catcher because it was an unique opportunity. And we certainly wanted to be able to perform [ph] that project. But, it was outside the regulatory process and all that kind of stuff, so and the risk involved of large transmission. So, this is a very different proposition within the framework of the existing processes.

So, we feel good about it.

Q - Steven I. Fleishman {BIO 1512318 <GO>}

Okay. Thank you.

Operator

Our next question is from the line of Angie Storozynski, Macquarie. Please go ahead.

Q - Angie Storozynski {BIO 15115714 <GO>}

Thank you. Bette Jo, congratulations. So, two questions. You mentioned that the Sempra Wind portfolio, both the operating assets and the development pipeline are actually exceeding your expectations. That together with some of the cost cutting, is that enough to keep you in the middle of your guidance range for this year?

A - Nicholas K. Akins {BIO 15090780 <GO>}

Oh, yeah. We feel good about where we stand for the guidance of this year and with the additions there along with our optimization activities. But also, we have gone through several series of rate cases in previous years that continue to benefit us as well.

So, I mean, obviously, there's a lot of issues to look at, a lot of areas where -- every year we have positives and negatives. But all in all, it comes down to where we fully support the guidance that we give. And I don't see an issue there at all.

Q - Angie Storozynski {BIO 15115714 <GO>}

Okay. And then secondly so, you have those additional growth drivers. So, the AMI, capex, the potentially rate base renewables in SWEPCo and PSO. How should we think about those? Are those going to elongate the current growth rate for the Company, i.e., there's going to be some reduction of transmission spending or some other capex to basically keep the growth rate unchanged? Or is this incremental to the current growth rate?

A - Nicholas K. Akins {BIO 15090780 <GO>}

Yeah. So, we continue to look at what the future holds and still an obviously long-term growth rate of 5% to 7%. We're still -- we'd be disappointed if it wasn't in the upper end of that because we expect to get approvals for these additional wind projects that we haven't included in our plan. We're watching the economy obviously. And you tell me what the timing is of getting the tariff issues resolved.

But they'll probably get resolved before the election, I would presume. If that's the case, then we should be in a really good shape. And of course, every year that goes by -- we're a large company, and fueling 5% to 7% growth is more and more of a challenge.

But, that's why we look at things like what is going on with our contractor renewables, the value of the Sempra deal, what's going on with the regulated additions, not just regulated additions in the western territories, but in the eastern territories as well, particularly with the legislation.

And keep in mind too, I think it's really important to focus on what Ohio has just done. It's opened up the ability for us to work directly with customers on the AEP Ohio side where they wanted to because there's customers who have said, we want you to do our solar projects, we want you to do the resources for these facilities.

And to this point, we've been unable to say that AEP Ohio could do that. Now we can. And so, I think that's going to fuel a further expansion from a renewables standpoint and from a resource standpoint, microgrids, and so forth.

And watch this House Bill 247 because I think that's really important around what we do on the digitization, automation, the technologies at the distribution side. And I continue to view the distribution wedge, capital wedge of this Company continuing to grow considerably as a result of that.

The other thing too is transmission. Transmission, we have to spend $2.5 billion just to keep the present average age. So, if you think about that, that's a foundation.

And if we ever want to advance the age, which is pretty old at this point, we have to continue to invest in a large degree in transmission to make sure that our system remains reliable and resilient. So, there's so many opportunities.

Well, another one I would point out is a pilot that we're doing in Virginia right now around broadband. We're doing sort of the midstream broadband that the others, AT&T and others are supportive of us doing because we're already putting in fiber for resiliency of the grid itself in terms of analytics. There's available capacity. We can bring the urban areas closer -- the rural areas closer to the urban centers as well, allow broadband to exist in these communities that don't have it today.

And that's another opportunity for us to continue to go. And then lensification [ph] of the economy. So, I'm bullish about the growth opportunities of this business. The question on our minds is how we manage our balance sheet around the FFO to debt and those kinds of metrics and be able to address all the capital opportunities we have.

And of course, that may mean recycling assets, doing what we need to do to optimize the efficiency of the use of that balance sheet. So, there's still a lot of work for us to do. There really is good work.

Q - Angie Storozynski {BIO 15115714 <GO>}

Just one follow-up to the balance sheet management. You never mentioned how you're going to finance this -- those rate-based renewables at SWEPCo and PSO. Is it fair to say that this update is coming only once the approvals are in, i.e., about 12 months from now?

A - Brian X. Tierney {BIO 15917272 <GO>}

Absolutely, Angie. So, obviously, when we talked about this opportunity, it's not what we laid out in our current financing plans. This would be incremental to it. And we would update that as we get approvals. But I think you've seen from us in the past really putting generally equal measures of debt and equity together to finance our capital plans and really fairly conservative management of our balance sheet. And I think you'll see that continuing going forward.

Q - Angie Storozynski {BIO 15115714 <GO>}

Great. Thank you.

A - Brian X. Tierney {BIO 15917272 <GO>}

Thanks.

Operator

Our next question is from Ali Agha, SunTrust. Please go ahead.

Q - Ali Agha {BIO 1509168 <GO>}

Thank you. Good morning. Bette Jo, best wishes to you as well.

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

Thank you.

Q - Ali Agha {BIO 1509168 <GO>}

First question, Nick or Brian, just wanted to clarify the growth outlook. I recall back in the past when you've talked about your base plan. And that was before you announced the wind projects and renewable projects that you thought that your base plan could track you to the high end of the 5% to 7% growth rate.

Is that still your expectation? And if so, and if you get these wind approvals, could that theoretically actually take you above the 5% to 7% growth rate?

A - Nicholas K. Akins {BIO 15090780 <GO>}

Well, I've always said and I continue to say, we believe it certainly will make 5% to 7% more robust. And we'd be disappointed if we weren't in the upper end. And we're going to have to get through and determine what happens to the load going forward.

We have the growth opportunities there. But, you know, if you have tempering aspects of load growth, I think it'd be probably good for us right now to stand padded at the 5% to 7% what we said previously that we expect to be and certainly would be disappointed if we weren't in the upper end of that 5% to 7%.

Q - Ali Agha {BIO 1509168 <GO>}

Okay. And then more near-term again, just to clarify. You've brought down your load expectations for this year from up 1% to now slightly down. Weather obviously has been a drag. Can you just kind of remind us in the very short term what are sort of the immediate offsets to think about that could help you this year? Is it all O&M? Or is there something that's actually gone better than perhaps budgeted to offset that?

A - Brian X. Tierney {BIO 15917272 <GO>}

Yeah, Ali. It's a couple of things. One is O&M. The other one is, we've had some positive rate outcomes that have outpaced our expectations for the year.

Q - Ali Agha {BIO 1509168 <GO>}

I see. Okay. And then lastly, just to also clarify, assuming that the entire $2 billion management is approved, would you consider that all incremental? Or is there an opportunity for you to standout some of the base capex and sort of fit it in within the current capex profile?

A - Brian X. Tierney {BIO 15917272 <GO>}

We've not made a determination on that yet, Ali.

Q - Ali Agha {BIO 1509168 <GO>}

Got you. Thank you.

Operator

And next question is from the line of Michael Lapides, Goldman Sachs. Please go ahead.

Q - Michael Lapides {BIO 6317499 <GO>}

Hey, guys. Good morning, guys. I got a longer-term question for you. When you look around across the jurisdictions, where do you have -- where do you lack regulatory mechanisms that you would like to see to get put in place? Which of the jurisdictions where you think your regulatory team has the most wood to chop? And how do you think that process plays out in those few jurisdictions, like what's on your wish list?

A - Nicholas K. Akins {BIO 15090780 <GO>}

Yeah. I have a lot of wishes. But we have about 65 -- I mean, two-thirds to 70% of our rate recovery is through tracker-rider mechanisms. So, we're doing pretty well from that perspective. But there are things obviously I'd like to see, because this utility business right now, we're needing to invest in the resiliency and the reliability of this grid, and really refurbish the grid in a major way.

And that tells me that it'd be great to have more forward-looking type of test years like we do in Indiana. The formula-based rate mechanisms are really good. But there's still some wet lagging. But they're better than waiting on rate cases and stuff.

And I think it's important to have mechanisms in place where there are formula-based rates, where there are forward-test years. Those kinds of things need to be in place to allow us to continue to invest and not impact our balance sheet from an FFO to debt perspective.

And you know, keep in mind, AEP did not go out for additional equity or anything with tax reforms. So, it certainly, it brought our credit metrics in to something that obviously we need to watch, particularly as you're investing capital. And then with load decreasing and revenue having an impact associated with that, that's going to further impact the FFO to debt. So, we're watching that very closely, those metrics to preserve our balance sheet.

And then, that's obviously something we're going to have to continue to work through. So, I don't know if you have anything to add, Brian.

A - Brian X. Tierney {BIO 15917272 <GO>}

Michael, we don't have any jurisdictions where we have real concerns any longer. There's been a lot of progress that's been made in places like Oklahoma where we still have integrated utilities, and it's not just wires only.

One of the initiatives that we're working on and taking a close look at from the terms of the risk of the customer and ourselves are the depreciation rates associated with our fossil generating stations and making sure that they're in line.

So, that's an initiative that all of our vertically integrated utilities are looking at. We made some headway in that in regards to the Rockport generation depreciation in Indiana where we had an offset associated with the flowback of the deferred income taxes.

We were able to shorten up the depreciation period and not impact customer rates by having that offset from the deferred income tax flowback. So, that's an initiative that we're working across the jurisdictions. But it's kind of a blessing, we don't have any that we would call trouble jurisdictions today.

The jurisdictions are operating well, and our operating companies have strong relationships with the regulators and legislatures. And we're getting good outcomes like Nick described in Ohio. So, there's no sore point that we are overly concerned about but just some broad-based initiatives that we continue to work.

A - Nicholas K. Akins {BIO 15090780 <GO>}

Yeah. A lot of balls on our equalizer chart, it's either because of weather or that we continue to invest heavily in these jurisdictions. But it's clearly important for us. And you're seeing advancement of formula-based rate mechanisms, Arkansas, for example.

We now have some riders -- significant riders in TSO in Oklahoma. And of course, the other riders in Indiana, Michigan, and so forth. And those are beneficial. But if I look at two things forward-looking for this industry, with the issues of cyber, physical security, refurbishment of the grid, ensuring that we maintain a reliable system going forward, it's imperative that we're able to invest and recover on a timely basis.

And that tells me, you know, formula-based rates, I'll take it, forward-test years, even better. And we need to work that around the horn across all the jurisdictions.

Q - Michael Lapides {BIO 6317499 <GO>}

Got it, guys. Thank you. Very thorough answer. Much appreciated.

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

Operator, we have time for one more call.

Operator

Okay. And that question is from the line of Praful Mehta of Citi. Please go ahead.

A - Nicholas K. Akins {BIO 15090780 <GO>}

Good morning, Praful.

Q - Praful Mehta {BIO 19410175 <GO>}

Hi good morning and congratulations Bette Jo. All the best.

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

Thank you.

Q - Praful Mehta {BIO 19410175 <GO>}

So, maybe the first question on slide 9, where you have the industrial growth, and I know you've touched on this in the past. But just wanted to confirm, year-to-date down 1.5%. But your budget clearly is positive. So, you clearly see already things that are in place that would increase in load between now and year-end. Is that right, just to confirm?

A - Brian X. Tierney {BIO 15917272 <GO>}

That's correct, Praful. And when we see expansions that are out a year or more than a year, we need to really weight those for probability of them coming in. We feel pretty confident about things as close in as six months.

Q - Praful Mehta {BIO 19410175 <GO>}

Yeah. Exactly. That's what I would have got. So, thanks for confirming. And secondly, maybe on the credit point that you all made because you have all these opportunities for investment, and you will be conservative by the sounds of it on the financing side, just wanted to understand how the cash effective tax rate fits into that because it's helpful, on slide 34, you've indicated around a 5% cash tax rate.

Is that something that you expect will stay around that level? Or does that -- you expect that to change? And would that put any pressure on the metrics over time?

A - Brian X. Tierney {BIO 15917272 <GO>}

So, we do expect the cash tax rate to be around that 5.25% going forward. Clearly, the flowback of the deferred taxes is a big use of our cash these days. But remember, we had gone in with this strong balance sheet before tax reform thinking we are going to become a big payor of taxes.

And now that we're not a big payor of taxes, we're a big flow backer of deferred income tax. That's -- I don't think that's a word. But we are now flowing back significant amounts of deferred taxes. So, for this year, given the orders that we had, we had anticipated flowing back both protected and unprotected, about $267 million.

We're now going to be flowing back about $330 million in 2019. Going forward, in the next three years, we anticipate that number being a lot closer to about $200 million.

Q - Praful Mehta {BIO 19410175 <GO>}

Got you. And that was a choice in terms of flowing back more this year given you have some room on the metrics?

A - Brian X. Tierney {BIO 15917272 <GO>}

It was a choice by our regulators.

Q - Praful Mehta {BIO 19410175 <GO>}

Got you. All right. Well, thank you so much. Really appreciate the color.

A - Brian X. Tierney {BIO 15917272 <GO>}

Thanks, Praful.

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

Thank you for joining us on today's call. And thank you all for the kind comments on the phone and all your emails. I'm a bit overwhelmed right now. And as always, the IR team will be available to answer any additional questions you may have.

Kevin, would you please give the replay information?

Operator

Thank you. Ladies and gentlemen, if you wish to call the replay number, you will call 1-800-475-6701 with the access code 469236. International calls may dial area code (320) 365-3844. Those numbers again, 1-800-475-6701 with the access code 469236. International callers, (320) 365-

3844 with the access code of 469236. Now that does conclude your conference. We do thank you for joining. You may now disconnect.