

American Electric Power Company, Inc. (AEP) CEO Nick Akins on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-24-19 Earnings Summary

 *Press Release*  *10-Q*  *Slides*

EPS of \$1.46 beats by \$0.15 | Revenue of \$4.3B (-0.58% Y/Y) misses by \$-286.67M

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American Electric Power Company, Inc. (NYSE:AEP) Q3 2019 Earnings Conference Call
October 24, 2019 9:00 AM ET

Company Participants

Darcy Reese - Managing Director, Investor Relations

Nick Akins - Chairman, President and Chief Executive Officer

Brian Tierney - Chief Financial Officer

Conference Call Participants

Julien Dumoulin-Smith - Bank of America Merrill Lynch

Steve Fleishman - Wolfe Research

Christopher Turnure - JPMorgan

Greg Gordon - Evercore ISI

Michael Lapides - Goldman Sachs

Angie Storzynski - Macquarie

Ali Agha - SunTrust Robinson Humphrey

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the American Electric Power Third Quarter 2019 Earnings Release Conference Call. At this point, all participant lines are in a listen-only mode. There will be an opportunity for your questions and instructions will be given at that time. [Operator Instructions] As a reminder, today's call is being recorded.

I'll turn the call now over to Ms. Darcy Reese. Please go ahead.

Darcy Reese

Thank you, John. Good morning, everyone and welcome to the third 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 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.

Nick Akins

Okay. Thanks, Darcy, and welcome to the call, your first time in the call. I'm willing Bette Jo Rozsa is still listening even though she is in retirement, but thanks for everyone for joining AEP's third quarter earnings call. Brian will update you on the financials for the quarter and year-to-date a little later, but I'll summarize my view of the quarter as we go forward.

First, we had a great quarter, supported by warm weather through September, previous positive regulatory outcomes that are now being reflected in our financial results, continued success in management or O&M expenses. And I have to say, load is making a comeback. After the lower load last quarter, it is good to see some improvement that generally remains flat to last year, but still positive from the second quarter. We're watching this trend closely during the fourth quarter and into next year.

Given all of that, we are raising and narrowing our operating earnings guidance range for 2019 from \$4 to \$4.20 per share to \$4.14 to \$4.24 per share with a new midpoint of \$4.19 per share. We're also reaffirming our 5% to 7% growth rate based upon our original guidance. Additionally, the AEP Board earlier this week authorized an increase of \$0.03 per share from \$0.67 to \$0.70 a share, a 4.5% increase. This increase keeps us firmly in the middle of our targeted 60% to 70% payout range. And along with last year's increase of 8.1% averages to a 6.3% increase for the last two years, commensurate with our 5% to 7% earnings growth rate. We continue to expect the dividend to grow in line with our earnings and firmly within our targeted payout ratio.

So let's step into a few highlight areas for the quarter. Regarding our North Central Wind projects, as you recall we had made filings for state approvals in Oklahoma, Louisiana, Arkansas and Texas on July 15 and during the third quarter, we requested FERC approval of this transaction as well. Also we would acquired three wind farms currently under development by Invenergy within service dates in 2020 and 2021 based upon requirements consistent with the integrated resource plans of both PSO and SWEPCO in the various jurisdictions. Finalized procedural schedules have been determined in all of the state jurisdictions at this point. The Oklahoma Corporation Commission has set the PSO schedule for hearings in January of 2020.

Louisiana Public Service Commission, SWEPCO Louisiana hearings for March 2020, the Arkansas Public Service Commission has also set its scheduled for March 2020, and the Public Utility Commission of Texas has set the schedule for hearings in February of 2020. So we're currently working with the discovery process in each jurisdiction, and we're on track to receive final decisions by the summer of 2020. I'll remind everyone once again that these projects are not in our capital plan.

Regarding regulated solar, HB 6 has cleared the path for credits to be applied to our existing solar request before the Ohio Commission. With this change, we have followed a temporary delay to provide additional clarity concerning project benefits to our customers, and we await a decision from the PUCO. While on the subject of Ohio, we are continuing our focus on HB 247 with hearings progressing well. This bill is important in regards to further grid modernization, technology deployment and behind-the-meter customer investment opportunities to improve the customer experience.

There is no doubt our business is changing at the distribution level in regards to technology, grid modernization, distributed generation and further grid and customer rate optimization efficiency opportunities. HB 247 modifies Ohio's electric retail service to allow the company to include these provisions in electric security plans filed with the PUCO. This allows us to provide that continued obligation for our customers to improve the customer experience and be able to provide universal access to the benefits of the clean energy economy.

Our contracted renewables, which have benefited from the recently acquired wind facilities, development opportunities and resources, continues to perform well. The projects are performing toward the upper end of acquisition assumptions and the development portfolio is making good progress as well. We have one project that we expect to place in service in 2020 using all the PTC safe harbor equipment and expect to release an announcement of a project, backed by long-term contract with an investment grade counterparty by the end of the year and there are others in the pipeline that look really good as well.

Our Regulated Utilities continue to perform very well. I just want to take a moment to congratulate our employees at the Cook Nuclear Plant that once again received an Info Excellence Rating. We are very pleased with that outcome and this exemplifies our belief that operational excellence is the foundation for anything else that AEP wishes to achieve from a strategic perspective. We're in the midst of four major rate cases that I'll update you on.

In Arkansas, we followed a settlement of that case and includes all the parties that contains a net \$18 million increase or 9.45% ROE with a formula base rate process for five years, because we have not filed the rate case in Arkansas on approximately 10 years. It's important to note this order included no disallowances on the \$1.2 billion of investments made on generation and environmental retrofits. The company requested a \$34 million net increase. So, all in all a decent settlement to move forward with a new form of base rate mechanism. The settlement of rates Arkansas Public Service Commission approval with rates assumed to go in effect in January 2020.

In Indiana, we filed a case in May of 2019 for a net increase of \$94 million and 10.5% ROE with a 2020 forecasted test year. The rate case includes our Innovate Indiana program that supports the continued operation of Cook nuclear plant, new smart grid technologies, AMI meters, expansion of electric vehicle charging and support for renewable energy.

Testimony by I&M and intervenors have already been filed and Indiana staff does not file testimony. We filed with testimony in September and hearings are currently ongoing. We expect an order on rates to go in effect by March 2020. In Michigan, I&M filed a base rate case in June requesting a net increase of \$52 million and a 10.5% ROE with also a 2020 forecasted test year.

The Michigan plant also includes support for the continued operation of Cook nuclear plant, and our commitment to distribution reliability through equipment upgrades tree trimming and AMI meters. Staff and intervenor testimony has been filed with staff recommending a 9.75% ROE with a \$38 million revenue increase. We'll follow a vital testimony in November with hearings also being in November and expect the commission order in April of 2020.

And lastly, regarding the AEP Texas rate case, we filed in May a base rate case review that included a net increase of \$35 million and a requested ROE of 10.5% with a 2018 test year. The rate request includes increased charges to retail electric provider's reps for use of AEP, Texas D&D lines, along with refunds and credits associated with the Tax Cuts and Jobs Act of 2017.

The PUC staff August and all this testimony with reductions in both the transmission and distribution revenue requirements based upon a 9.35% ROE removing various incentive and expenses incremental distribution forestry expenses and other tax and depreciation related adjustments.

The hearings concluded in August. The case has been fully briefed and we AEP from the ALJs in mid-November. We will then follow exceptions and expect a ruling from the commission in the first quarter of 2020. Summaries of all of these cases are included in the earnings slide presentation.

Now moving to the economy. This quarter has indicated some bright spots to consider. Many have talked about this economy being driven forward by the consumer, because of low unemployment and higher wages. We are seeing that as well in our service territory. While industrial overall is still down, but improved from last quarter residential and commercial are both more than expected. We have the lowest unemployment on record in our territory going back to 1,990 and wages are growing faster than inflation.

And even in the industrial sectors, which have improved overall from last quarter. The oil and gas sector growth was the strongest we've seen since 2016. As you know our margins are higher on residential and commercial and industrial. So overall financial results are positive. So all-in-all I would say it's time for a return of optimism regarding the economy.

So, now moving to the equalizer graph. The overall regulated operations ROE is currently 10.1%. It was 9.7% last quarter. We generally project the ROE for our regulated segments to be combined to be in the 9.5% to 10% range. We have a long track record of delivering these results and we expect that to continue. The reason for the increase in third quarter 2019 versus second quarter includes the effect of favorable weather this September.

I'll also not bore you the size above for you the size of in the chart. It's interesting to note that AEP Transmission Holdco is now the second largest operating utility behind Appalachian power. So that's interesting to note and you have several of them to approximately the same size companies as well that follow on to that. So we're continuing to make quite a bit of progress. And it is interesting to note.

Moving on to the sale on AEP, Ohio, the ROE for AEP Ohio at the end of the third quarter was 11.3% and we expect to end 2019, 11% as the legacy fuel and capacity charges the poor and the RSR as they recalled roll off and we continue to invest in the distribution of smart grid.

APCo the ROE for APCo at the end of third quarter 2019 was 9%. APCo's change in ROE from second quarter 2019 is primarily due to favorable weather and rate proceedings when comparing third quarter 2019 with third quarter 2018, partially offset by lower normalized usage in third quarter 2019 versus third quarter 2018.

West Virginia. As you recall the West Virginia new base rates in March 2019 which was a \$44 million base rate increase based on 9.75% ROE. Virginia's first review is in 2020 and we'll cover the 2017 to 2019 periods and ROE of 9.42% will be used for tri-annual period review was 70 basis points bandwidth ranging from 8.72% to 10.12. So that will be coming up.

As far as Kentucky Power is concerned, the ROE for Kentucky Power at the end of the third quarter was 7.8%. Kentucky's change in ROE from second quarter is primarily due to slightly favorable normalized usage weather and transmission revenues. We're working on optimizing revenue and scrutinizing the OEM and capital to improve ROE by the end of the year.

With I&M, I&M at the end of the third quarter was 11.6%. I&M's positive performance through the third quarter of 2019 is primarily driven by timing of expenses, favorable financing of long-term debt, supportive regulatory environments and some onetime adjustments.

I&M expects to end the year with an ROE around 10.5% which is higher than authorized ROEs in Indiana and Michigan primarily due to onetime adjustments. I&M continues to successfully execute, its capital programs in generation, transmission and distribution and recently followed future test year rate cases in Indiana and Michigan to only recover your ongoing capital costs.

Regarding PSO, PSO ended the quarter with an ROE at 11.3%. PSO's increase in ROE was due primarily to summer weather and normalized usage. PSO received an order in our case settlement in March 2019, as you recall approving a \$46 million increase and a 9.4% ROE. So we've seen a great turnaround in Oklahoma. And in fact Oklahoma is a broad spot from the economic process as well. Oklahoma continues to operate on all cylinders and continue to increase in terms of load.

SWEPCO. SWEPCO the end of third quarter 2019 was 6.7%. The most recent 12-month ROE increased primarily due to favorable weather and favorable normalized load. We did as I mentioned follow the Arkansas base rate case and the settlements that are pending there and an ROE of 9.45% and cash structure of 52.1% debt and 47.9% equity.

SWEPCO's ROE continues to be affected by the Arkansas share of the Stuart plant that is not in retail rates. As far as Texas is concerned, the ROE for AEP Texas at the end of the third quarter was 8.8%. The main driver for the increase in ROE is primarily due to favorable summer weather. We expect the ROE to decline by year-end due to lag associated with the timing of annual filings and the base rate review filed with the PUCT in May.

Favorable regulatory treatment has allowed us to file annual DCRF and bi-annual filings and recover our costs on distribution and transmission related capital investments. But during a rate review year there is a lag associated with these filings. In addition continued high levels of investment and timing of our planned comprehensive rate review will continue to have the impact on ROE and AEP Texas in 2019.

And then the ROE for AEP Transmission Holdco at the end of the third quarter was 11.4%. AEP's transmission Holdco, ROE was higher than second quarter 2019 driven by the prior year radial impact adjustment falling off and higher revenues due to differences between

actual and forecasted revenues in third quarter. Transmission is forecasting a higher ROE than authorized at the end of fiscal 2019 as a result of higher revenues and a prior year favorable true up.

So as we as we look forward to EEI, you can expect AEP to give further updates regarding continued affirmation of our 5% to 7% growth rate, details of capital plans, additional focus on OEM-related initiatives and any further updates on renewables, rate cases and other matters.

There's no question AEP continues to fire in all cylinders as we continue our promise of being a premium regulated utility with the consistency and quality of earnings and dividends that our shareholders expect. We reiterate our intention of achieving the higher end of our 5% to 7% growth rate. We'd be disappointed not to achieve it. We believe the foundation is there to achieve just that.

As the Duty Brothers one of the latest nominees and it's about time they were an nominee for the Rock Hall of fame this year, said we got to let the music play what the people need is a way to make them small. Well that's what we want for our investors and we intend on letting a great AEP team play, so listen to the music. Brian?

Brian Tierney

Thank you Nick and good morning everyone. I will take us through the third quarter and year-to-date financial results, provide some update on more than the economy review our balance sheet and liquidity and finish with a preview of what we will present at the EEI Conference.

Let's talk briefly on Slide 6 which shows the comparison of GAAP to operating earnings for the quarter and year-to-date periods. GAAP earnings for the third quarter were \$1.49 per share compared to \$1.17 per share in 2018. GAAP earnings through September were \$3.58 per share compared to \$3.17 per share in 2008. There is a reconciliation of GAAP to operating earnings in the release.

Let's get into the detail on Slide 7 and look at the drivers of quarterly operating earnings by segment. Operating earnings for the third quarter were \$1.46 per share or \$722 million compared to \$1.26 per share or \$619 million in 2018. Operating earnings for Vertically Integrated Utilities were \$0.89 per share up \$0.18 primarily driven by rate changes which were favorable by \$0.07. Weather was also favorable this quarter up \$0.04 from last year. Smaller impacts for this segment are listed on the slide.

The Transmission & Distribution Utilities segment earned \$0.27 per share down \$0.03 from last year. Earnings in this segment declined due to the roll-off of legacy riders in Ohio and higher O&M, depreciation and property taxes. These items were partially offset by recovery of increased transmission investment in ERCOT, weather and rate changes.

The AEP Transmission Holdco segment continued to grow contributing \$0.25 per share, an improvement of \$0.10 over last year. This growth reflected the return on incremental rate base as well as the impact of a non-recurring prior year accounting adjustment.

Net plant increased by \$1.4 billion or 18% since September of last year. Generation & Marketing earned \$0.16 per share up \$0.08 from last year primarily driven by favorable taxes that will levelize over the year. This segment reflects the growth in the renewables business and favorable wholesale margins.

Corporate and Other was down \$0.13 primarily due to tax items that will levelize over the year as well as higher O&M and interest expense.

Let's turn to slide 8 and review our year-to-date results. Operating earnings through September were \$3.65 per share or \$1.8 billion compared to \$3.23 per share or \$1.6 billion in 2018.

Looking at the earnings drivers by segment. Operating earnings for Vertically Integrated Utilities were \$1.9 per share up \$0.16 with rate changes being the largest driver in the segment. Other positive items included lower O&M and taxes as well as higher AFUDC. While weather was favorable compared to normal, it was unfavorable compared to last year subtracting \$0.12.

Normalized load was also down for the year and depreciation increased due to incremental investment. Through September, the Transmission & Distribution Utilities segment earned \$0.85 per share up \$0.07 from last year influenced by the reversal of a regulatory provision in Ohio.

Other favorable drivers included higher rate relief and ERCOT transmission revenue as well as favorable carrying charges in Texas, partially offsetting these favorable items with the roll-off of legacy riders in Ohio, unfavorable weather, higher depreciation property taxes and O&M.

The AEP Transmission Holdco segment contributed \$0.82 per share up \$0.25 from last year. This growth in earnings reflected a return on incremental rate base, a favorable annual true-up in FERC settlement, higher AFUDC and the non-recurring prior year accounting adjustments.

Generation & Marketing produced \$0.30 per share. The renewables business grew with the repowering of Trent Mesa and Desert Sky as well as the acquisition of multiple renewable assets. Increases in retail and wholesale margins were partially offset by lower generation sales due to lower energy prices, plant retirements and outages.

Finally, Corporate and Other were down \$0.15 driven by higher tax expense primarily from consolidating tax items that will reverse by year-end with a tenure relating to prior period tax adjustments. Interest expense was also higher.

Overall, we are pleased with our financial results and are confident in raising and narrowing our annual operating earnings guidance to \$4.14 per share to \$4.24.

Now let's turn to slide 9 to provide an update on our system load. Starting in the lower right chart, normalized retails sales were essentially flat for the quarter compared to 2018. This represents a marked improvement from our last quarterly update.

Third quarter sales are up at the Transmission & Distribution Utilities and public service company in Oklahoma while the remaining Vertically Integrated Utilities experienced the decline. For the year-to-date comparison, AEP's normalized retail sales were down six-tenths of a percent from last year.

Through September, the growth in residential sales has being offset by decline in commercial and industrial sales. You will notice that our latest year end estimate is projecting normalized retail sales we'll finish the year down five-tenths of a percent from 2018. The mix of sales -- of sales growth combined with rate design nuances give us confidence in our 2019 guidance in light of our load outlook. I'll cover rate design later in the presentation.

Moving to the upper left chart. Normalized residential sales increased by seven-tenths of a percent for the quarter. Customer count growth was responsible for three-tenths of a percent increase while the remaining four-tenths was due to improvement in normalized usage.

Third quarter residential sales were up at several of our operating companies with the exceptions of Appalachian Power, I&M and SWEPCO. Year-to-date normalized residential sales increased by two-tenths of a percent, which was mostly driven by an increase in residential customer count.

The uptick in residential sales this year is consistent with macroeconomic drivers. Unemployment rates across the AEP service territory are at record lows. Tight labor market has created upward pressure on the wages. This has allowed personnel income to grow faster than inflation through most of 2019. As incomes rise, customers tend to purchase more electricity and consuming products.

Moving to the upper right chart. Normalized commercial sales increased by four-tenths of a percent for the quarter. The results varied by operating company but were strongest in the Transmission & Distribution Utilities segment. Seven of our top 10 commercial sectors posted growth this quarter with the strongest growth coming from the utilities, hospitals and accommodation sectors. Through September, normalized commercial sales were down seven-tenths of a percent from last year.

Not surprising the sector that posted the biggest draft in commercial sales was traditional retail. As you can see on this chart there has been a consistent improvement over the last 12 months in commercial sales growth.

Finally in the lower left chart, industrial sales decreased by 1.1% for the quarter, which brought the year-to-date comparison to 1.4% below last year. For both periods industrial sales were down at most operating companies with the exception of PSO which has experienced double-digit growth from oil and gas activity. We are fortunate to have these sectors in our industrial mix. The impact of the General Motors strike on our load was negligible.

Turning to Slide 10, I'll provide a brief update with respect to industrial sales growth by sector. This chart shows the distinction growth between the oil and gas sectors and all other industrial sectors. Industrial sales to oil and gas industries increased by 7.8%, which was the strongest growth in these sectors since the first quarter of 2016.

This was largely driven by the 16.3% growth in the pipeline and transportation sector. Most of the growth in the quarter was a result of a number of anticipated expansions that will address congestion issues coming out of the major shale regions in our service territory. There are still additional oil and gas related expansions in the development pipeline that will provide more growth over the next 18 months.

Focusing your attention on the green bars, the non-oil and gas industrials were down for the quarter but lesser than last quarter. For the AEP system, chemicals manufacturing and transportation equipment manufacturing accounted for most of this impact.

Now let's turn to Slide 11 and review the status of our regional economies. As shown in the left chart, GDP growth in AEP service territory was 2.4% for the quarter, which is 0.3% above the U.S. The strongest growth for the quarter came from our Oklahoma service territory. All of our service territories experienced GDP growth for the quarter.

Moving to the right chart, you see an employment growth for the AEP service territory improved this quarter to 0.8% above last year while U.S. growth moderated slightly in the third quarter. Throughout the AEP footprint, nearly 16000 jobs were added in the third quarter with 42% of those coming from the education and health care sector.

Turning to Slide 12. I want to point a nuance related to customer class rate design. Some 72% of industrial rates across our system are fixed rather than variable, a 1% decline in industrial load is much less impactful than a 1% decline in residential load, where 82% of

the rate is variable. For your reference, a 1% change in industrial sales is worth about \$0.02 per share.

Now let's move on to Slide 13 and review the company's capitalization and liquidity. Our debt to total capital ratio improved slightly during the quarter to 58.7%. Our FFO to debt ratio was solidly in the BAA1 range at 15.2% and our net liquidity stood at about \$2.6 billion supported by our revolving credit facility.

Our qualified pension funding decreased approximately 2% to 94%, a drop in interest rates increased the pension liability here. OPEB funding decreased approximately 7% to 123%. This was a result of lower interest rates and a new OPEB liability experience study both of which increased the OPEB liability.

Let's try and wrap this up on Slide 14 and get to your questions. The strong results we delivered year-to-date and our confidence in our plan for the remainder of the year allow us to raise and narrow the operating earnings guidance range to \$4.14 per share to \$4.24.

Our message at EEI will be that we are the premium regulated utility, delivering 5% to 7% earnings growth with dividends growing in line with earnings. Our plan has line of sight transparency to growth and has greatly reduced execution risk. We will provide detailed drivers for 2020 earnings by segment and updates to our capital expenditure and financing plans.

One final item. We have historically released fourth quarter and full year earnings in January of the subsequent year. In 2020, we released 2019 full year and fourth quarter earnings in late February, more coincident with the following of the 2019 10-K. We look forward to seeing many of you in Orlando in a couple of weeks.

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

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] And first in the line Julien Dumoulin-Smith with Bank of America Merrill Lynch. Please go ahead.

Julien Dumoulin-Smith

Hey, good morning.

Nick Akins

Hey, Julien.

Julien Dumoulin-Smith

So, perhaps if I can go back to some of the commentaries on the last call and brief, certainly some variations across the service territory on your sales trends would be curious, how does this position you relative to your broad plans and thought process against the 5% to 7%? Just want to be exceptionally clear, as you think about having closed some good results here in the third quarter and again reaffirming the higher end?

Nick Akins

Yes, there is no change in our thought process. We're still tracking 5% to 7%. We disappointed if we weren't in the upper range of that, because obviously, when you look at the components of load here from a financial perspective, it's not having much impact on our plans. And though by the way, we adjust all the time, for weather, for all kinds of things. And we have a big opportunity to do that.

And I think there's a real opportunity for us to continue to advance, particularly with the renewables play and everything else that's going on. So, even without that though, I think we're in great shape. So it hasn't changed anything. I mean, probably last quarter we probably talked almost too much about the loans and the industrial side of things. And really there's nothing compared to what we experienced back in 2009 and that did pretty well weather in that storm.

So -- but in this case, I think you're seeing some resiliency there from an industrial and manufacturing standpoint and you're seeing it start to pick up. And from the -- and as we said, it's also interesting to note, it's great to have diversity in load, because we've got the oil and gas activity that's going gangbusters with the transportation sector.

And then also you think of what's going on just the consumer side and everyone's talking about this being a consumer-driven economy. And there's no question that people have more money in their pockets and more people have jobs. And you're seeing that reflected in the numbers that we see. So we stand committed to what we've always said before, and we fully expect to be in the upper range of that 5% to 7%.

Julien Dumoulin-Smith

Thanks for the clarity there. And then perhaps if I can jump in real quickly. How are you trending on energy supply as you think about the -- and you said, you might be updating this with respect to EEI, but can you elaborate at least initially on how you're trending on the energy supply side of the business? Obviously, there's a number of different moving factors within that segment of the business renewables increasing sort of legacy stuff declining still. How is that trending all together? If you can give us a little bit of a sense here, especially again relative to that longer-term 5% to 7%.

Nick Akins

Yes. It's going to be up versus what we talked about last year at EEI. But the fact of the matter is, as we've sold off some of the competitive generation of the retiring plants, we're replacing some of those earnings with the renewable business that we had. So it's not declining the way you might expect from the sale of the competitive assets and the retirements, but we've filled in some of that gap with the renewables, but we don't expect that to be a huge growing business for us going forward.

Brian Tierney

And by the way on the contract -- contracted renewables, we continue to do very well in that business. Obviously, it's measured with a \$2.2 billion of capital that we've allocated to it. The organization there is doing a wonderful job of being judicious about that. Obviously, the acquisition that we made was very positive, but the development opportunities are significant there. And we have some other opportunities that we continue to work on.

So that pipeline can continue as long as we wanted to continue. And to what extent we want to continue. But we're able to make that kind of decision regarding that business, because we also have a huge transmission business and a growing distribution business is huge already, but there's all kinds of opportunities there. So really our big issue is continuing to manage around a strong and robust balance sheet continuing to deploy the capital.

Julien Dumoulin-Smith

Great. I'll leave it there. See you guys soon. Cheers.

Brian Tierney

Thanks.

Operator

Next we'll go to line of Steve Fleishman with Wolfe Research. Please go ahead.

Nick Akins

Good morning Steve.

Steve Fleishman

Hey, good morning. I'm just the first curious question on the growth at the PSO particularly on energy because from an energy standpoint you would have thought that's been the area where the rig count has gone down the most. So is there a way to kind of make sense of that?

Nick Akins

Well, there has been some industrials that have in place down there and some expansions. And so Oklahoma has a governor down there that is really focused on economic development and I think it's having an impact on the state.

We're very happy to see that. There's certainly low rates there, and the ability to put these industrials in place, but it's probably a more balanced economy as well. Steve, even what you're seeing with rig count. A lot of the growth that we've seen has been a mid and downstream. And a lot of that specifically in pipeline transportation un-congesting a lot of the shale region congestion that's happened over the last several years and it's moving the products and commodities out of those regions.

Steve Fleishman

Okay. That makes sense. Thanks. And just -- I think you kind of answered this, but just the renewables acquisition that you made. Can you just give us kind of a flavor of how well that's gone versus pro forma? And just how much are you seeing the ability to potentially expand.

Nick Akins

Yeah, I think we're non-utility renewables. Yeah, so we're particularly pleased with the performance of that particular acquisition and really in concert with the other development opportunities that we were focused on. But when you think about the acquisition of not only the projects and really the economics was based on the active projects that were ongoing the developmental opportunities we've hardly placed any value on, because you didn't know they would happen. But in fact those have continued to progress quite nicely.

So it really has been an opportunity for us to continue the expansion of that effort. And then you also have to include Santa Rita in that where we've continue to expand from that perspective. So I think that business is moving along quite well. We're very disciplined in the way we approach it and I think it's paid off.

Steve Fleishman

Okay. Thank you.

Nick Akins

Yeah.

Operator

Our next question is from Christopher Turnure with JPMorgan. Please go ahead.

Nick Akins

Good morning.

Christopher Turnure

Good morning, guys. My first question is just on forward-looking guidance. I guess, one, it sounds like you would not put out a 2021 range at EEI for EPS? And then, two, related to that, can you remind us of the current drivers underlying your 2020 range?

Nick Akins

Yes. So, we're likely just to focus on 2020. At EEI we reaffirmed our 5% to 7% earnings growth rate. Remember that our guidance for 2020 is \$4.25 to \$4.45 and we're likely to say that that's what it will be again for 2020. And the key drivers are the things that you would think about for a traditional premium regulated utility.

It's rate outcomes, ability to invest in our organic regulated businesses, our ability to continue to invest in contracted renewables, and then, of course, things like weather and load will impact the earnings outlook as well. So not to forget, of course, our ability to constrain as we have over many years O&M spending and we're particularly going to be focused on that in 2020.

Brian Tierney

You're going to hear more about now achieving excellence program that really is focused on a forward view of where our business needs to go. And our employees are all energized around it, because we have to redefine ourselves going forward.

And the outcome of that, obviously, is to be able to deploy more capital, but also to reduce O&M, because you're able to deploy capital and be able to optimize and drive efficiencies through automation digitization and all those kinds of things.

And so, for us it's really a focus on changing that business. And the fact that we're coming out with our guidance for 2020 and then the 5% to 7% growth rate, I think, we're comfortable with just doing that because that element of consistency is there and we don't expect it to change. I mean you can sort of do your own math.

And typically what we've done is, when we go down over the year we just did the math for you. So just think of it from that perspective. Now the one thing that could change that is the regulated renewables that are not included in the capital plan. So you could have a step change and then continue at 5% to 7%. So that's the kind of thing that we're looking at right now.

Nick Akins

A positive step change.

Brian Tierney

Yes, positive step change.

Christopher Turnure

Okay. That's good to hear. So it sounds like some of the positive things over the past year that have changed underlying 2020 are potentially curtailed a little bit, maybe by load or other factors. But, net-net, you're pretty much come back to the same place?

Nick Akins

No. We're not saying anything back in 2020, because obviously our transmission business continues to do well and other components of our business as well. And then the load itself. There's components of that load that's doing really well.

And from a financial perspective, load will have not that much of an impact on the earnings of the company. So we're not saying that at all. I mean 2020, it's full speed ahead. And then 2021, we'll obviously see the outcome of the regulated renewable piece of it and go from there.

Christopher Turnure

Okay. Excellent. And then, just given one of your peers in Texas and some of the back and forth in their rate case proceeding, can you give us an update on kind of the latest in the rate case process and dialogue and any thoughts to the overall Texas environment changing?

Nick Akins

Well, certainly, Texas is Texas. I mean, there's all kinds of opinions and interveners obviously have their opinions. But when it comes down to it it's AEP Texas is a transmission and distribution utility. And it's very difficult to disallow costs that are spent from a transmission and a distribution perspective. So that's going to be up to the Texas Commission.

And certainly, we have a different fact patterns than the other one that you referred to. And every case is different, every company is different, the kind of investments are different. So we feel good about our position in AEP Texas. That's why we continue to invest the way we do. So, obviously, we're looking for a positive outcome as a signal to continue investing.

Christopher Turnure

Okay. Thanks, Nick.

Nick Akins

Yes.

Operator

Next we'll go to Greg Gordon with Evercore ISI. Please go ahead.

Nick Akins

Yes. Hi, Greg.

Greg Gordon

Hey, how are you? Good morning. Great quarter. Congrats.

Nick Akins

Thanks.

Greg Gordon

What is the fascination down in Texas with the idea of ring fencing? I know that it's been proposed in both the -- one of your competitors' pending cases as well as staff positions proposing it in yours. And I'm just wondering what your perspective on that is and where you think they're coming from?

Nick Akins

Yes. It's probably a better question for the commission than for us. But, obviously, during the Encore proceedings that's where sort of all this started. And obviously a company like Encore they wanted to make sure that there are some local type of control. And we're you operating in the state and have been for years.

And I think the commission obviously is interested in how much control is placed within Texas around the assets that they feel like that benefit the state of Texas. So, I suspect you may see some reminiscence of that showing up in various cases, but we have been in and are operating in Texas for a long time and that's not going to change.

Brian Tierney

Greg, the things that's ironic particularly given our situation in Texas is that we are a net investor in Texas. Meaning we're putting debt and equity capital to work in Texas rather than taking it out.

So, for us I think they want to see us continue doing what we've been doing now for years which is investing that capital in Texas rather than taking it out and that's what we intend to continue to do.

Nick Akins

Texas is one of the fastest-growing territories that we have. And we're not going to -- I mean we're not going to fall back on our ability to invest and produce benefits for our customers. And in East Texas obviously we have direct contact with the customers in the portion is at T&D and -- but certainly, I think that this line is getting more and more all the time and that's probably a feature that needs to be discussed in Texas about how to deal with that. But nevertheless that's down for the strategy part of it in the future.

Gregory Gordon

Thank you. Then one more. I know it's early days, but what is the -- so has there been any public response from intervenor groups with regard to the North Central wind proposal? And do we see a more sort of accepting initial response than we did in your wind catcher proposal? Or is it too early to say?

Nick Akins

I'd say it's too early to say. At this point, there's nothing public that's been out there. But I'll say that we purposely filed this to where it had a lot of variability, a lot of optionality to it, and certainly consistent with the ongoing existing processes of the integrated resource planning of each one of the areas.

And I would say just back alone we've had more -- at least a more positive reception of how to deal with it. And so I would have to say things are going reasonably well at this point. And certainly the parties involved know and understand it because after going through wind catcher this one, you can really talk about what the differences are and the beneficial differences.

If they were concerned about transmission don't be concerned about it. If you are concerned about a large area just one area you don't concerned about that either. And if you're concerned about dependency on one area versus no don't worry about that either.

So, I think our processes and with the procedural schedules already defined in every jurisdiction, we're rolling along to a summer of getting the approvals and moving ahead.

Gregory Gordon

Fantastic. Thank you, guys.

Nick Akins

Thanks Greg.

Operator

And next the line of with Greg [Indiscernible] with UBS. Please go ahead.

Nick Akins

Good morning.

Unidentified Analyst

Yes, thank you. Good morning. I was wondering if it's possible to get a preview of the CapEx update at EEI maybe just -- maybe the drivers and I assume the backlog would increase.

Nick Akins

So, I really want to see the detail after EEI. But if you looked at the trends for how we've been spending dollars over the last decade or so, the preponderance of it going to all regulated properties and the preponderance of that going to the wire side of the business. So, that trend that you've seen in the past is going to continue in the detail that we're going to release it yet.

Unidentified Analyst

Okay. Thank you. Look forward.

Nick Akins

Good. Thanks.

Operator

Next move to Michael Lapides with Goldman Sachs. Please go ahead.

Nick Akins

Hey Michael.

Michael Lapides

Good morning guys. Congrats on a good quarter.

Nick Akins

You got a big game coming up.

Michael Lapides

We got to get a quarter back healthy before we play out -- scare the heck out again. A couple of things. One interest rates, obviously, are way down especially the long end of the curve. Just curious how you're thinking about what this means for not just pension expenses that flow through the income statement, but also pension contributions.

Nick Akins

So, that's a good question. We plan every year as we go into the year to pay to contribute to the pensions about equal to our annual service cost. For the last two years, both 2019 and 2018, we sort of had a funding holiday and the decrease in interest rates has pushed down our funding a little bit really into the mid-90s for pensions and still very well over OPEB, but rates can only go down so much more I think. And so, I think we don't have much downside on the pension fund.

Again, we'll be watching every year what our funding is going to be for next year. We plan on putting in about \$100 million for service -- annual service costs, and we still expect the expense side of that equation to be about zero to maybe a slight positive credit.

Brian Tierney

That's a good thing about being well-funded on our pension and OPEB, that gives us a lot of flexibility and there's really no surprises.

Michael Lapides

Got it. And then one follow-up. When you think about the docking, especially obviously PSO and the different SWEPCO stage for the North Central Wind's process, how do you think this is different than what you went through with Wind Catcher?

Nick Akins

I think Wind Catcher was a unique situation. I mean we obviously looked at it and thought that there's a great opportunity for all of these jurisdictions. But, at the end of the day, there was a large project and one area with a large generation or connect transmission, whatever you want to call it. And you got hanging up on the risk associated with that, particularly with all the customer savings and trying to figure that out and making sure that everyone was comfortable with that kind of project.

I still stand by it. It was a great project. There's no question about it. But we learned from that. And I think the more you stick with the regulatory processes that the commissions have had longstanding. I mean we've had other renewable projects that we've done the same exact process with that have gone through in their problem.

We want to refashion this thing to make sure it is what everybody expected to see. And when you look at these projects, there's three different wind farms that are involved with that with a lot flexibility on new-in and news-out. And it gives us the ability to not only do that, but also not depend upon additional transmission, so you don't have to focus on that piece of it.

And then also for us to be able to look at the project benefits themselves, those benefits are still substantial. So, I would say that -- and of course, the way it worked out in the bidding itself -- I can't talk about this, but we chose those three projects because they were much better than the others that were bid from a pricing perspective, but also all three of them happen to be with a party that we have continually done business with on a regular basis.

So, we're very comfortable with the deliverability of that -- of those projects. And, we feel confident that the savings that we've presented in the various commission followings are secured, and we're very happy about that.

And then also, part we got hang up a little bit on our own natural gas forecast versus standard natural gas forecast out there. So, even though we thought our forecast was a good one, we decided okay, we're going to just use those standard forecasts for the evaluation, so they buy new that it was coming from an independent party and we wouldn't get into the conversation of your forecast is showing more benefits than another standard forecast. So, we did it from that perspective as well.

I think the other big difference too. We did have a lot of outreach to the individual staff and so forth at the various commission levels with Wind Catcher to try to explain what it was about. Well, it's sort of a natural progression for us to be able to move to the outreach programs that we have, because we've already had substantial discussions of the benefits of wind power in general.

Now, it's a matter of okay, this is what the RFP process is. This is what the wind power that's available, the attractiveness of the wind power and we're going through the regular process to do it. And that communication has been positive, and we've also communicated with other parties in the process too to let them know what's going on. So, I would say that all-in-all, it's been much better and probably a much more pleasant experience than before.

Michael Lapedes

Got it. Thank you, Nick. And one last thing. Tax rates, how should we think about what the consolidated tax rate for income statement reporting purposes is going to be in 2019 liquidity assuming guidance?

Brian Tierney

So, for GAAP taxes, we're anticipating about a 2.6% to 3% effective tax rate for the year, obviously driven down by the amortization of the deferred protected and unprotected taxes. But for 2019, there's also an AMT credit carryforward from prior periods. So that 2.6% to 3% is going to be lower than what we anticipate going forward where we anticipate a rate after the amortization of the deferred taxes to be about 10% going forward.

Michael Lapidès

Meaning, if I think about 2020 tax rate and 2021, you're using about 10% for guidance for those years.

Brian Tierney

We are, but -- and let me be clear about that. That's what we're using for guidance. That's what's in our numbers. That's what we figure to be around at 10%. If we were to have incremental income because we're maxing to the 75% allowed for the upper taxes. If we -- I'm sorry for the production tax credits. If you were to have incremental income and you're trying to model that in, you should use a 24% rate. Does that make sense?

Michael Lapidès

I think so, but I can follow-up offline guys.

Brian Tierney

So let me just try to be clear. What's in our \$4.25 to \$4.45 guidance for 2020 assumes an effective tax rate of about 10%. If you were to layer in incremental, you need to use a 24% rate.

Michael Lapidès

Got it. Understood. So the -- it have to be a lot of incremental to move the needle on the weighted average.

Brian Tierney

Yes sir.

Michael Lapidès

Cool. Thank you, Brian. Much appreciated guys.

Brian Tierney

Thanks, Michael.

Operator

Next we'll go to Angie Storzynski with Macquarie. Please go ahead.

Brian Tierney

Good morning, Angie.

Angie Storzynski

Good morning. Very few questions. Just going back to the oil and gas related sales. So you mentioned pipeline investments, but we're actually hearing that drillers are switching pump from diesel to electric and that could be a meaningful driver of sales growth of electric companies, but the companies are in our shale regions. Are you seeing this?

Nick Akins

That's been going on for a while actually the conversion to electric. And then also when you look at the transportation fees there's a lot of activity around ability to get out of the shale gas fields and the gas out of the shale gas field. So there's not a lot of optimization on the transmission side. Brian?

Brian Tierney

Yeah, it's a lot of -- rather than just on the pumping side and pipeline transportation, we're seeing a lot of electric compression.

Angie Storzynski

Okay. And then to that point, you're showing us that the sensitivity of earnings, the changes in industrial sales is actually very low. So O&M the plan that you gave some efficiencies on the O&M side that you point on there about the EEI that would be actually a more meaningful earnings driver. Is that fair?

Brian Tierney

Yeah. I think the other key areas we look at is if we need to deploy capital and reduce O&M because if you think about load in general, I think this is for many utilities but load in general, you can't have the expectation of ever increasing energy demand. You got to really think about efficiency what it means and what it means to the economy.

And also if you assume that then the way that you continue to grow from a 5% to 7%, which we've confirmed is not only to deploy capital, but to reduce O&M. So it's a huge -- and that's why we say bending the O&M curve or doing those activities. It's going to be a key component in the future, I would say not for us -- but not just for us but for just about every utility.

Angie Storzynski

Okay. And lastly so I understand that the rate based renewables are not currently embedded in either your CapEx plan or funding needs. I mean, assuming that mid of next year you get a green light at least on a portion of this incremental CapEx, you probably have incremental equity needs to fund this spending, would you consider some, sort of, an optimization of your current portfolio as a way to pay for the CapEx?

Brian Tierney

Yes, we would and I think one of the big processes we have going forward will be around optimization of our balance sheet and capital rotation and capital management and asset management goes with that. Obviously it would be a great opportunity to get the wind power resources and we'll be looking at all kinds of methods to be able to fund that investment.

Angie Storzynski

Very good. Thank you.

Brian Tierney

Thank you.

Darcy Reese

Hey John, we have time for one more call.

Operator

And that will be from Ali Agha with SunTrust Robinson Humphrey. Please go ahead.

Ali Agha

Good morning.

Brian Tierney

Good morning.

Ali Agha

First question, Brian or Nick, I just wanted to understand the philosophy behind the annual dividend changes. As you mentioned last year, you moved it up 8%. And I believe that was to get you to the midpoint of your payout ratio. This year it's 4.5%, perhaps being a little below that midpoint, so just thinking the lumpiness there. How should we think about the philosophy behind that?

Brian Tierney

Yeah. We're trying to keep it right in the middle of the payout range and that's what we do. This year -- you put last year and this year together, it's above the midpoint of our long-term growth rate for earnings. And I think the Board is trying to reward investors by keeping it right in the midpoint of that 60% to 70% stated payout ratio.

Nick Akins

It's just unfortunate that we have quarters and years around the annual calendar and stuff like that. But lot of times you're looking at these the dividend side of things and of course it's going to move generally in that 5% to 7%. And it's been no secret that's tagged around the 6% range. And we are committed to stay firmly in the middle of that 60% to 70% payout range.

But there's a lot of things to consider. I mean, we got the same questions, when we did 8.1% last year. What does that mean?

So we're reiterating that, it will be in line with our 5% to 7% growth rate. But year-to-year you see just things that kind of round off on pennies and that kind of thing. But there should not be any interpretation that our Board feel differently about the prospects of growth of this company in the future.

And so, we debated that quite a bit, because we did want to reaffirm this 5% to 7% growth rate. So, don't read anything into it.

Ali Agha

Got you and then, last question, with regards to the 2020 range, 4.25 to 4.45. I mean that was provides with a long-time back. I think, EEI, if I recall it, lots has happened and got some very good rate case outcomes in Oklahoma, et cetera.

So any thought on that, I mean I expect 2019 is turning out that maybe you could move that up or maybe the upper half or upper end more comfortable, as we sit here today, any thoughts around that?

Brian Tierney

We're just -- we're going to refresh at EEI, Ali. But Nick always says we'd be disappointed if we weren't in the upper end of the range. And I think that's going to be true, for 2019 and 2020.

Nick Akins

And probably some of these things just sort of have to prove themselves out over time. And we went to 5% to 7% after we sold the unregulated generation we were at 4% to 6% at that point, because we felt like that 5% to 7% was something that we saw going forward for the long-term.

It is a long-term growth rate. So, we'll have to see. Obviously, we're seeing some positive outcomes. And we continue to see that. The question is okay, how sustainable is that on a long-term basis going forward, based on what we see today.

And we're comfortable with the 5% to 7%. We're getting more comfortable with the upper ranges of 5% to 7%. But, before you change to 6% to 8% or are you asking if I can, you have to be able to credibly see that for the long-term. And that's something you have to sort of warm over to overtime.

Ali Agha

I understood. Thank you.

Nick Akins

Yeah.

Darcy Reese

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

Operator

Certainly, ladies and gentlemen, the replay starts today at 11:15 a.m. Eastern and will last until October 31 at midnight. You may access the replay at any time by dialing 1800-475-6701 or 320-365-3844. The access code is 472043. Those numbers again: 1800-475-6701 or 320-365-3844 with the access code 472043.

That does conclude your conference for today. Thank you, for your participation. You may now disconnect.