Q4 2018 Earnings Call

Company Participants

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

Other Participants

- Ali Agha, Analyst, SunTrust Robinson Humphrey
- Angieszka Storozynski, Analyst, Macquarie Research
- Gregory Gordon, Analyst, Evercore ISI
- Jonathan Arnold, Analyst, Deutsche Bank
- Julien Dumoulin-Smith, Analyst, Bank of America Merrill Lynch
- Paul Ridzon, Analyst, KeyBanc Capital Markets
- Praful Mehta, Analyst, Citigroup

Presentation

Operator

Ladies and gentlemen, thank you for standing by and welcome to the American Electric Power Fourth Quarter 2018 Earnings Conference Call. At this time, all participants are in a listen-only mode. Later we will conduct a question-and-answer session, instructions will be given at that time. (Operator Instructions) As a reminder, this conference is being recorded.

I would like to now turn the conference over to our host, Managing Director of Investor Relations, Bette Jo Rozsa. Please go ahead.

Bette Jo Rozsa {BIO 16484334 <GO>}

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

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

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

I will now turn the call over to Nick.

Nicholas K. Akins {BIO 15090780 <GO>}

Okay. Thanks, Bette Jo. Good morning, everyone and thank you for joining us today for AEP's fourth quarter 2018 earnings call. As we move into the new year and look back at 2018, we are pleased to report solid earnings for the quarter and for the year. Favorable weather continued into the fourth quarter, with the economy remaining healthy albeit tempered later in the year by the negative impacts of trade tariffs issues and a strong dollar.

With that said, 2018 was the strongest for normalized load growth since 2011. We continue to see customer counts pickup and low growth continue in primarily the oil and gas sectors and residential sales growth as well. Overall, good, but we'll keep a close watch on this sector growth in the economy and the customer load growth makeup.

As you all know, we earlier, during third quarter 2018 revised our guidance for operating earnings from $3.75 to $3.95 per share to $3.88 to $3.98 per share, and came in for the year solidly in the upper end of the revised guidance at $3.95 per share. We're very pleased with how our employees continue to work to provide a better customer experience, while being dependably consistent to our shareholders on delivering these results. 2018 was clear -- was clearly has been a great year, but I -- I'm even more pleased with the track record over the last eight years of what we have achieved.

Brian and I and the rest of the team take this very personally and see this as one of the hallmarks of the emerging brand of AEP. So let's take a look at the actual numbers for 2018. Starting with the financial performance for the fourth quarter, we came in with GAAP earnings of $0.74 per share versus $0.81 per share in 2017 and operating earnings of $0.72 per share versus $0.85 per share in 2017. This brought the year-to-date 2018 total GAAP earnings to $3.90 per share versus $3.89 per share in 2017. And year-to-date 2018, total operating earnings to $3.95 per share versus $3.68 per share in 2017.

The difference between the GAAP and operating earnings primarily being generation plant related impairments and tax adjustments. We also concluded rate cases in five states, it was a pretty heavy year from that perspective, Indiana, Michigan, Kentucky, Oklahoma and Texas. AEP also filed rate cases in two states, West Virginia and Oklahoma which will conclude early this year.

Tax reform related activities were also major regulatory undertakings in the AEP state jurisdictions as well. All have proceeded well and orders generally ranging from primarily excess unprotected ADIT refunds being amortized over various periods were applied against depreciation or various riders. Almost all of the states have concluded orders reflecting these adjustments and we do not expect any additional impacts during 2019.

Moreover, even with the headwinds described earlier in an increasing interest rate environment, AEP continues to outperform the S&P 500 Electric Utilities Index and the S&P 500 over the 1-year, 3-year and 5-year periods. Again as I said last year at this time, the very definition of a premium regulated utility. So great performance in the past, but in recognition of one of this year's Rock Hall of Fame inductees Janet Jackson and the title of one of her songs, what have you done for me lately, let's talk about what we see in 2019.

AEP's operating earnings per share guidance range for 2019 is $4.00 per share to $4.20 per share. As we have said during EEI Financial last November and continue to say with the capital plan we have outlined for the next five years, including $6.5 billion in 2019, our focus on disciplined capital allocation among our businesses and additional opportunities to grow renewables beyond our financial plan, we will be very disappointed to not ultimately be in the upper range of our 5% to 7% growth rate.

Additionally I will reiterate, the regulated renewables opportunities represented by the various integrated resource plans filed in our state jurisdictions are not included in our capital forecast, so upside potential certainly exists. We also continue to work to bend the O&M curve through efficiencies, process automation and digitization as well as implement technologies to drive efficiencies, while improving the customer experience.

Regarding the renewables opportunities we have filed integrated resource plans and RFPs with all of the SWEPCo and PSO state jurisdictions representing up to 2,200 megawatts of wind resources. On March 1st, bids are due focused on ownership of these facilities, primarily due to factors such as balance sheet optimization, scalability opportunities, deliverability and various other risks versus the use of PPAs. We will file the results of the RFP process in August and each state regulatory circumstance will determine the path forward. Our view is, that all construction will be completed by the end of 2021, thereby taking advantage of the 80% PTC value and contribute to earnings starting in 2022.

The Ohio 400 megawatt solar review process continues, which is part of the 900 megawatts of renewables contemplated for AEP Ohio. Hearings are continuing this week and the next week regarding the question of need for these facilities really focused on a strict definition based on capacity or other broader stated issues regarding renewables, job creation, state economic development which Governor DeWine is very interested in and others.

It is interesting to note, low income customers support us in this case, because of the accessibility of renewable resources that would not otherwise be available. This position goes directly to the message that utilities are inherently equipped to provide the scale to reduce cost and the ability to provide universal access to these types of resources and technologies. After the hearings, we will continue to push this process forward to resolve this important question for Ohio. As far as rate cases are concerned, we contemplate -- we completed a heavy load of rate cases in 2018 as I mentioned earlier in the five states and we await the finalization of the already filed West Virginia and Oklahoma rate cases soon this year. We will also be filing rate cases in Arkansas and Texas as soon as well.

Regarding the West Virginia rate case, we have already filed a settlement agreement among the major parties including the staff is effective in March, so we should get an order soon from the

Commission. Regarding Oklahoma as you all know, this is our third try to receive a positive outcome in Oklahoma, where we have been woefully underachieving from a financial viewpoint, while providing excellent customer satisfaction and operational performance.

Intervenors and staff testimony has been filed and we believe our tenor of where we stand at this point is even keeled with some bright spots of at least recognizing while perhaps concerned with the concept of performance-based ratemaking for various reasons, there maybe options for distribution riders or forward test years, that could alleviate the pressure of regulatory lag.

The ROEs filed by the parties were slightly higher than the proposals from last -- the last case we went through, but are still among the lowest in the nation. Is Oklahoma really opened for business and economic development as the new Oklahoma Governor expresses, we'll find out. We are always open to settlement discussions with the parties to resolve these important issues, but we have a long way to go. And in no doubt will come down to the Oklahoma Corporation Commission making the ultimate call. I would ask them as our referee to make the right call and not be like the NFC championship game.

This is important from the perspective of the integrity of the regulatory process in Oklahoma, the health of PSO and its ability to invest in the state and from an economic development standpoint that concerns the significant AEP presence, not PSO but AEP of over 600 employees centralized in Tulsa. We expect interim rates in Oklahoma to be in place in April and an order from the Commission soon thereafter.

So now I'll turn over to the equalizer chart and talk about some of the state actions here. Overall, the regulated operations ROE is currently 9.7% versus 10.1% last quarter. I'll remind you that we generally project the ROE for our regulated segments, combined to be in the 9.5% to 10% range. The primary reason for the slight decline from quarter four versus quarter three was the increase in O&M and fourth quarter this year versus the lower spend as we had very tempered weather last year in the fourth quarter. So some adjustments were made there.

As far as AEP Ohio is concerned, the ROE for AEP Ohio at the end of the fourth quarter 2018 was 14.5%. The primary drivers obviously continue to be some of the adjustments that were made previously. The RSR, the fuel, the PIRR, those kinds of adjustments that are going to roll off by the end of -- some roll off by the end of last year and some will roll off towards the middle part of this year. We expect to see the ROEs come closer to the authorized range as we go forward.

APCo, the ROE for APCo at the end of the fourth quarter 2018 was 9.4% compared to 9.9% at the end of third quarter. APCo's change in ROE from third quarter is primarily attributable to higher storm restoration expense during the fourth quarter and a tax true-up. And again I will remind you there is the settlement agreement that will be -- become effective in March 2019. In Virginia, APCo's first triennial review is in 2020 and we'll cover the 2017 to 2019 periods.

For the first triennial case and for rate adjustment clauses in the period of December 2018 to November 2020, the Virginia Corporation Commission authorized the 9.42% ROE, which would be the reference going into the period to determine whether APCo's Virginia earnings for the three-year period are within the allowed range. The approved ROE for West Virginia is 9.75% right now.

In Kentucky, the ROE for Kentucky at the end of fourth quarter was 9% compared to 9.2% at the end of third quarter. Kentucky Power continue to perform well in 2018 from a 5.1% ROE at the end of 2017 to the 9.0% ROE at the end of 2018. So great progress in Kentucky. Our NIM, the ROE and our NIM at the end of the fourth quarter was 11.4% versus 12% in third quarter, I&M posted strong results in 2018, primarily driven by favorable weather, disciplined O&M spending and one-time true-ups associated with the regulatory items.

Favorable rate reviews in both Indiana and Michigan also contributed to the strong year. And then as far as PSO is concerned, the ROE, we talked about previously is 6.9% versus 7.7% at the end of third quarter. PSO's ROE continues to improve over last year, which was 5.92%, but was slightly down in fourth quarter, mainly due to unfavorable normalized retail margins. However, the ROE continues to be challenged, primarily because of ongoing regulatory lag. And as you know, we have a rate case filed there to resolve some of those issues.

SWEPCo, their ROE at the end of fourth quarter was 6.5% versus 7.4% at the end of third quarter. Primary reason for the decrease in the ROE is the impact of the most recent Texas rate case. The Company recorded $31 million in December, 2017, that related back to an implementation date of May 2017. SWEPCo's ROE continues to be affected by the Arkansas share of the Turk Plant, it's not in retail rates. This impacts ROE by about 135 basis points. SWEPCo also had contracts expire with certain wholesale customers during the period as well, so that had an effect. We plan to file an Arkansas base rate case this year. So we'll continue with that to try to address the SWEPCo's issues.

AEP Texas at the end of fourth quarter was 8.5% versus 8.8% at the end of third quarter. While earnings have grown year-over-year, the reason for the declining ROE is due to lag associated with the timing of annual filings as we continue to make significant capital investments along with some timing related O&M spend. Favorable regulatory treatment has allowed us to file an annual DCRF and biannual TCOS filings. But the fast growth in rate base and associated property taxes and depreciation has made lag, a more significant factor. So we continue to invest heavily down there.

AEP Transmission Holdco, the ROE for Transmission at the end of fourth quarter was 10% versus 10.4% in third quarter, and it's primarily lower in the third quarter due to differences between actual taxes and equity balances versus projected taxes and equity balances filed in our formula rate revenue applications. These difference will be recognized in our June 2019 formula rate true-up. So all-in-all, still within the range we have talked about previously, the 9.5% to 10%, we expect it to continue in that range and we also expect continual improvement in the ones that are hanging a little bit lower.

So as we move forward into 2019, we are intent on building upon our tremendous track record of delivering earnings well within our guidance range. And in fact, in the last six years have exceeded the mid-point of our guidance range each and every year. Borrowing the lyrics from another of this year's Rock Hall of Fame inductees, Def Leppard from the song Hysteria, our consistency and quality of delivering positive financial and operational results, it's such a magical mysteria. When you get that feel-in, better start believe-in, that AEP is in fact, the premium regulated utility.

I have two scores to settle real quickly, Nos [ph] I hope you are having a great day. And Scott, I need more cowbell. Brian?

Brian X. Tierney {BIO 15917272 <GO>}

Thank you, Nick and good morning, everyone. I will take us through the fourth quarter and year-to-date financial results, focusing primarily on year-to-date, provide some insight on load and the economy, review our balance sheet liquidity and pensions, and finish with a review of our outlook for 2019.

Let's begin on Slide 7, which shows that operating earnings for the fourth quarter were $0.72 per share or $354 million compared to $0.85 per share or $420 million in 2017. Most of this year-over-year variance was expected and came from higher O&M, as we reduced spending in 2017 in response to that year's unfavorable weather. All the detail by segment is shown in the boxes on the chart, but the change in our regulated businesses was driven by higher O&M and decreased load, more than offsetting the return on incremental investment to serve our customers. The Generation and Marketing segment produced operating earnings of $0.07 per share, up $0.02 from last year due to higher energy margins and favorable income taxes. Corporate and other was down $0.10 due to higher O&M, interest and income tax expenses.

Turning to Slide 8, we will review the year-to-date comparison in more detail. Our annual operating earnings for 2018 were $3.95 per share or $1.9 billion compared to $3.68 per share or $1.8 billion in 2017. This difference can primarily be attributed to favorable weather and recovery of incremental investment, partially offset by higher O&M as we reduced spending in 2017. Our regulated segments experienced growth for the year. And as expected, our competitive Generation and Marketing business was down due to last year's asset sales.

Looking at the earning drivers by segment. Operating earnings for Vertically Integrated Utilities were $2.00 per share, up $0.36 with the single largest driver being weather, which added $0.33. Looking at total degree days, 2018 was the highest in the last 30 years, while 2017 ranked 29th. Successful implementation of rate changes added another $0.26. Other favorable items included higher transmission revenues and AFUDC, as well as lower non-service pension costs and income taxes.

Offsetting these items were anticipated decreases in wholesale load and lower normalized retail margins, as well as increased O&M and depreciation expenses. The Transmission and Distribution Utilities segment from $1.05 per share, up $0.04 from last year. Favorable drivers included higher rate changes, normalized load and weather, as well as lower non-service pension costs. These were partially offset by higher depreciation.

The AEP Transmission Holdco segment contributed $0.75 per share, up $0.03 over 2017. This growth reflected the return on incremental rate base, which was mostly offset by prior period accounting adjustments and minimal formula rate true-ups this year compared to the larger one in 2017. Net plant grew by $1.4 billion or 21% since December of 2017. The Generation and Marketing segment produced earnings of $0.29 per share, down a $0.01 from last year due to the sale of assets, and mostly offset by favorable income taxes. Finally, Corporate and Other was down $0.15 per share from last year due to the prior year investment gains and higher interest, O&M and income tax expenses. We are pleased with our results for 2018. As Nick said, we landed in the upper end of our updated earnings guidance range.

Now let's turn to Slide 9 for an update on normalized load growth. Starting in the lower right chart, normalized retail sales decreased by 0.7% for the quarter, but ended the year up 0.8% compared to 2017. Even with the modest load performance over the last half of 2018, normalized load growth for the year was the strongest AEP has experienced since 2011. Every operating company experienced normalized growth in retail sales in 2018, with the exception of Kentucky Power.

Moving clockwise, industrial sales increased by 0.3% for the quarter and ended the year at 2% higher than 2017. The growth in industrial sales moderated in the fourth quarter and was driven by increases in the oil and gas sectors. Industrial sales, excluding oil and gas experienced a slight contraction in the quarter. This was driven by a more restrictive US trade policy, a weaker global economy, a stronger dollar and lower energy prices.

In the upper left chart, normalized residential sales increased by 0.2% for the quarter and ended the year up 0.6% over 2017. The growth in residential sales was mostly due to customer count growth, while normalized usage was down 0.5% for the quarter. For the year, residential customer accounts increased by 0.6%, which is twice the growth experienced in 2017.

Finally, in the upper right chart, commercial sales decreased by 2.8% in the fourth quarter and ended the year down 0.5% from 2017. Commercial sales were down across all our operating companies for the quarter and the year. The estimates for load growth presented on this chart differs slightly from what we showed at the EEI Conference in fall due to the fact that we now have actual numbers for the full year of 2018, rather than the estimates we had at that time. Our actual load estimate for 2019 has not changed.

Now let's turn to Slide 10 and review the status of our regional economies. As shown in the upper left chart, GDP growth in AEP service territory was 2.8% for the quarter, which is 0.3% below the US. The US economy has eclipsed that of the AEP service territory since the tariffs went into effect in the second quarter. As discussed on previous calls, AEP has a higher exposure to tariff given its higher concentration to export manufacturing. In fact 38% of all US exports originate in the 11 states served by our regulated utilities.

The upper right chart shows the gap between employment growth is narrowing between AEP service territory and the US. The US has experienced stable job growth over the past two years and the job market within AEP's footprint has continued to improve. For the quarter, job growth in AEP's territory was 1.3% with higher growth in the West. The unemployment rate for AEP's territory fell to 4.1% this quarter, which is the lowest level on record. The sectors that added the most job this quarter were professional and business services, education and health services and leisure and hospitality.

Final chart at the bottom shows that income growth within AEP's footprint has not kept pace with the US in recent months. For the quarter, personal income growth in -- for AEP was 0.2%

below the US. Income growth is a key driver for residential and commercial sales growth. It is too early to know what the impact of the partial Federal Government shutdown will have on our economy. Federal Government share of unemployment across our territory ranges between 0.7% in Arkansas to 7.2% in Texas, with some portion of these numbers being unaffected military employees.

The longer the shutdown lasts, the higher impact we would expect to see in residential and commercial sales due to lower personal income and spending. Overall, 2018 was a strong year for the economy and AEP service territory. The boost to incomes from a robust job market and tax reform create a momentum earlier in the year that carried us through the headwinds of the tariffs, stronger dollar and higher interest rates. We expect the economic growth to continue in 2019.

Now let's move to Slide 11 and review the Company's capitalization, liquidity and pensions. Our debt to total capital ratio increased slightly during the quarter to the 57%. Our FFO to debt ratio was solidly in the Baa1 range at 17.8%, and our net liquidity stood at about $3.1 billion, supported by our revolving credit facility. Our qualified pension funding decreased to 99% and our OPEB funding decreased to 129%. A drop in yields increased the liabilities for both plants, while at the same time falling equity prices detracted from asset returns.

Our fixed income holdings provided a positive offset to the liability increases and equity losses. Investors have been asking if our pension expense estimates are increasing in 2019 due to market volatility late in 2018. We are not seeing a meaningful change in our assumed pension expense. This is largely due to having what we believe are appropriately conservative assumptions regarding discount rate for liabilities and the expected rate of return for investments. We are also comfortable with our asset allocation.

As we disclosed at EEI, our assumed pension discount rate for 2018 was 3.65% and for 2019 it's 4.3%. Our assumed asset rate of return has increased slightly by 25 basis points to 6.25%. Our target asset allocation is 25% equities, 60% fixed income, and 15% alternatives. Our combined pension, OPEB, pre-tax expense was a credit of $65 million in 2018 and we expect a credit of $59 million in 2019.

Now let's wrap this up on Slide 12 and try to get to your questions. We begin 2019 with a solid track record. Our earnings were strong in 2018 as we continue to invest capital in our businesses. For eight years now we have maintained O&M discipline and kept spending net of offsets in a tight range of between $2.8 billion and $3.1 billion. In addition, over time, we have grown our dividend with earnings and expect to be able to do so going forward. Last year AEP's Board of Directors increased the quarterly dividend by 8.1% on an annual basis. This increase along with the midpoint of our 2019 earnings guidance range brings our payout ratio to the middle of our 60% to 70% targeted range.

Looking ahead to 2019, we are reiterating our operating earnings guidance of $4.00 to $4.20 per share. We will finalize our pending rate cases and move forward with opportunities in the renewable space. We will continue our disciplined approach to allocating capital, and are confident that there is significant runway in our capital programs to reaffirm our 5% to 7% operating earnings growth rate.

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

Questions And Answers

Operator

(Operator Instructions) And our first question comes from the line of Julien Dumoulin-Smith with Bank of America. Your line is open.

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

Hey, Julien.

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

Hey, good morning.

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

How are you doing? Good.

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

Hey, good. Congratulations.

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

Thank you.

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

So, Nick let me go back to where you started the call a little bit, and certainly was impressed by the comment on being disappointed of not being at the high end of that 5% to 7% range. Can you comment a little bit on what gives you that confidence today, just given some of the moving pieces in the end of the year, but also I just wanted to understand what your expectations are for that moderating ROE in Ohio? I know we've been talking about it for a little bit, but basically are you still talking about being at the higher end potentially despite having that moderation and where are the other pluses this year as you think about it?

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

Yeah. So yeah, we do expect the higher end of that moderation. And also as I look at the year going into it, certainly with the capital plan that we've put out there, the consistency associated with that as well, the opportunities that exist in front of us, we continue to look at those opportunities certainly in the integrated resource plans that are filed with the various states. What we're doing, not only from -- that from a bending O&M curve perspective. I think we have more tailwinds than headwinds. And I -- when we look at the plan that we put forward, it's a solid plan. And as I have reiterated several times, it doesn't include some real opportunities out there for us to even achieve a better result.

So -- and I don't -- and really -- I really think of that as sustainable results not like up one year, down another year that kind of thing. We pride ourselves in that element of consistency and certainly the capital plan demonstrates that but also the opportunities ahead of us, there are more singular opportunities, more singles and doubles, because obviously if we had gotten something like Wind Catcher, for example, with front-end loaded, many of the integrated resource plan activities, but in this case, we're following these plans and they'll be smaller projects, they'll come into play and we'll see the continuing improvement. I think we have a great case for the utility and -- for the AEP utilities to own these assets. And depending upon the outcome of that, certainly I would suspect some positive movement from that perspective.

So I feel good about it. I think I feel good about our culture, of the organization, our culture is around innovation, but it's also definitely around bending the O&M curve and addressing the issues in front of us. And you look at the -- for example, the weather last year in '17 versus, now it's two years ago, versus '18, very mild weather in '17, earnings still came in where we really we're telling the market they would come in at. '18 it was ahead, still came in where we said it would be and obviously beat the midpoint. So we have some resiliency that's built-in in our organization and the culture of the organization that really drives to those kinds of results. So I'm optimistic.

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

Excellent. And can you comment or perhaps elaborate rather on some of the developments in Oklahoma. You alluded to several potential positive riders and other new mechanisms (inaudible) in Oklahoma to help improve your earned ROEs. What does that mean with respect to another rate case or do you think largely you could achieve some of this through the current rate case. And I know it's still pending. But I just want to understand at least from a -- more of a process perspective how you're thinking about it here?

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

Yeah, I certainly don't want to presuppose the outcome, it'd be great if we got pretty considerable result in this rate case to get us back on the even footing. And certainly Walmart, I guess, was one of the intervenors that had said obviously performance-based rate-making, you know, about that, but certainly looking -- forward looking test years, well that would be a great outcome to be able to look at forward looking test years. And as well some of the other even, I think it was the Attorney General and may have been someone else, but was opened to actually putting in additional generation -- additional distribution related rider activity.

So -- and that was -- still have work to do with the industrials, they were probably the most negative from an intervenor perspective. But I really believe when you look at the discussions and what was centered versus last -- the last case and the previous case, there at least now is recognition of the issues that we have. And there is no doubt that the issues that we're discussing are well known by the commissioners and certainly the intervenors. So I'm hopeful that it can certainly move to a more positive outcome.

What we're looking for, obviously is progress, and we expect progress. And I think there it has to be a clear message around that, because we've languished since 2013 in Oklahoma. And that just has to change. And matter of fact, with the integrated resource plans, we have filed in those various states, PSO in Oklahoma, obviously is one of those, we need to see a positive outcome of rate case where we make additional investments of that kind in the state and obviously the timing will workout to where we'll be able to make those kinds of decisions.

And then, I think it's pretty well known now that Tulsa, Oklahoma is like a second corporate headquarters to us with over 600 people there that focus on primarily the Western properties, but also some of the Eastern activities as well. Those are not PSO employees, they're AEP employees. So we should put AEP up on top of the building there so that Oklahoma knows that we do have a significant presence there.

And I think that's important, and I think it's important to the livelihood of the Tulsa area, but also I think it's important for this Company to be able to have a central location like that, that we're able to operate out of. So there's a lot of things in the context of all this, that's probably becoming more well known and hopefully all drive us to a better outcome.

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

Excellent. Thank you. Best of luck.

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

Thank you.

Operator

Thank you. And our next question comes from the line of Jonathan Arnold of Deutsche Bank. Your line is open.

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

Good morning, Jonathan.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Good morning, guys. Hi.

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

Good morning.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Good morning. Just trying to get back to your comments on the upper end of the or upper range of the 5% to 7%. Were those specific to 2019 guidance or were they more a statement about your confidence in executing in that range on over the five-year plan? I wasn't quite clear when you said it at the outset?

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

Yeah, we said 5% to 7% growth rate, long-term growth rate over the future periods. And obviously when you put in renewables, that are not going to be in place until 2022 from a financial standpoint, that's part of it. So it's -- I would say it's geared more towards the long-term, but the trajectory should hold true. And there will be things that come in during '19, there will be things that come in during '20 and '21 and in the future years. So I think we have real opportunities in each and every year, but obviously we're positioning this as part of our 5% to 7% growth rate.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Okay. So that upper range that was kind of over the plan effectively?

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

Yeah, that's right.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Yeah. Great, thank you, Nick for that. And then on just the slowdown you saw in sales in the fourth quarter, can you give us a little more of a sense of why you remain confident keeping the 2019 sales estimate unchanged from EEI and maybe some color on what you're seeing early this year and what you're hearing from your customers?

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

Yeah, certainly Brian can cover this in more detail, but the way I see it is, we're seeing somewhat of a tempered economy because of the trade issues. And as Brian mentioned, that we have a lot of companies in our territory that are, certainly trade has an impact and once those shackles come off, we believe the economy will continue on its previous trajectory. And so, it's certainly difficult to tell when that's going to happen. But I think you're hearing some more promising dialog from our national leaders. Let's hope that continues to be the case.

But even then, I guess probably we look at customer accounts. Customer accounts is up considerably. So we're very happy with that and the fundamentals seem to still be in place for the economy continuing to roll along. From the world economy perspective, obviously that would have an impact, but I think that's probably again tariff-driven from many respects.

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

Julien [ph], a lot of the growth that we anticipate in 2019 is going to be driven by the industrial space. And particularly industrial space in the oil and gas sector, we see a lot of company-proposed and company invest and customer invested in expansions in that area. And they are close at hand, we expect a lot of those to come on in 2019. In the fourth quarter oil and gas was up 5.6%, in the third quarter it was up 7.7% and we expect that expansion to continue in 2019.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Brian, can you do the math for us though, how much everything that wasn't oil and gas was down in 4Q?

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

Yeah. In the fourth quarter, it was down 0.6%, non-oil and gas industrial. And in the third quarter, non-oil and gas industrial was up 0.6%.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Okay. And then obviously -- so obviously your outlook is premised on assumption that growth continues. You talked about the plan having been building resilience, the company. Could you talk maybe a little bit about how resilient you think your plan is to maybe if that view doesn't pan out?

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

Yeah, I think if you look at and Nick talked about it, the change that we had year-on-year, '17 to '18 in terms of weather and how we were able to adjust O&M in both years, to be able to hit our numbers, I think that demonstrates that resilience, so whether it's weather, whether it's load growth, whether it's tariff impact or whatever, we actively manage our way throughout the year putting the brakes on or the accelerator on as the case may be to get work done that we need to get done. So I think just the weather year-on-year demonstrates that resiliency.

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

And I think we are seeing sort of a -- if you put a microscope to it, with the industrials impacted by the tariffs in particular, the commercials, particularly the supply to the major industrials and those kinds of establishments all have an impact. And I think we'll probably see in somewhat of an immediate impact there. And again, I think as the industrial start to pick back up, the commercials should start to come back as well.

Q - Jonathan Arnold {BIO 1505843 <GO>}

Thank you, guys.

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

Yeah.

Operator

Thank you. And our next question comes from the line of Ali Agha of SunTrust. Your line is open.

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

Hey, Ali.

Q - Ali Agha {BIO 1509168 <GO>}

Hey, good morning.

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

Good morning.

Q - Ali Agha {BIO 1509168 <GO>}

First question, Nick or Brian, just reconfirming when you talk about the 5% to 7% growth rate, what's the base, have we changed, have you rolled it forward or can you just remind us the base year for that?

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

It's the midpoint of 2018 guidance. So it's off 3.85.

Q - Ali Agha {BIO 1509168 <GO>}

Off 3.85. I got you.

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

Yeah, yeah 3.85.

Q - Ali Agha {BIO 1509168 <GO>}

I see, okay. And then the renewables that you talked about in Ohio and in other places, the potential, if you do get approvals for those, can you just remind us in aggregate, what kind of incremental CapEx we'd be talking about and roughly over what period?

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

Yes, so as for the renewables in Ohio that we've been talking about, it's not incremental CapEx, right? So the solar that we're talking about are going to be PPAs. So that's not CapEx. For the competitive renewables, okay, so, I'm not talking about Ohio, but I'm talking about Chuck's business, for the five-year period, '19 forward, we anticipate spending about $2.2 billion over that five-year period.

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

But the renewables associated with the regulated side of the integrated resource plans of PSO and SWEPCo, that would be additional capital requirements based upon really what the ownership percentage winds up being.

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

And important to say, Nick, because we get these questions, the earnings associated with that are not reflected in our numbers today.

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

That's right. That's right. And as far as Ohio is concerned, we elected not to participate in the construction of the project. But at the end of the day when we get approval, there is an added component to the plan going forward, that really reinforces our cap structure at AEP Ohio and evaluates the risk associated with long-term PPA events of that sort in the construction. So you'll still see the earnings impact of the Ohio solar as well.

Q - Ali Agha {BIO 1509168 <GO>}

I see, but just to be clear, the -- from a regulated grade base perspective, there is no incremental CapEx associated with the Ohio renewables? Did I hear that...

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

No and actually when the bids come in in March we'll have a better understanding of what the CapEx looks like.

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

That's for the consumer protection plan.

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

Yeah.

Q - Ali Agha {BIO 1509168 <GO>}

Okay. And the CapEx numbers that you have in the back of the slide, no changes there since EEI, is that correct?

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

That's correct.

Q - Ali Agha {BIO 1509168 <GO>}

Yeah. And my last question on Oklahoma, Nick, I mean again, assuming that the outcome is sub-optimal or not as good as you would like it to be, what's your latest thinking there? Does that still give you hope that you can keep pushing and maybe get to the end result or how are you thinking about Oklahoma post this last -- this current rate case?

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

I think some of the positions taken by the intervenors and others, there is some calls for hope at least there is recognition of the issues. But I'm not going to presuppose the outcome, because I did that two times before and who knows what the outcome will be that -- certainly the issue should be very well known. I would say that just based on the response of the intervenors, it's marginally better than what -- how they responded earlier.

So I guess you can look at that as some positive, but we won't know until we get into discussions with them or -- and go through the -- go through this process, really what matters is what the Oklahoma Commission comes up with in terms of renting in order. And do they recognize the value that PSO provides to the state. And so, that's what we're looking for and if -- and as I have said earlier, we will wait for those results and then we'll make determinations of what the next steps are.

Q - Ali Agha {BIO 1509168 <GO>}

Understood. Thank you.

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

Yeah.

Operator

Thank you. And our next question comes from the line of Paul Ridzon of KeyBanc. Your line is open.

Q - Paul Ridzon {BIO 1984100 <GO>}

Good morning.

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

Good morning, Paul.

Q - Paul Ridzon {BIO 1984100 <GO>}

Can you just clarify when you say, bend the O&M curve, is that decelerating O&M growth, is that flattening or is it negative growth?

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

Negative.

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

Yeah it's negative. We really -- by bending, we wanted to go negative.

Q - Paul Ridzon {BIO 1984100 <GO>}

Okay. Can you try and give a percentage kind of, to think about over the next few years?

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

Yeah. So we haven't said what that would be, Paul. If you look at our $2.8 billion to $3.1 billion that we've been in for about the last eight years, we're looking to break through that and turn that negative. And we have plans to do that. It includes what we've done on lean activities, what we've done on process improvement. It includes automation, box, it includes partnering with third-party suppliers like what we've done with an accounting and tax initiative with Accenture and it's bringing all those things to bear across the Company that we're going to try and break through that $2.8 billion of non -- of spending that's not altered in pass throughs.

Q - Paul Ridzon {BIO 1984100 <GO>}

Thank you. And then just to clarify, the 5% to 7% does not include renewables, FPSO or SWEPCo or Chuck's business, is that correct?

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

It includes the capital in Chuck's business.

Q - Paul Ridzon {BIO 1984100 <GO>}

Okay.

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

The $2.2 billion over the plan. It does not include the regulated renewables and does not include Ohio.

Q - Paul Ridzon {BIO 1984100 <GO>}

Thank you. And then any projects that could be impacted by the situation at FERC?

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

No, no, we don't see any projects impacted from that perspective, because FERC obviously continues to advance transmission spending and actually the resource projects themselves, we moved to less transmission involved with those, so I'm assuming you're talking about transmission.

Q - Paul Ridzon {BIO 1984100 <GO>}

Yes, sorry.

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

Yeah. We don't see any impact there.

Q - Paul Ridzon {BIO 1984100 <GO>}

And then finally, the 2.8% reduction in commercial sales, is that just quarterly volatility or was there something more underlying there?

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

We think it's quarterly volatility, we don't see that continuing as a trend in the 2019, could have been associated with higher consumer interest costs and some demand side management that we see across our system. But we don't see that as continuing into the new year.

Q - Paul Ridzon {BIO 1984100 <GO>}

Thank you very much.

Operator

Thank you. And our next question comes from the line of Praful Mehta with Citigroup. Your line is open.

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

Good morning, Praful.

Q - Praful Mehta {BIO 19410175 <GO>}

Thanks so much. Hi guys.

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

Good morning.

Q - Praful Mehta {BIO 19410175 <GO>}

Good morning. So just first want to understand, in Chuck's business, any exposure to PG&E or California utilities that we should be aware of or thinking about?

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

No.

Q - Praful Mehta {BIO 19410175 <GO>}

Okay, good. That...

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

Yeah. There is the right answer. Very fortunate in that regard, a lot of our off takes are with municipals co-ops and end-use customers.

Q - Praful Mehta {BIO 19410175 <GO>}

Okay, great. Yes, so dodged a bullet, which is great. I guess just touching on the review, I guess strategic review that you've talked about in the past and obviously you've touched on Oklahoma already, but just from a strategic perspective, is there any view that we should be thinking about around any of the utilities, if they don't -- if you don't get the outcomes you're looking for. Is that still on the table right now or is that too far out at least not a 2019 event?

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

So I think and the way we look at it is, every utility that we have, we wanted to grow and prosper. And to the extent that they can grow and prosper and have proper regulatory treatment, it's a great outcome. I think a couple -- three years ago we -- I guess for years we're talking about Kentucky and Kentucky has turned around, we focused on two things.

The regulatory relationship and the compact that we have there, but also our emphasis placed upon the economic development in the State of Kentucky. And that picture has turned around markedly for PSO, PSO is now in the radar screen and probably in the middle of the radar screen, because we definitely want to be a part of the economic development picture of Oklahoma. And we definitely want to be able to move forward in a very positive way on investments that benefit the customer experience in that state.

So the way we look at it is, we have a set of assets and if they perform well, fine. If they're chronically underperforming then we have to take steps in some fashion to alleviate that situation for our shareholders and really the focus, because many times when you have an underachiever a lot of effort goes into trying to reconcile the situation and there are some that say, that PSO doesn't have a revenue problem, it has a spending problem. And that is just so far from the truth, it's just incredible, because we run seven utilities and we run those utilities in much the same fashion. And we know what it takes to provide the customer services required and PSO has been at the top of the list in terms of its performance.

And I really believe that if you're a residential customer, if you're an industrial customer, you should really take a hard look at what's happening there in Oklahoma and could very well have an impact on not only the presence in the future, but also the customer experience itself and we don't want that to happen. So as we look at these assets obviously, we'll continue to make steps to further optimize our portfolio based upon what we see.

Q - Praful Mehta {BIO 19410175 <GO>}

Got you, that's super helpful. And then -- and finally, clearly you guys have been able to manage through different load profile years. But it sounds like if you do have the shackles that are continuing to stay, let's say, from tariffs and other constraints from a macro perspective and if weather doesn't work in your favor, is there any time that we should be worried about the '19 profile or do you think you have enough tools in the toolkit to manage through any of those potentially macro challenges around the earnings for '19?

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

Yeah, I think we're fine. We've had, and if you looked over the last two years, three years and maybe even longer than that, we've had perturbations of customer class going up and down and actually residential going down, has more of an impact than commercial or industrial. And so, the mix obviously has an impact, because the margins are different based upon each customer class.

But our service territory is very diverse, very -- certainly every part of the economy is represented and our customer mix is really pretty resilient in and of itself. So there's a lot of internal levers that continue to adjust for one another from that perspective. But at the same time, we will adjust when the economy is -- if the economy were to chronically be suffering and we saw that on a continual successive quarterly trend, then we would certainly make adjustments that were necessary to ensure that we remain financially healthy and we intend on doing that.

But I really believe we're in good shape from that perspective. And we'll watch this next quarter and the quarter after and hopefully we'll see some progress in the Federal government side. I think certainly immigration needs to get solved and the two parties need to start talking to one another again. And maybe that will warm up and then they'll move to greater and better things for the economy, but they've got to get going.

Q - Praful Mehta {BIO 19410175 <GO>}

Got you. Thanks so much guys and congratulations.

Operator

Thank you. And our next question comes from the line of Greg Gordon with ISI. Your line is open.

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

Good morning, Greg.

Q - Gregory Gordon {BIO 3419434 <GO>}

Thanks guys. So just two quick questions. One, just to be clear you said the anchor for the 5% to 7% is 3.85 in '18?

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

Yes.

Q - Gregory Gordon {BIO 3419434 <GO>}

Great. Okay. So I mean, I guess, this is just tautologically correct. But the high-end of the guidance range for '19 which would put you above 7%, you're not -- this is more of a long-term target than an annual, we're going to be tight inside this band [ph] type of guidance. I just to be clear on (multiple speakers)

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

Yes -- that's right. I think when you look at the midpoint of the 5% to 7%, and then you look at the opportunities available to us in that 5% to 7% bandwidth, it's -- like I said, it's more tailwinds and headwinds.

Q - Gregory Gordon {BIO 3419434 <GO>}

And then just one final question, because it's just been -- there's been some conversation about this. But you continue to give us a financial forecast that even though the absolute level of leverages come up since 2013, the FFO to debt metric continues to be really resilient, just around 18% and you're still confident that through this forecast period, you can maintain, there'll be no deterioration in your FFO to debt metrics?

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

No, we haven't said that. We do anticipate that it will decrease over the time period and we expect it to approach to 15% level during the term of the forecast.

Q - Gregory Gordon {BIO 3419434 <GO>}

Okay, okay. Well that's a higher number than the other people have prognosticated anyways. So I just wanted to make sure we understood what you thought the trend was. Thank you.

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

No, we're very interested in the FFO to debt percentage and we intend on maintaining our credit ratings.

Q - Gregory Gordon {BIO 3419434 <GO>}

Okay. So you think 15% is the -- is sort of where you'll trend down to over this forecast period?

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

That area, yes.

Q - Gregory Gordon {BIO 3419434 <GO>}

Okay, thank you.

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

Thanks, Greg.

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

Operator, we have time for one more question.

Operator

Perfect. And our next question comes from the line of Angie Storozynski of Macquarie. Your line is open.

Q - Angieszka Storozynski

Good morning. Thanks for taking my question.

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

Good morning.

Q - Angieszka Storozynski

I have a -- good morning. I have a bigger picture question. So we are hearing about this precipitous drop in prices for solar power and that more and more C&I customers are signing those contracts or PPAs simply because they see it as a way to heterogate [ph] volatility in forward natural gas prices, but also I mean those PPAs seem to be at prices which are now below observable forward power curves. So two questions. Do you see it as a risk to your Vertically Integrated Utilities, given that you do have commercial generation assets. And number two, is there a way to tap into this growth beyond that $2.2 billion that you're planning to spend on renewables on the commercial side?

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

I would say, first of all, we don't see a risk if we're doing it. And we are doing it, and I think we are in discussions with many customers about what their specific resource needs are. We are also looking at various technologies that enable that to happen and some of these are large customers. So we really have an opportunity to engage in that discussion.

But the other part of it too is, you see solar, you see energy storage, those types of applications continue to advance and that -- and with certainly on the transportation sector, you're making up -- whatever you're going to lose, you're going to make it up with channel growth -- sales channel growth, particularly associated with the advent of electric transportation.

So there is real opportunities for us to engage in that, and I think AEP is in a very, very favorable situation of being able to focus on those types of issues as opposed to something that some calamity that's occurred. And we're intent on making sure we maintain our operational excellence, so that we can focus on those particular types of activities.

And certainly that's happening not only on the regulated side, and obviously we're having to work with the regulators to broaden the perspective there. For example, continuity of service is not just a distribution line going to the home, it's distribution with energy storage derived through outages and really drive toward continuity of service as opposed to just basic service.

Certainly what we're doing with smart cities, what we're doing with other applications and engaging customers in a very substantial sense, those were things that we see as the future, and we're not going to be -- get left behind from that perspective. And as a matter of fact, from a technology standpoint, we're at the forefront of these technologies across the gamut. So we have pilots running in every one of our operating companies on various aspects of these technologies and we intend on that channel growth to occur.

Q - Angieszka Storozynski

Okay. Thank you.

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

Yeah.

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

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

Operator

Ladies and gentlemen, this conference will be available for replay after 11:15 AM today until 11:59 PM on January 31st. You may access the AT&T Teleconference Replay System at any time by dialing 1800-475-6701 and entering the access code, 461331. International participants, please dial 320-365-3844. Again, those numbers are 1800-475-6701 and 320-365-3844, using access code, 461331. That does conclude our conference for today. Thank you for your participation and for using AT&T Executive Teleconference. You may now disconnect.