

Electric-Corporate  
U.S. and Canada  
Credit Analysis

**American Electric Power Co.**

**Ratings**

Security Class	Current Rating
IDR	BBB
Senior Unsecured	BBB
Junior Subordinated Debentures	BB+
Short-Term IDR/Commercial Paper	FZ

iDR – Issuer default rating.

**Outlook**

Stable

**Financial Data**

American Electric Power Co.  
(\$ Mil.)

	LTM 9/30/09	12/31/08
Revenues	13,197	14,201
Gross Margin	8,554	8,446
Cash from Operations	2,258	2,454
Operating EBITDA	4,061	3,811
Total Capitalization	29,345	27,516
ROE (%)	10.7	13.29
Capex/Depreciation (%)	235.2	279.8

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**Related Research**

**Applicable Criteria**

- Rating Hybrid Securities, Dec. 29, 2009
- U.S. Power and Gas Comparative Operating Risk (COR) Evaluation and Financial Guidelines, Aug. 22, 2007
- Credit Rating Guidelines for Regulated Utility Companies, July 31, 2007

**Rating Rationale**

- Fitch Ratings affirmed the ratings of American Electric Power Co. (AEP) on Jan. 26, 2010. AEP's ratings take into consideration the company's ownership of nine electric utility subsidiaries that provide some cash flow diversity and operate in generally balanced regulatory environments. In addition, Fitch recognizes constructive financial actions taken by management, particularly the significant reduction of capital spending in 2009 and planned capex in 2010, as well as the \$1.64 billion equity offering in April of 2009, which has preserved cash flow and liquidity at the company in a challenging economic environment.
- 2009 consolidated financial performance was generally consistent with Fitch's expectations. AEP reported \$1.36 billion of ongoing earnings, compared with \$1.30 billion for 2008. Despite a reduction in industrial load of 15.6% and demand reduction in the off-system sales market, the company was able to secure approximately \$725 million in rate increases throughout the year, primarily from Ohio, Virginia, and West Virginia. This, in combination with cost controls on operating and maintenance expenses, allowed the company to maintain credit metrics that are consistent with utility parent peers in the 'BBB' rating category, with adjusted EBITDA to interest at more than 4.0x and debt leverage, as measured by the ratio of debt to EBITDA, at 3.8x for the year ended Dec. 31, 2009. Fitch projects that credit protection measures will remain at or near current levels over the next two years, assuming reasonable outcomes in pending rate cases, recovery of recent ice storm related costs, and modest load growth as the economy improves.
- Rating concerns primarily relate to AEP's exposure to potential emissions regulations or legislation given the company's large coal-fired generation fleet, as well as weak economies in several service territories, particularly Ohio, Michigan, and Kentucky. In addition, AEP faces some regulatory uncertainty relating to the end of the current electric security plans (ESP) for the Ohio utilities (Ohio Power Co., issuer default rating [IDR] 'BBB', Stable; and Columbus Southern Power Co., IDR 'BBB+', Stable) in 2011 and other regulatory proceedings. In the near term, the Public Utilities Commission of Ohio (PUCO) has yet to determine the methodology for the Significantly Excess Earnings Test (SEET), which requires the PUCO to determine if rate adjustments included in the ESP resulted in significantly excessive earnings. An adverse ruling from the PUCO regarding earnings at the Ohio companies could place pressure on the ratings of AEP and its operating subsidiaries.

**Key Rating Drivers**

- Regulated operations benefit from relatively stable and predictable cash flows.
- Credit coverages consistent with the rating category and utility parent peers.
- Solid competitive operating position with ownership of low-cost, coal-fired assets.
- Balanced market structure in Ohio through year-end 2011.
- Exposure to potential emissions regulation or legislation.
- An inability to recover significant environmental compliance investments and a deterioration of regulatory relations could negatively affect ratings.

## Related Research

### Applicable Criteria (Continued)

- *Parent and Subsidiary Rating Linkage (Fitch's Approach to Rating Entities Within a Corporate Group Structure)*, June 19, 2007
- *Issuer Default Ratings and Recovery Ratings in the Power and Gas Sector*, Nov. 7, 2005

### Other Research

- *Fitch Affirms Ratings for American Electric Power Co.; Outlook Stable*, Jan. 26, 2010
- *Columbus Southern Power Co. and Ohio Power Co. (Subsidiaries of American Electric Power Co.)*, Jan. 15, 2010
- *Appalachian Power Co. (A Subsidiary of American Electric Power Co.)*, Sept. 23, 2009
- *Kentucky Power Co. (A Subsidiary of American Electric Power Co.)*, Sept. 11, 2009

## Recent Developments

### Regulatory Update

**Arkansas:** In November 2009, the Arkansas Public Service Commission (APSC) approved a \$17.8 million base rate increase for Southwestern Electric Power Co. (SWEPCO, IDR 'BBB'; Negative Outlook), premised upon a return on equity (ROE) of 10.25%. The rate order also includes a separate generation rider of approximately \$11 million annually related to the recovery of carrying costs, depreciation, and operations and maintenance (O&M) expenses on the 508-MW natural gas-fired stall unit once it is placed into service as expected in mid-2010.

**Texas:** In August 2009, SWEPCO filed a rate case with the Public Utility Commission of Texas (PUCT) to increase non-fuel base rates by approximately \$75 million, including an ROE of 11.5%.

**West Virginia:** In September 2009, the West Virginia Public Service Commission (WVPSC) issued an order granting a \$355 million increase over a four-year phase in period for Appalachian Power Co. (APCo, IDR 'BBB-'; Stable) related to the company's expanded net energy charge (ENEC).

### Cook Nuclear Power Plant

On Dec. 23, 2009, the Cook nuclear plant Unit 1 reached full power after completing testing and monitoring of the restored turbine generator system. Reactor start-up and reconnection to the transmission grid has also taken place. The 1,030-MW unit has been out of service since September 2008 when turbine vibrations damaged the turbine generator, support structure, and associated systems. Repair of the property damage and replacement of the turbine rotors and other equipment could cost up to approximately \$330 million. Management believes that the company should recover a significant portion of these costs through the turbine vendor's warranty, insurance, and regulatory mechanisms.

AEP maintains property insurance through NEIL with a \$1 million deductible. As of Sept. 30, 2009, the company recorded \$119 million in prepayments and other current assets representing recoverable amounts under the insurance policy. The company also maintains a separate accidental outage policy with NEIL whereby, after a 12-week deductible period, AEP is entitled to weekly payments of \$3.5 million for the first 52 weeks following the deductible period. After the first 52 weeks, the policy pays \$2.8 million per week of up to an additional 110 weeks. To date, AEP has recorded \$185 million in revenues.

### Capital Expenditure Update

While AEP has announced reductions in capital spending for 2010, Fitch notes that capex budgets remain relatively high compared to historical levels, with \$2.0 billion forecasted in 2010 and 2011. The largest components of capex include: investments in distribution and transmission, environmental compliance costs and new generation. AEP is actively involved in several electric transmission investment initiatives, including pursuing opportunities in Texas, as well as areas in the Southwest, Midwest and on the East Coast.

### New Generation

**Turk Plant Update:** On Jan. 22, 2010, the Arkansas Pollution Control and Ecology Commission affirmed the air permit for Turk, which was under appeal by plant opponents in June 2009. To date, SWEPCO has spent \$717 million on constructing the Turk plant, with a total projected cost of \$1.6 billion.

**AEP New Generation Update**

(As of Sept. 30, 2009)

Company	Name	Location	Cost (\$ Mil.)	Fuel Type	Capacity (MW)	Operating Date
AEGCo	Dresden	Ohio	321	Gas	580	2013
SWEPCo	Stall	Louisiana	386	Gas	500	2010
SWEPCo	Turk	Arkansas	1,633	Coal	600	2012
APCo <sup>a</sup>	Mountaineer	West Virginia	—	Coal	629	—
CSPCo/OPCo <sup>a</sup>	Great Bend	Ohio	—	Coal	629	—

<sup>a</sup>The construction of the IGCC plants is subject to regulatory approvals.  
Source: Company reports.

**New Technology: Carbon Capture Storage**

AEP has been selected to receive funding from the U.S. Department of Energy (DOE) through the Clean Coal Power Initiative Round 3 to pay part of the costs of installing a commercial-scale carbon dioxide (CO<sub>2</sub>) capture and storage system on its Mountaineer coal-fired power plant in West Virginia. The company will receive \$334 million to assist with the installation of a system that will use a chilled ammonia process to capture at least 90% of the CO<sub>2</sub> from a 235-MW commercial scale portion of the plant's 1,300 MW of capacity. The system will begin commercial operation in 2015. In September 2009, the initial 20-MW demonstration capture portion of the project was placed into service, and in October 2009 the company started injecting CO<sub>2</sub> successfully in underground storage.

AEP has also received DOE funds for an \$87 million investment in gridSMART technology.

**Transmission Update**

AEP is pursuing a significant number of capital intensive transmission projects. The majority of these efforts are being undertaken with utility partners in joint venture ownership structures to offset business and financial risk.

Please reference the table below for AEP's active transmission projects.

- **Upper Midwest EHV Development — SMART Study:** In August 2009, AEP joined several other Midwest utilities, including American Transmission Co., Exelon Corp., NorthWestern Energy, and MidAmerican Energy Co. to sponsor a comprehensive study of the transmission needed in the Upper Midwest to support renewable energy development and to transport that energy to consumers in markets to the east. The study will provide recommendations for new transmission development in the Upper Midwest, including North Dakota, South Dakota, Iowa, Indiana, Ohio, Illinois, Minnesota, and Wisconsin. The Strategic Midwest Area Transmission Study (SMARTransmission Study) is scheduled for completion at the end of the first quarter 2010.

**AEP New Transmission Projects**

Project Name	Location	Expected Completion Date	Owners	Total Est. Cost at Completion (\$ Mil.)	Approved ROE (%)
Electric Transmission Texas (ETT)	ERCOT (Texas)	2017	MidAmerican Energy Holdings (50%), AEP (50%)	3,097	9.96
PATH Tallgrass	Ohio/West Virginia Oklahoma	2014 2013	Allegheny Energy (50%), AEP (50%) OGE Energy (50%), Electric Transmission Assets (50%)	1,800 500	14.30 12.80
Prairie Wind	Kansas	2013	Westar Energy, ETA (50%)	400	12.80
Pioneer	Indiana	2015	Duke Energy (50%), AEP (50%)	1,000	12.54

Source: Company reports.

- **Potomac-Appalachian Transmission Highline (PATH) Project Postponed:** In December 2009, AEP and its partner, Allegheny Energy (AYE) withdrew their applications for PATH in Virginia at the request of PJM. Due to the change in load and demand in the PJM region, the regional transmission operator is reviewing its long-term transmission needs for its footprint.

### Liquidity

As of Dec. 31, 2009, AEP has sufficient liquidity to meet ongoing financial needs. The company has approximately \$3.6 billion in credit facilities, with maturities from March 2011 through April 2012. The revolving credit agreements contain a covenant that requires AEP to maintain a debt to total capitalization ratio at or below 67.5%. As of Dec. 31, 2009, AEP has net available liquidity of \$3.4 billion, including cash on hand of \$490 million.

The utility subsidiaries have access to short-term borrowings through a cash pool managed by AEP, whereby entities with excess short-term liquidity lend to affiliates with cash needs. External financing needs of this pool are sourced directly by the parent.

### AEP Liquidity Position

(As of Dec. 31, 2009)

Sources and Uses	Amount (\$ Mil)	Maturity
<b>Commercial Paper Backup:</b>		
Revolving Credit Facility	1,500	3/11
Revolving Credit Facility	1,454	4/12
Revolving Credit Facility	627	4/11
<b>Total</b>	<b>3,581</b>	<b>—</b>
Cash and Cash Equivalents	490	—
<b>Total Liquidity Sources</b>	<b>4,071</b>	<b>—</b>
Less: AEP Commercial Paper Outstanding	(119)	—
Letters of Credit Issued	(568)	—
<b>Net Available Liquidity</b>	<b>3,384</b>	<b>—</b>

Source: Company reports.

### Debt Maturities

AEP's debt maturities are manageable with maturing debt expected to be funded through a combination of internal cash generation and external financings as needed. AEP's parent maturities are minimal with \$490 million maturing in 2010 and \$243 million maturing in 2015.

### AEP Long-Term Debt Maturities

(\$ Mil, As of Sept. 30, 2009)

2010	2011	2012	2013	2014
1,908	1,018	857	1,847	1,060

Source: Company reports.

### Capital Structure

#### Capital Structure — American Electric Power Co. Inc.

(\$ Mil As of Dec. 31, 2009)

Short-Term Debt	126
Long-Term Debt	15,518
<b>Total Debt</b>	<b>15,644</b>
Total Hybrid Equity and Minority Interest	46
Common Equity	13,140
<b>Total Capital</b>	<b>28,830</b>
Total Debt/Total Capital (%)	54.3
Total Hybrid Equity and Minority Interest/Total Capital (%)	0.2
Common Equity/Total Capital (%)	45.6

Source: Company reports.

**Financial Summary — American Electric Power Co., Inc.**

(\$ Mil., Fiscal Year-End Dec. 31, 2010)

	LTM 9/30/09	Year End			
		2008	2007	2006	2005
<b>Fundamental Ratios (x)</b>					
FFO/Interest Expense	4.2	3.9	4.1	4.6	2.9
CFO/Interest Expense	3.3	3.7	3.9	4.7	3.6
Debt/FFO	5.2	6.3	5.9	4.7	9.0
Operating EBIT/Interest Expense	2.7	2.7	2.8	2.9	2.6
Operating EBITDA/Interest Expense	4.2	4.2	4.6	4.8	4.4
Debt/Operating EBITDA	4.0	4.4	4.0	3.5	4.0
Common Dividend Payout (%)	96.3	47.8	—	—	—
Internal Cash/Capex (%)	45.5	47.1	46.1	58.9	53.0
Capex/Depreciation (%)	235.2	279.8	254.9	251.1	189.7
<b>Profitability</b>					
Adjusted Revenues	13,197	14,201	13,141	12,500	12,022
Net Revenues	8,554	8,446	8,174	7,827	7,487
Operating and Maintenance Expense	3,779	3,925	3,867	3,639	3,649
Operating EBITDA	4,061	3,811	3,604	3,505	3,130
Depreciation and Amortization Expense	1,423	1,358	1,395	1,405	1,267
Operating EBIT	2,638	2,453	2,209	2,100	1,863
Gross Interest Expense	965	904	779	726	714
Net Income for Common	1,271	1,380	1,089	1,002	814
Operating and Maintenance Expense % of Net Revenues	44.2	46.5	47.3	46.5	48.7
Operating EBIT % of Net Revenues	30.8	29.0	27.0	26.8	24.9
<b>Cash Flow</b>					
Cash Flow from Operations	2,258	2,454	2,273	2,673	1,833
Change in Working Capital	(835)	(207)	(163)	61	442
Funds from Operations	3,093	2,661	2,436	2,612	1,391
Dividends	(736)	(666)	(633)	(594)	(560)
Capital Expenditures	(3,347)	(3,800)	(3,556)	(3,528)	(2,404)
Free Cash Flow	(1,825)	(2,012)	(1,916)	(1,449)	(1,131)
Net Other Investment Cash Flow	77	40	(202)	(122)	55
Net Change in Debt	191	2,169	1,835	1,420	(91)
Net Equity Proceeds	1,759	159	144	99	(25)
<b>Capital Structure</b>					
Short-Term Debt	352	1,976	660	18	10
Long-Term Debt	15,883	14,801	13,756	12,324	12,520
<b>Total Debt</b>	<b>16,235</b>	<b>16,777</b>	<b>14,416</b>	<b>12,342</b>	<b>12,530</b>
Total Hybrid Equity and Minority Interest	46	46	46	46	46
Common Equity	13,064	10,693	10,079	9,412	9,088
<b>Total Capital</b>	<b>29,345</b>	<b>27,516</b>	<b>24,541</b>	<b>21,800</b>	<b>21,664</b>
Total Debt/Total Capital (%)	55.3	61.0	58.7	56.6	57.8
Total Hybrid Equity and Minority Interest/Total Capital (%)	0.2	0.2	0.2	0.2	0.2
Common Equity/Total Capital (%)	44.5	38.9	41.1	43.2	41.9

Note: Numbers are adjusted to exclude interest, principal payments and amortization on utility tariff bonds. LTM – Latest 12 months. Operating EBIT – Operating income before total reported state and federal income tax expense. Operating EBITDA – Operating income before total reported state and federal income tax expense plus depreciation and amortization expense. Note: Numbers may not add due to rounding.

Source: Company reports and Fitch Ratings.

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# MOODY'S

## INVESTORS SERVICE

Credit Opinion: American Electric Power Company, Inc.

Global Credit Research - 25 Mar 2010

Columbus, Ohio, United States

### Ratings

Category	Moody's Rating
Outlook	Stable
Sr Unsec Bank Credit Facility	Baa2
Senior Unsecured	Baa2
Jr Subordinate	Baa3
Commercial Paper	P-2
<b>AEP Capital Trust I</b>	
Outlook	Stable
Preferred Shelf	(P)Baa3
<b>AEP Capital Trust II</b>	
Outlook	Stable
Preferred Shelf	(P)Baa3
<b>AEP Capital Trust III</b>	
Outlook	Stable
Preferred Shelf	(P)Baa3
<b>Appalachian Power Company</b>	
Outlook	Stable
Issuer Rating	Baa2
Senior Unsecured	Baa2
Preferred Stock	Ba1

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### Key Indicators

[1] American Electric Power Company, Inc.

	2009	2008	2007	2006
(CFO Pre-W/C + Interest) / Interest Expense	4.0x	3.3x	3.5x	3.9x
(CFO Pre-W/C) / Debt	17.6%	13.4%	14.4%	17.0%
(CFO Pre-W/C - Dividends) / Debt	14.2%	10.4%	11.1%	13.5%
Debt / Book Capitalization	53.2%	58.9%	56.2%	54.5%

[1] All ratios calculated in accordance with the Regulated Electric and Gas Utilities Rating Methodology using Moody's standard adjustments

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

## **Opinion**

### **Rating Drivers**

Large, predominantly rate-regulated electric utility holding company a credit positive

Diversity of regulatory jurisdictions, geographic regions and service territories viewed positively

Financial profile and balance sheet deterioration has abated near-term / expectations for maintaining strong financials

Longer-term business and operating challenges, including more stringent environmental mandates

Near-term liquidity profile appears adequate but sizable maturities in 2010 and 2011 including crucial credit facilities

### **Corporate Profile**

American Electric Power Company (AEP - Baa2 senior unsecured; Stable) is a large electric utility holding company with rate-regulated utilities operating in 11 states. AEP owns approximately 38,000 MW's of generating assets, primarily coal. AEP is headquartered in Columbus, Ohio.

### **Recent Developments**

On March 23, 2010, Moody's affirmed AEP's Baa2 senior unsecured rating and changed the rating outlook from negative to stable. The rating action reflects the material financial policy change at AEP as solidified by the \$1.6 billion equity infusion and the substantial reduction in capital expenditures over the intermediate term horizon. The action also takes into consideration AEP's improved financial metrics which are expected to be maintained over the near to intermediate term horizon.

### **SUMMARY RATING RATIONALE**

AEP's Baa2 senior unsecured rating considers the diversity it enjoys from owning and operating nine rate-regulated electric utilities across 11 states. The rating also considers the consolidated financial profile of AEP, which does not maintain a material amount of parent holding company debt, a credit positive. A sizeable 2009 common equity infusion and significantly reduced capital expenditure and cost reduction plans implemented in 2009 and continuing in 2010 have helped improve the prospective financial metrics that are consistent with the Baa2 rating category. The Baa2 rating also considers the increasing challenges associated with managing a large fleet of coal-fired generation assets and service territories still experiencing economic recessionary pressures.

### **DETAILED RATING CONSIDERATIONS**

#### **DIVERSITY OF RATE REGULATED CASH FLOWS**

AEP's businesses and assets are well diversified, although they are concentrated within the electric utility sector. AEP's utility subsidiaries are located in 11 different states, and are therefore regulated by 11 different regulatory authorities (the largest being Ohio, Virginia and Texas - ranked by rate base). These jurisdictions translate into good diversity in revenues (by state and operating utility), cash flows, assets, debt outstanding, customers and generation capacity. From a credit perspective, Moody's views this diversity as a meaningful credit strength due to the insulation that benefits the parent company from any unexpected adverse event or other negative development occurring at one of its companies or with one of its state service territories.

#### **SUPPORTIVE REGULATORY JURISDICTIONS A CREDIT POSITIVE**

AEP is exposed to eleven different state regulatory commissions which Moody's views favorably, due to their reasonably transparent rulemaking procedures and likelihood to settle as opposed to litigate rate cases. We observe that most of these commissions are appointed (Louisiana and Oklahoma are elected); that a majority of the states did not pursue a legislatively mandated form of deregulation (with the exception of Ohio, Texas, Virginia and Michigan - although the two latter states have more recently pursued re-regulation), that fuel / purchased power costs trackers are allowed in some fashion in all states (except for Ohio, which has a fuel and purchased power tracker but is subject to an overall rate cap) and that most have approval authorities over securities issuances and M&A change of control (except Michigan). As a portfolio, these regulatory commissions are viewed as maintaining a relatively constructive relationship with the utilities they regulate and are considered a benefit to AEP's over-all business and risk profile.

#### **MAINTAINING FINANCIAL PROFILE KEY TO MAINTAINING RATINGS**



The vast majority of AEP's revenues, earnings, cash flows and assets are related to its numerous rate-regulated electric utility subsidiaries, which we view, in general, as having a relatively low over-all business and operating risk profile. We would be concerned if AEP finds it increasingly difficult to maintain its consolidated cash flow from operations before working capital adjustments (CFO pre-w/c) to total debt credit metric at a level that remains comfortably within the mid-teen's range. For year end 2009, AEP reported a ratio of CFO pre-w/c to debt of 17.6% versus 13.4% in 2008 and 14.4% in 2007.

Prospectively, we expect AEP to continue to exhibit some improvement to its financial profile, despite the continuing recessionary pressures being experienced in its many service territories. We view AEP's sizeable reductions in its capital expenditure and its O&M cost containment plans positively for the credit profile.

#### **LARGE CAPITAL EXPENDITURE PROGRAM**

Over the next few years, AEP is expecting to invest approximately \$10 billion into its operating infrastructure. While reduced from prior estimates, we still view investments in regulated rate-base positively for the credit profile, and we incorporate a view that most regulators will provide meaningful and timely recovery for prudently incurred investments. Nevertheless, we remain cautious as to the scale and scope of capital expenditure plans of this size, due to the negative free cash flow that will be incurred over the next few years and the potential regulatory overhang associated with the ultimate impact on end-use customer rates. In our opinion, utilities that are embarking on a capital investment program of this size should also be redoubling their efforts to bolster their balance sheet and cash flow credit metrics, in an effort to create enough financial strength to weather potentially distressful environments related to uncertain economic conditions, volatility in commodity markets, regulatory changes or other unanticipated developments.

#### **COAL GENERATING ASSETS VULNERABLE TO SIGNIFICANT ENVIRONMENTAL LEGISLATION**

We observe the potential for significant environmental legislation, especially related to carbon dioxide emissions, as a material risk affecting AEP's coal-fired generating assets. However, Moody's incorporates a view that the timing of compliance requirements within any potential new legislation may be many years in the future and that the costs associated with any new legislation regarding emissions will generally be recovered through rates (either through existing fuel clause pass-through mechanisms or other incremental rate riders).

#### **Liquidity**

As of December 31, 2009, AEP had three separate credit facilities totaling \$3.6 billion; two of which are \$1.5 billion five year credit facilities expiring in March 2011 and April 2012. These facilities contain a debt to capitalization limit of 67.5%. AEP asserts that it remains in compliance. There is a \$750 million letter of credit capacity (prior to final Bank of America litigation judgment, \$600 million after) on each facility (\$1.5 billion in total, \$1.2 billion after Bank of America resolution), a \$500 million accordion feature for each facility (for a total accordion of \$1.0 billion) and a one-year extension option.

There are no material adverse change restrictions on drawings, no litigation representation provision at the time of borrowing and a definition adjustment to exclude one of AEP's subsidiaries, AEP Texas Central, as a "significant subsidiary" to prevent cross-acceleration in the event of a default. AEP also has a \$627 million credit facility, expiring April 2011, that can be utilized for letters of credit or draws and has covenant restrictions similar to the primary 5-year facilities.

AEP has approximately \$1.6 billion of long term debt coming due in 2010 (of which \$1.0 billion will mature over the remainder of 2010) and \$600 million due in 2011. In the next two years, we estimate that AEP will spend approximately \$2.5 billion annually in capital expenditures and approximately \$850 million in dividends annually. As of year end 2009, AEP's credit facilities had approximately \$119 million utilized in support of commercial paper outstanding and roughly \$568 million of LC's posted, leaving approximately \$2.9 billion of capacity available. Combined with \$490 million of cash, total liquidity amounted to roughly \$3.4 billion.

For year 2009, AEP generated approximately \$2.7 billion in cash from operations, made approximately \$3.3 billion capital investments and paid roughly \$761 million in dividends, resulting in roughly \$1.4 billion of negative free cash flow.

#### **Structural Considerations**

After considering the ratings for a number of AEP's utility operating subsidiaries, several of which are also rated in the Baa2 ratings category, there could be some structural subordination pressure for AEP to defend its Baa2 senior unsecured rating, at least over the longer-term horizon. Nevertheless, we see good diversity and low-risk business profile among its numerous operating utility subsidiaries, which could mitigate this issue. Ratings upgrades at subsidiaries, Appalachian Power and Indiana-Michigan Power (both rated Baa2 senior unsecured) would materially

benefit the credit positioning of AEP.

### Rating Outlook

The stable rating outlook reflects the rating resolution on a number of AEP's utility operating subsidiaries in 2009, the expectation that AEP will continue to demonstrate discipline in its financial policies, and the improvement in its cash flow generation in relation to its debt, all of which help mitigate increasing challenges over the longer-term horizon with respect to managing a diverse group of service territories which are all experiencing severe economic recessionary pressures, along with a sizeable coal-fired generating fleet.

### What Could Change the Rating - Up

Ratings upgrades appear unlikely over the near term, primarily due to the ratings positioning of AEP's numerous subsidiary operating utilities. While the diversification of these numerous subsidiaries benefits the over-all credit profile, we observe that a majority of the utility subsidiaries appear to be well positioned within the Baa1 and Baa2 rating categories. Nevertheless, if AEP was successful in producing a stronger set of key financial credit metrics, including a ratio of CFO pre-w/c to debt near 20% on a sustainable basis upward rating pressure could materialize.

### What Could Change the Rating - Down

AEP's ratings could be downgraded based on the structural subordination risks associated with the ratings of its subsidiaries, particularly its larger subsidiaries. In addition, the ratings could be downgraded if AEP was to produce financial metrics that appear weak for its rating category, including a ratio of CFO pre-w/c to debt in the low teen's range. The ratings could also be downgraded if AEP experiences material set-backs with its various regulatory proceedings, or if a more contentious regulatory / political relationship materialized or if its capital investment program was financed aggressively with debt, which in turn will likely impact its consolidated cash flow generation financial metrics.

### Rating Factors

American Electric Power Company, Inc.

Regulated Electric and Gas Utilities	Aaa	Aa	A	Baa	Ba	B
Factor 1: Regulatory Framework (25%)				X		
Factor 2: Ability to Recover Costs and Earn Returns (25%)				X		
Factor 3: Diversification (10%)						
a) Market Position (5%)			X			
b) Generation and Fuel Diversity (5%)						X
Factor 4: Financial Strength, Liquidity & Financial Metrics (40%)						
a) Liquidity (10%)				X		
b) CFO pre-WC + Interest / Interest (7.5%) (3yr Avg)				X		
c) CFO pre-WC / Debt (7.5%) (3yr Avg)				X		
d) CFO pre-WC - Dividends / Debt (7.5%) (3yr Avg)				X		
e) Debt / Capitalization or Debt / RAV (7.5%) (3yr Avg)					X	
Rating:						
a) Methodology Implied Senior Unsecured Rating				Baa2		
b) Actual Senior Unsecured Rating				Baa2		

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# Analysis

# Moody's Global Infrastructure

February 2009

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## American Electric Power Company, Inc.

Columbus, Ohio, United States

American Electric Power Company, Inc. (AEP) is a large utility holding company with electric utility operations serving approximately 5 million retail customers across 11 states. AEP is headquartered in Columbus, Ohio.

- Electric utility operations are diversified geographically and by state regulatory authorities—a credit positive—but a majority of operations focus on traditional, vertically integrated electric utility activities, which does not provide AEP with same diversity of operations as some peers
- Regulatory support among all jurisdictions allows timely recoveries of prudently incurred costs and investments—a critical element to growth and credit-rating stability
- Maintaining key metrics may become more challenging in the current economic and financial market environment, especially because most jurisdictions are experiencing severe recessionary pressures
- Capital investment plans are primarily centered upon rate-base additions—generally viewed as a long-term credit positive—and recent cutbacks in investment plans are viewed as short-term delays
- Significant coal-fired generating fleet raises risk profile because of the prospect for more stringent environmental mandates—especially regarding CO<sub>2</sub> emissions
- Liquidity profile appears adequate at this time, but access to capital markets will be necessary to meet negative free cash flow needs and sizeable scheduled debt maturities and pension contributions in 2010
- Potential concerns over aspects of corporate governance, including apparent concentration of power by CEO

This Analysis provides an in-depth discussion of credit rating(s) for American Electric Power Company, Inc. and should be read in conjunction with Moody's most recent Credit Opinion and rating information available on Moody's website. [Click here to link.](#)



**Moody's Investors Service**

## American Electric Power Company, Inc.

**Rating rationale**

AEP's Baa2 senior unsecured rating considers its generally lower-risk business profile in part due to the concentration of rate-regulated electric utility business activities in states with relatively supportive regulatory and political environments. The diversity by geography and regulatory jurisdiction benefits the long-term consolidated financial profile. In addition, AEP's financial profile, which has produced key financial credit metrics within the Baa-rating category over the past 3-5 years relatively consistently, is also benefited by the divestiture or exit of more risky, non-regulated ventures, and by resolving some outstanding litigation.

Nevertheless, the rating faces some material headwinds: a severe economic recession across its service territories and a significant capital expenditure plan. In addition, AEP manages a large coal-fired generation fleet that is vulnerable to new carbon dioxide emission regulations and other environmental mandates; a subsidiary is experiencing an extended outage of one unit of its only nuclear plant (increasing all-in "pool" power costs which could introduce purchased power recovery challenges in regulatory proceedings); and the company maintains a liquidity strategy that assumes unfettered access to the capital markets.

Our negative rating outlook is primarily based on our views of the company's intermediate and longer-term strategic plans, the diversity of its cash flow generation from rate-regulated electric utilities, and a reasonably predictable financial profile that is expected to experience some modest but sustained declines to its key financial credit metrics, the most important of which involve cash flow and total adjusted debt outstanding.

**Table A**

<b>Summary ratings and selected financial data</b>						
(Billions)	Sr. Secured	Sr. Unsecured	Ratings Outlook	2007 Year End		
				Debt	GFO	Revenue
AEP	--	Baa2	Negative	\$19.0	\$2.6	\$13.4
Appalachian Power	Baa1	Baa2	Stable	\$3.1	\$0.4	\$2.6
Columbus Southern Power	--	A3	Stable	\$1.5	\$0.5	\$2.0
Indiana Michigan Power	--	Baa2	Stable	\$2.6	\$0.5	\$2.0
Kentucky Power	--	Baa2	Stable	\$0.5	\$0.1	\$0.6
PS Oklahoma	--	Baa1	Stable	\$1.1	\$0.1	\$1.4
			Stable	\$8.8	\$1.5	\$8.6
Ohio Power	--	A3	RUR - down	\$3.2	\$0.6	\$2.8
Southwestern Electric Pwr	--	Baa1	RUR - down	\$1.4	\$0.2	\$1.5
AEP - Texas Central	Baa1(P)	Baa2	RUR - down	\$3.0	\$0.0	\$0.8
AEP - Texas North	--	Baa1	RUR - down	\$0.3	\$0.0	\$0.3
			RUR - down	\$7.9	\$0.8	\$5.4

Source: AEP, Moody's Financial Metrics

**A note on structural subordination**

Moody's recently took a number of rating actions on AEP and its wholly owned electric utility subsidiaries, placing approximately 40% of AEP's consolidated utility rate base on review for possible downgrade. Assuming these reviews concluded with one-notch downgrades, a majority of AEP's subsidiaries would be rated Baa2 senior unsecured, thereby creating some structural subordination pressure on the parent company's rating.

## American Electric Power Company, Inc.

### Company profile

American Electric Power Company, Inc. (AEP) is a large utility holding company with electric utility operations serving approximately 5 million retail customers across 11 states.<sup>1</sup> In addition, AEP owns a sizeable barge and coal-handling business, which is non-regulated, along with an energy trading and hedging operation and a small wholesale generation company.

About 90% of AEP's consolidated revenues are associated with rate-regulated electric utility operations. These operations are primarily conducted through nine separate utility companies, of which seven are vertically integrated. Two utilities enjoy monopolistic electric transmission and distribution (T&D) only service territories in Texas, while another two have monopolistic service territories in Ohio. Legislators in Ohio are continuing their efforts to restructure the state's traditional electric utility market framework.

AEP owns or leases roughly 37 GW of electric generation capacity, much of it fuelled by coal, and diversified by geographic region and regulatory jurisdiction. Approximately 87% of this generation capacity (about 33 GW) is associated with vertically-integrated electric utilities, and roughly one-third (12 GW) is associated with the Ohio-based regulated utilities, currently undergoing legislative intervention and market restructuring.<sup>2</sup> Roughly 13% (5 GW) is considered non-regulated, although the capacity is essentially fully subscribed by affiliate utilities, through AEP Generating Company.

We consider these power-generation assets extremely important and critical for the local infrastructure, representing a broad swath of the United States extending from the upper mid-west region to south Texas. These assets face some uncertainty due to increasingly stringent environmental mandates now being developed at both state and Federal levels. The risk of a major dispute regarding the environmental intention or legal interpretation could increase considerably with these new policies.

### Diversity of operations

AEP's businesses and assets are well diversified in terms of geography and state regulatory oversight, but not by business activity, since they are all primarily electric utilities. Other large, comparable peer group holding companies such as Sempra Energy, Dominion Resources and MidAmerican Energy conduct other business activities, such as interstate natural gas pipelines,<sup>3</sup> regulated natural gas distribution businesses, and international operations, among others. These non-electric utility business activities provide a diversity benefit to the consolidated enterprise that AEP does not enjoy.

AEP has utility subsidiaries in 11 different states, subject to 11 different regulatory authorities.<sup>4</sup> These varied jurisdictions provide AEP with strong diversity in revenues and rate base (by state and operating utility); cash flows; assets; debt outstanding; customers; and generation capacity.

From a credit perspective, this diversity is a credit strength, protecting AEP from any unexpected, adverse development at one of its subsidiaries, or within any of its specific service territories.

<sup>1</sup> Arkansas, Indiana, Kentucky, Louisiana, Michigan, Ohio, Oklahoma, Tennessee, Texas, Virginia and West Virginia. AEP also oversees a small utility operation in a twelfth state, Tennessee.

<sup>2</sup> For more information about regulatory changes under way in Ohio, read our Special Comment, "Investor-Owned Electric Utilities in Ohio," February 2009.

<sup>3</sup> Regulated by the Federal Energy Regulatory Commission (FERC).

<sup>4</sup> The largest are Ohio, Texas and Virginia, ranked by rate base.

## American Electric Power Company, Inc.

Table B

<b>Example of diversification of customers and generating capacity</b>
--

2007 Consolidated
-------------------

	Customers (thousands)	Customers as a % consolidated	MW capacity	MW capacity as a % consolidated
AEP (consolidated)	5,043		38,168	
Arkansas	110	2%	440	1%
Indiana	454	9%	4,747	12%
Kentucky	175	3%	1,060	3%
Louisiana	172	3%	650	2%
Michigan	126	2%	2,200	6%
Ohio	1,417	28%	9,339	24%
Oklahoma	512	10%	4,173	11%
Tennessee	46	1%	0	0%
Texas	1,094	22%	5,415	14%
Virginia	504	10%	1,683	4%
West Virginia	435	9%	8,461	22%

Source: AEP

### Regulatory environments support long-term credit quality

In general, we view the state regulatory commissions that oversee AEP's utilities favorably. These commissions have shown reasonably transparent rulemaking procedures and a tendency to settle rate cases. Most of these commissions are appointed (in Louisiana and Oklahoma, commissioners are elected). Most of the AEP states have not pursued a legislatively mandated form of deregulation<sup>5</sup>; allow fuel cost / purchased-power cost trackers in some fashion<sup>6</sup>; and have approval authority over securities issuances and M&A change of control.<sup>7</sup>

Seen as a whole, these regulatory commissions maintain a relatively constructive relationship with the utilities they regulate. We consider them a benefit to AEP's overall business and risk profile.

<sup>5</sup> The exceptions are Ohio, Texas, Virginia and Michigan—although some of these states have also back-tracked their efforts, to various degrees.

<sup>6</sup> Except Ohio.

<sup>7</sup> Except Michigan.

## American Electric Power Company, Inc.

Table C

Diversification of State regulatory authorities				
Jurisdiction	Rate Base (\$billions)	Approved ROE	Effective Date	Moody's expectations
APCO - Virginia	\$2.42	10.20%	Nov-08	Requests for additional rate relief in 2009
APCO - W. Virginia	\$1.66	10.50%	Jul-06	Requests for additional rate relief in 2009
Kentucky Power	\$0.86	10.50%	Mar-06	
I&M - Indiana	\$1.81	12.00%	Nov-93	December 2008 - \$44mm rate increase, including trackers. Settlement pending in front of Indiana Utility Regulatory Commission
I&M - Michigan	\$0.27	13.00%	Apr-91	
CSP - Ohio	\$1.56	12.46%	May-92	Resolution of ESP filing in 2009
Ohio Power - Ohio	\$2.18	12.81%	Mar-95	Resolution of ESP filing in 2009
PSO - Oklahoma	\$1.47	10.50%	Jan-09	
SWEPCO - Louisiana	\$0.58	10.57%	Aug-08	
SWEPCO - Arkansas	\$0.41	10.75%	Sep-99	Rate request expected 2009
SWEPCO - Texas	\$0.47	15.70%	Feb-83	
TCC - Texas	\$1.57	9.96%	Jun-07	
TNC - Texas	\$0.53	9.96%	Jun-07	

Source: AEP

### Prospects for financial weakening pose credit concern

The vast majority of AEP's revenues, earnings, cash flows and assets are related to its rate-regulated electric utility subsidiaries, which we view, in general, as having a relatively low over-all business and operating risk profile. Over the past 3-5 years, AEP has generated an average cash flow to debt credit ratio of about 15% on a consolidated basis.

But while some of AEP's operating utilities appear reasonably well positioned within their respective rating categories, others appear less well positioned. We continue to believe AEP's investments in its non-utility, non-regulated operations will remain modest.

We view AEP's current shareholder-rewards strategies as somewhat inconsistent with the risks facing the industry in general, and AEP specifically, based on a number of factors: the level of spending that AEP anticipates; the continued increases in non-fuel operating and maintenance expenses; the volatility associated with natural gas prices; rising costs for coal and nuclear fuel; an aging workforce; and uncertainties associated with increasingly stringent environmental compliance mandates.

We do not dispute the board of directors' need to maximize shareholder value. Even so, we remain concerned about the fixed nature of AEP's common-stock dividend policy and its dividend payout targets. For example, over the five year period 2003 – 2007, AEP generated approximately \$13.8 billion in CFO and invested roughly \$13.6 billion into its system, leaving \$0.2 billion in internally generated funds. AEP paid roughly \$3.2 billion in shareholder dividends during this period. As a result, Moody's observes that AEP generated approximately \$3.0 billion in negative free cash flow and its total adjusted debt balance increased by roughly \$2.4 billion.

We believe AEP already has very little "cushion" within its rating category. Should a meaningfully adverse development damage AEP's cash flows, the company could see rating pressure develop. We observe that several of AEP's peers appear much more soundly positioned within their given rating categories, although most fall within the overly-biased shareholder rewards classification.



## American Electric Power Company, Inc.

Given AEP's Baa2 rating category, we would become concerned if AEP were to find it increasingly difficult to maintain its consolidated financial credit metrics at a level that remains comfortably above 15% CFO pre-w/c to debt (cash flow before working capital adjustments). The CFO pre-w/c to debt for year-end 2007, and for the latest 12 months ended June 2008, appear to be very close to the 15% threshold—a level that does not provide much cushion for unexpected events or developments.

Table D

## AEP consolidated summary historical financial profile

(\$ billions)	2003	2004	2005	2006	2007	LTM 1Q'08	LTM 2Q'08	LTM 3Q'08
Revenue	\$14.7	\$14.2	\$12.1	\$12.6	\$13.4	\$13.7	\$14.1	\$14.5
EBITDA	\$3.3	\$4.1	\$3.9	\$4.1	\$4.5	\$5.0	\$5.1	\$5.0
Interest	\$1.0	\$0.9	\$0.9	\$1.0	\$1.1	\$1.1	\$1.2	\$1.2
Net inc.	\$0.1	\$1.1	\$0.8	\$1.0	\$1.1	\$1.3	\$1.4	\$1.5
CFO	\$2.6	\$3.1	\$2.6	\$2.9	\$2.6	\$2.9	\$2.9	\$3.1
Cap Ex.	\$1.6	\$1.9	\$2.6	\$3.7	\$3.8	\$3.6	\$3.7	\$3.9
Dividends	\$0.8	\$0.6	\$0.6	\$0.6	\$0.6	\$0.6	\$0.6	\$0.7
FCF	\$0.1	\$0.7	(\$0.6)	(\$1.4)	(\$1.8)	(\$1.4)	(\$1.4)	(\$1.5)
Total Adj. Debt	\$17.4	\$15.2	\$15.3	\$16.9	\$19.0	\$18.8	\$19.3	\$22.0
Total Equity	\$7.9	\$8.6	\$9.1	\$9.4	\$10.1	\$10.5	\$10.6	\$10.9

Source: AEP; Moody's Financial Metrics

Table E

## AEP consolidated Key financial credit metrics

	2003	2004	2005	2006	2007	LTM 1Q'08	LTM 2Q'08	LTM 3Q'08
CFO / debt	15%	21%	17%	17%	14%	15%	15%	15%
CFO pre w/c / debt	14%	18%	15%	17%	15%	15%	15%	15%
FFO / debt	17%	18%	15%	17%	14%	17%	16%	16%
RCF / debt	12%	14%	11%	14%	11%	13%	13%	13%
FCF / debt	0.6%	4.4%	(4.0%)	(8.3%)	(9.3%)	(7.3%)	(7.5%)	(7.2%)
Debt / EBITDA	5.2x	3.7x	3.9x	4.1x	4.2x	3.8x	3.8x	4.0x
CFO pre w/c - div / Cap Ex.	102%	113%	63%	61%	57%	61%	63%	61%

Source: AEP; Moody's Financial Metrics

## American Electric Power Company, Inc.

Chart A

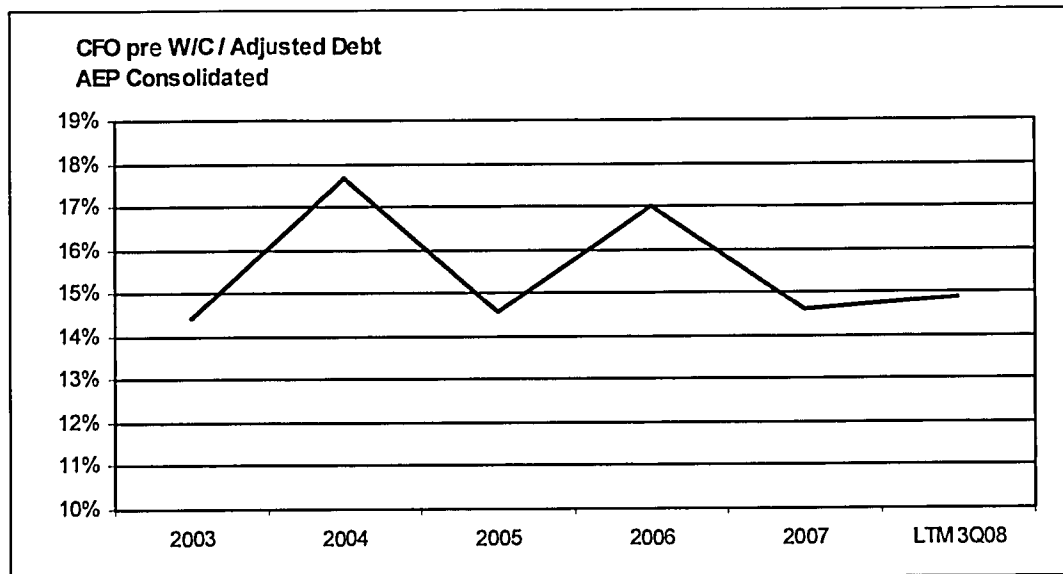


Table F

## Summary of historical cash flow / debt credit metrics

	CFO pre W/C / Adjusted Debt				
	5 Year Average (2003-2007)	3 Year Average (2005-2007)	2007	LTM 2Q '08	LTM 3Q '08
AEP	15.7%	15.4%	14.6%	15.4%	14.9%
Appalachian Power	16.3%	12.4%	12.5%	9.2%	13.1%
Columbus Southern Power	24.9%	22.6%	25.2%	27.3%	28.3%
Indiana Michigan Power	20.4%	20.4%	20.4%	24.1%	24.9%
Kentucky Power	16.5%	15.9%	16.9%	17.6%	20.0%
Ohio Power	19.9%	18.0%	17.4%	19.0%	17.1%
PS Oklahoma	17.4%	14.0%	6.1%	16.0%	12.7%
Southwestern Electric Pwr	22.3%	20.0%	14.6%	8.3%	13.9%
AEP - Texas Central	5.8%	3.2%	1.6%	5.5%	6.6%
AEP - Texas North	24.8%	24.4%	22.2%	18.8%	17.8%

Source: AEP, Moody's Financial Metrics

### Capital investment plan raises near-term risks

Over the next several years, AEP is expecting to invest about \$10 billion into its business infrastructure, although the total amount may change or shift out a few years. A significant portion of these investments can be considered longer-term plans, and therefore somewhat aspirational and subject to various forms of regulatory pre-approvals before funding is committed. Even so, this level of spending could clearly place financial pressure on the company, given its other cash outflow needs.

From a credit perspective, we generally hold a positive view of regulated rate-base investments, and we believe regulators will provide meaningful and timely recovery for prudently incurred investments. Nevertheless, we remain cautious as to the scale and scope of capital expenditure plans of this size, due to

## American Electric Power Company, Inc.

the negative free cash flow that will be incurred over the next few years, and to the potential regulatory overhang associated with the ultimate impact on end-use customer rates. The current recessionary pressures only add to our concern.

Moody's notes that AEP has materially reduced its expectations for 2009 and is currently revising its forecast for 2010.

**Table G: Summary of capital expenditure forecast**

<b>AEP Capital Investment Plans - Forecast Under Review</b>						
(\$ in millions)	2007A	2008F	2009F	2010F	2009 Revised	2009 Difference
Generation	\$891	\$591	\$469	\$368	\$478	\$9
Environmental	\$994	\$875	\$668	\$623	\$436	(\$232)
Corporate	\$133	\$168	\$129	\$125	\$89	(\$40)
Nuclear	\$64	\$74	\$130	\$103	\$128	(\$2)
Distribution	\$871	\$1,031	\$949	\$1,021	\$686	(\$263)
Transmission	\$446	\$564	\$476	\$625	\$532	\$56
New Generation	\$515	\$527	\$513	\$551	\$235	(\$278)
<b>Total</b>	<b>\$3,914</b>	<b>\$3,830</b>	<b>\$3,334</b>	<b>\$3,416</b>	<b>\$2,584</b>	<b>(\$750)</b>

Source: AEP

We believe AEP, in embarking on this \$10 billion capital investment program, should also redouble its efforts to bolster their balance sheet and cash flow credit metrics. This would help give AEP the financial strength needed to weather potentially stressful environments related to economic conditions, volatility in commodity markets, regulatory changes, or other unanticipated developments during a high investment period. It remains unclear to us whether a reduction in capital expenditure plans is a longer-term positive for this company, in spite of any near-term relief associated with a reduced spending plan, due to the rate base nature of the majority of investments. Moody's is especially concerned with the potential risks associated with increased reliability challenges associated with reductions in distribution expenditures.

### Coal assets vulnerable to environmental legislation

Significant environmental legislation, especially related to carbon dioxide emissions, poses a material risk to AEP's coal-fired generating assets. We believe the timing of compliance requirements within any potential new legislation may be many years in the future, and that the costs associated with any new legislation regarding emissions will generally be recovered through rates.<sup>8</sup> Nevertheless, we remain concerned about the potential for recovery lag, given the realities of increasing costs on an economy suffering from a severe recession.

### Conservative approach to managing commodity exposures

AEP manages its exposure to commodities primarily through the use of forward physical contracts, interspersed with derivative instruments. Physical contracts allow AEP to manage its price risk, shielding the company from large swings in collateral posting during 2008. From the period June 30 to September 30, 2008, the company returned \$200 million in collateral postings to counterparties.

Because AEP's use of financial derivatives is low, so is its resulting counterparty risk associated with these contracts. As of September 30, 2008, AEP's counterparty exposure was \$877 million gross, or \$827 million net; the difference marked \$50 million of collateral postings. While the \$50 million collateral only represents 6% of its gross exposure, only \$133 million of this is with non investment grade companies.

All things considered, AEP's hedging program appears to work relatively well in managing the price, credit and liquidity risks associated with its commodity exposure.

<sup>8</sup> Either through existing fuel clause pass-through mechanisms or other incremental rate riders.

## American Electric Power Company, Inc.

### Modest pension exposure

AEP sponsors relatively large defined-benefit pension plans, reporting approximately \$4.1 billion of obligations and \$4.4 billion of assets as of December 31, 2007. AEP's pension investment strategy appears marginally more conservative than most, investing roughly 55% of its assets invested in equities and approximately 40% in debt; a "normal" investment strategy would direct about 60% of its assets into equities and 30% into debt.

Despite this strategy, we expect that the \$300 million over-funding as of December 2007 will revert to an under-funding of approximately \$1 billion. Management recently indicated their expectation for upward of \$300 million in cash contributions in 2010 and no contribution in 2009 due to a prior year credit. We believe AEP has adequate liquidity to support these contributions. Under-funded pension obligations are treated as debt in our key financial credit metric calculations.

### Corporate governance is a potential concern

Overall, AEP has important governance strengths that outweigh most weaknesses, but we are concerned with some evidence of a concentration of power at the CEO level. Nevertheless, at this time, we believe the impact on the rating is limited.

AEP's board has taken a fairly structured approach to corporate governance—for example, by subdividing it into a number of committees—which improves its ability to focus on proper detail, but also carries some risk of inadequate overall board integration. Board independence has been strengthened with the addition of two new directors during the last year, and we now consider nine of the 12 directors to be independent. These strengths help to mitigate some of our concerns.

Even so, we are concerned about certain indicators of a concentration of power at the CEO level. While we are not concerned about high pay on an absolute basis, we note that the CEO's total compensation opportunity was five times that of AEP's second highest paid executive in 2007 (and four times in 2006), whereas a more common pay practice allows the CEO to earn double or triple the compensation of the next-highest-paid executive. AEP's chief executive in 2007 received more than six times the level of long-term incentive awards as did the four other top executives, and roughly four times the level of incentive awards in 2006. AEP's CEO perks—valued at \$646,000 in 2007 and \$676,000 in 2006—were the highest by value for utility company peers for both years. We believe long-term and persistently wide gaps between CEO pay and pay for other top executives, as well as relatively high levels of perquisite awards, could indicate a concentration of power at the CEO level, "key person" risk around the CEO, or board passivity in setting compensation.

While AEP's annual incentive (bonus) plan appears balanced from a creditor perspective, we view the long-term incentive plan as highly shareholder-focused. AEP is the only company among its peers that exclusively uses performance units tied to earnings per share (EPS) and total shareholder return (TSR) targets; others use a mix of restricted shares, stock options and performance units. This may encourage management to take shareholder-friendly actions at the expense of bondholders, since awards do not pay out if performance targets are not met.

### Ohio regulatory environment remains in transition<sup>9</sup>

Ohio today is contemplating significant changes to its electricity market framework, so utilities that operate in the state regularly face potential legislative and regulatory intervention risk. Nevertheless, we view the regulatory environment favorably from a credit perspective, as we believe the Public Utility Commission of Ohio (PUCO) works in a generally constructive manner, produces relatively transparent rulings in accordance with existing legislation, and is generally accessible to investors.

We do not expect Ohio to fully resolve its intervention effort for many years. Since several variables remain unclear today—what the final outcome of any market modification will entail, what form any legislation might take, or how much business strategies might have to change—we see electric utilities that operate in Ohio as having higher levels of business and operating risk.

<sup>9</sup> For a fuller discussion of Ohio's electricity market intervention, see "Special Comment: Investor-Owned Electric Utilities in Ohio," February 2009.

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A recent resolution at Duke Energy Ohio suggests that Ohio-based utilities will most likely reach some form of negotiated agreement with PUCO that essentially extends their current Rate Stabilization Plans. We expect to see some built-in rate increases that address legislators' desires to protect consumers from rate shocks and industrial consumers with some form of rate stability. As the situation in Ohio continues to evolve, we will update our views regarding how to incorporate these potential risks into our credit analysis.

Table H

## Ohio Subsidiaries - Key Financial Profile

## Ohio Power

(\$ in millions)	2003	2004	2005	2006	2007	LTM Q2 '08	LTM 3Q '08
Revenue	\$2,245	\$2,373	\$2,635	\$2,725	\$2,814	\$3,048	\$3,148
CFO	\$408	\$564	\$409	\$585	\$579	\$590	\$611
Capital Expenditure	\$284	\$337	\$708	\$978	\$918	\$630	\$621
Dividend	\$169	\$174	\$30	\$ -	\$ -	\$ -	\$ -
Free Cash Flow	\$(45)	\$53	\$(329)	\$(392)	\$(339)	\$(39)	\$(10)
Total Adjusted Debt	\$2,443	\$2,327	\$2,496	\$2,755	\$3,192	\$2,980	\$3,224
(CFO Pre-W/C) / Debt	23%	23%	19%	18%	17%	19%	17%
(CFO Pre-W/C - Dividends) / Debt	16%	15%	18%	18%	17%	19%	17%
(CFO Pre-W/C - Dividends) / Capex	139%	104%	63%	50%	60%	90%	89%

Source: AEP; Moody's Financial Metrics

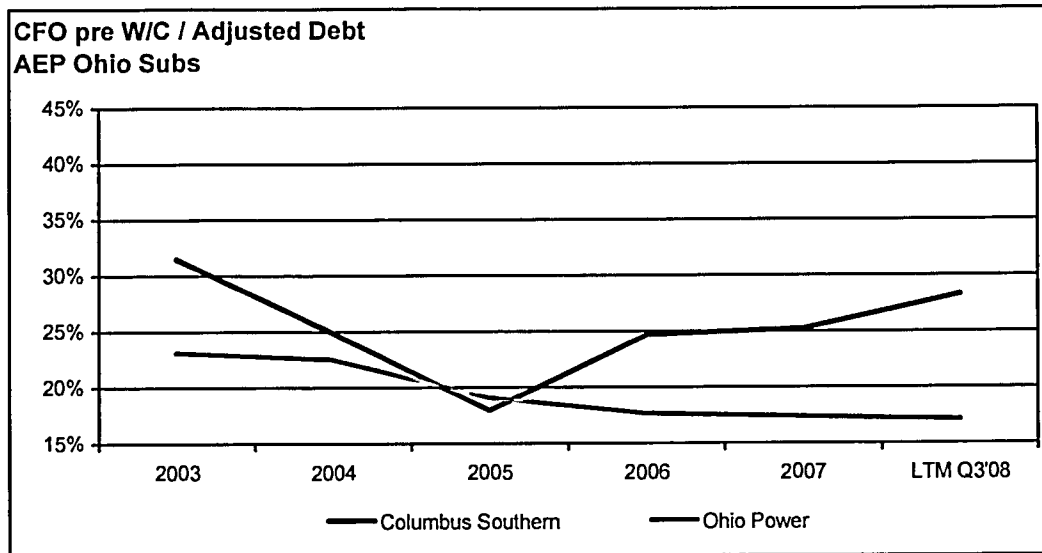
## Columbus Southern Power

(\$ in millions)	2003	2004	2005	2006	2007	LTM Q2 '08	LTM 3Q '08
Revenue	\$1,432	\$1,448	\$1,542	\$1,807	\$2,043	\$2,180	\$2,237
CFO	\$290	\$331	\$190	\$398	\$459	\$427	\$488
Capital Expenditure	\$144	\$154	\$172	\$306	\$337	\$360	\$395
Dividend	\$163	\$125	\$114	\$90	\$150	\$173	\$148
Free Cash Flow	\$(17)	\$52	\$(96)	\$2	\$(28)	\$(105)	\$(55)
Total Adjusted Debt	\$1,005	\$1,202	\$1,392	\$1,396	\$1,491	\$1,503	\$1,503
(CFO Pre-W/C) / Debt	32%	25%	18%	25%	25%	27%	28%
(CFO Pre-W/C - Dividends) / Debt	15%	15%	10%	18%	15%	16%	19%
(CFO Pre-W/C - Dividends) / Capex	107%	114%	79%	83%	67%	66%	70%

Source: AEP; Moody's Financial Metrics

## American Electric Power Company, Inc.

Chart B

**Appalachian Power – expectations for an improving financial profile**

Appalachian Power Company (APCo, Baa2 senior unsecured) is a vertically integrated electric utility and is the largest utility subsidiary of AEP ranked by rate base. About 55% of APCo's \$3.7 billion rate base is regulated by the Virginia State Corporation Commission (VASCC), with the remainder under the Public Service Commission of West Virginia (PSCWVA).

APCo's Baa2 senior unsecured rating reflects a relatively low-risk, vertically integrated electric utility operating in states with regulatory authorities that are viewed as being reasonably supportive to credit quality. Rate cases are typically settled in these jurisdictions, and annual fuel clause provisions exist in both states.

APCo's financial profile has shown a steady, though modest, deterioration over the past few years, but we expect a recovery to begin in the near term. The ratio of cash from operations before working capital adjustments (CFO pre-w/c) to debt has declined from approximately 24% in 2003 to approximately 11% in 2007, and 13% for the 12 months that ended September 2008. We expect APCo to sustain marginally positive free cash flow over the next three years with a modestly declining capital expenditure program, thus possibly reducing the need for debt financing and retaining or improving these ratios. We view many of the southern electric utilities as most comparable to APCo, including Virginia Electric and Power (Baa1 senior unsecured), Alabama Power (A2 senior unsecured), Georgia Power (A2 senior unsecured), Duke Energy Carolinas (A3 senior unsecured), Progress Energy Carolina (A3 senior unsecured) and Progress Energy Florida (A3 senior unsecured).

The rating is constrained by APCo's large capital investment plan, and by the financing plans associated with those expenditures. For the 12 months that ended September 2008, APCo invested about \$700 million in its infrastructure—a level that is expected to decline over the next several years.

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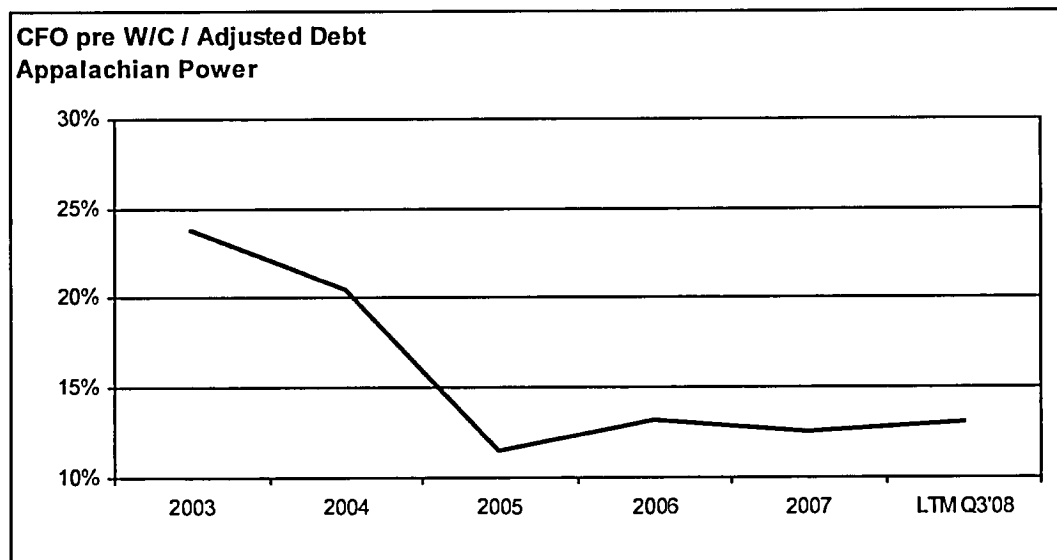
Table I

## Appalachian Power - Key Financial Profile

(\$ in millions)	2003	2004	2005	2006	2007	LTM Q2 '08	LTM Q3 '08
Revenue	\$1,957	\$1,958	\$2,176	\$2,394	\$2,607	\$2,787	\$2,879
CFO	\$472	\$405	\$226	\$438	\$357	\$232	\$344
Capital Expenditure	\$300	\$447	\$599	\$888	\$759	\$688	\$709
Dividend	\$129	\$51	\$6	\$11	\$26	\$1	\$1
Free Cash Flow	\$43	\$(93)	\$(379)	\$(460)	\$(428)	\$(457)	\$(366)
Total Adjusted Debt	\$2,039	\$2,038	\$2,354	\$2,831	\$3,067	\$3,189	\$3,259
(CFO Pre-W/C) / Debt	24%	20%	11%	13%	13%	9%	13%
(CFO Pre-W/C - Dividends)/Debt	17%	18%	11%	13%	12%	9%	13%
(CFO Pre-W/C - Dividends)/Capex	119%	82%	44%	41%	47%	42%	60%

Source: AEP; Moody's Financial Metrics

Chart C



### SWEPSCO's increasing risk profile

Southwestern Electric Power Company (SWEPSCO, Baa1 senior unsecured) is a vertically integrated electric utility serving approximately 456,000 retail customers in Texas, Louisiana and Arkansas. The company is under the regulatory jurisdictions of the Public Utility Commission of Texas (PUCT), the Louisiana Public Service Commission (LA PSC), the Arkansas Public Service Commission (AR PSC) and the Federal Energy Regulatory Commission (FERC). SWEPSCO owns or operates approximately 4.7GW of generating capacity and is a member of the SPP market.

The company's rate base of about \$1.3 billion is equally diversified among its three jurisdictions. In general, we view these three regulatory authorities as being generally supportive to long-term credit quality, and we observe that the approved ROEs are high compared with recent authorizations in other states.

SWEPSCO's key financial credit metrics have recently weakened, with few prospects for improvement over the intermediate term. The ratio of CFO pre-w/c to debt has been declining, from roughly 29% in 2003 to 22% in 2006, and to about 14% for the 12 months that ended September 2008. These credit metrics do not appear to

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be improving to ranges more appropriate for Baa1-rated electric utilities, and could pressure ratings over the near- to intermediate term.

SWEPSCO has a significant capital investment plan in progress, which we estimate will cost about \$500 million per year over the next several years and will almost double its existing rate base. While we generally view rate base investment as a credit positive, we would be concerned with the impact to SWEPSCO's key credit metrics based on the company's publicly announced financing plans. Recovery risks increase when a regulated company's cash outflows begin significantly outpacing its authorized cash inflows, thereby increasing pressure on management to seek financial relief from regulators. We believe SWEPSCO will succeed in managing its regulatory relationships and its investment commitments in a manner viewed as prudent, and therefore recoverable over a reasonable period of time. However, we are cautious about differing opinions that appear to be evolving between SWEPSCO's three regulatory authorities, and we would be concerned if relations between the company and its regulators were to take on a more contentious tone.

The decision to begin construction of a new coal-fired generating facility in Arkansas will result in a materially higher business and operating risk profile for SWEPSCO. This increased risk profile is partly due to the numerous legal challenges associated with the plant's permitting process; the cost associated with construction; and the likelihood of meaningful declines in the projected credit metrics over the next several years. As a result, the ratings are under significant pressure.

**Table J**

### Southwestern Electric Power Company – Key Financial Profile

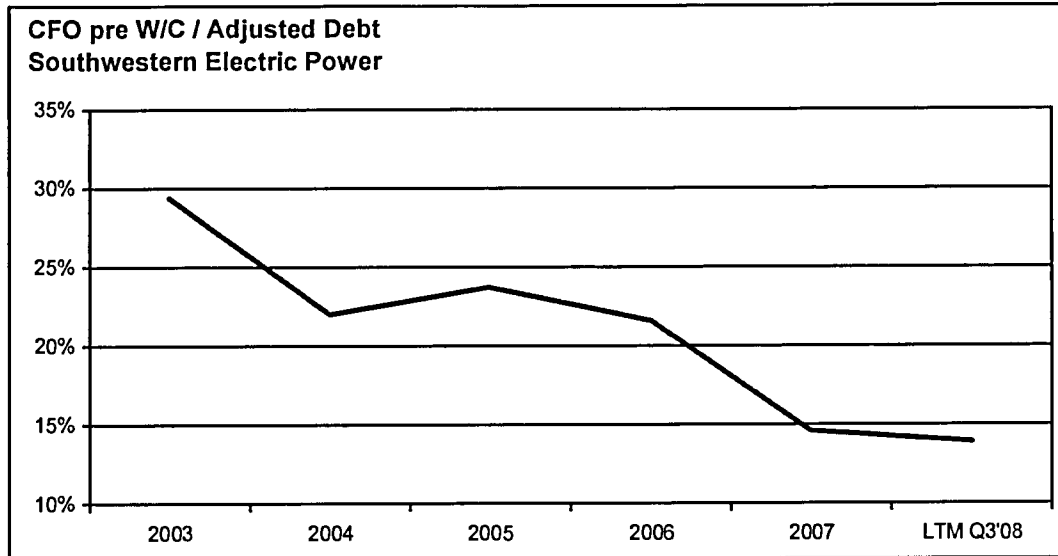
(\$ in millions)	2003	2004	2005	2006	2007	LTM Q2 '08	LTM Q3 '08
Revenue	\$1,147	\$1,091	\$1,405	\$1,432	\$1,483	\$1,557	\$1,621
CFO	\$253	\$234	\$206	\$219	\$178	\$132	\$128
Capital Expenditure	\$126	\$106	\$166	\$335	\$510	\$526	\$581
Dividend	\$73	\$60	\$55	\$40	\$-	\$-	\$-
Free Cash Flow	\$54	\$68	\$(15)	\$(156)	\$(332)	\$(394)	\$(458)
Total Adjusted Debt	\$946	\$1,026	\$945	\$958	\$1,434	\$1,742	\$1,744
(CFO Pre-W/C) / Debt	29%	22%	24%	22%	15%	8%	14%
(CFO Pre-W/C - Dividends)/Debt	22%	16%	18%	17%	15%	8%	14%
(CFO Pre-W/C - Dividends)/Capex	163%	157%	102%	50%	41%	28%	42%

Source: AEP; Moody's Financial Metrics



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Chart D



### Indiana Michigan's nuclear challenge – a chronic problem?

Indiana Michigan Power Company (I&M, Baa2 senior unsecured) is a vertically integrated electric utility regulated by the Indiana Utility Regulatory Commission (IURC, 65%), the Michigan Public Service Commission (MI PSC, 15%) and the Federal Energy Regulatory Commission (FERC, 20%). I&M's generation capacity is roughly 60% coal-fired and 40% nuclear-powered.

The regulatory authorities in both Indiana and Michigan allow reasonable recovery mechanisms as a component to the rates, including fuel-clause trackers and other recovery mechanisms. Both jurisdictions tend to settle, rather than litigate, rate proceedings. Nevertheless, timeliness of a final order and all-in recovery could become more challenging in these Midwestern states, which are experiencing severe recessionary pressures.

I&M's Baa2 senior unsecured rating reflects the generally supportive regulatory jurisdictions in Indiana and Michigan, a material credit positive. In addition, the rating considers the strong historical financial metrics for I&M's rating category, although we are incorporating a view that there will be some modest near-term deterioration.

The rating is constrained by I&M's sizeable capital investment program, and by the costs of managing the extended outage of its DC Cook nuclear facility. A concern is developing with respect to the Cook nuclear facility, which experienced an extended outage for both units during 1998-2000. While we acknowledge that the current issue related to the DC Cook plant relates to a turbine, which is non-nuclear, we continue to view the DC Cook plant as a credit negative. In our opinion, we do not incorporate a view that these extended outages will occur at a nuclear plant, which includes all of the balance of plant in addition to the reactor.

I&M's financial profile is strong for its rating category, but we expect some modest deterioration over the next few years. I&M has exhibited a relatively steady production of key financial credit metrics, including a ratio of CFO pre-w/c to debt of approximately 20%. This ratio was reported at approximately 24.6% for the 12 months to September 2008. On a prospective basis, we expect the metrics to soften in the next few years due to the acute economic conditions in I&M's service territory, and to higher expenses associated with the Cook nuclear plant outage.

Loss of partial capacity from the Cook plant could be replaced by other AEP fleet capacity, but the replacing plants could also operate at a higher cost. The timeliness of the recovery of such costs could impact I&M's financial metrics over the near term. With approximately \$2.5 billion of adjusted debt expected on the balance

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sheet in the next several years, I&M will need to produce approximately \$450 million to \$500 million of CFO to maintain a ratio to debt in the high teens (consistent with its Baa2-rated peers).

I&M has a reasonably large capital investment plan over the next three years, with about \$350 million targeted for 2009 (this is reduced from the earlier expectation of almost \$500 million). While these investments are primarily related to building the rate base, a credit positive, we would be concerned if I&M's cash outflows began to materially outpace its authorized cash inflows—especially under gloomy economic conditions.

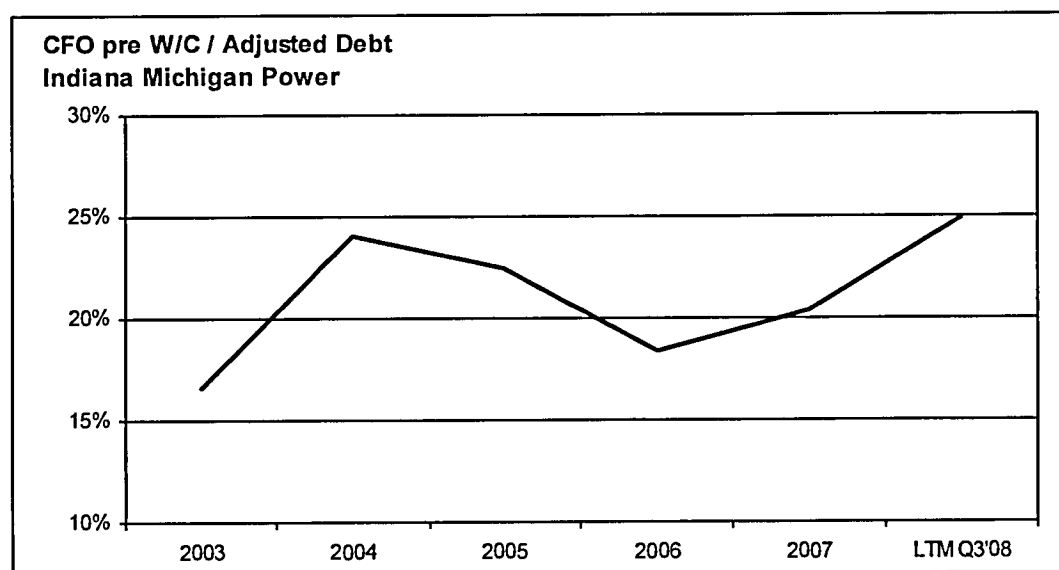
**Table K**

### Indiana Michigan Power Company – Key Financial Profile

(\$ in millions)	2003	2004	2005	2006	2007	LTM Q2'08	LTM Q3'08
Revenue	\$1,596	\$1,741	\$1,893	\$1,977	\$2,043	\$2,144	\$2,208
CFO	\$303	\$613	\$462	\$506	\$512	\$468	\$512
Capital Expenditure	\$265	\$259	\$416	\$478	\$434	\$475	\$490
Dividend	\$42	\$99	\$62	\$40	\$40	\$58	\$66
Free Cash Flow	(\$4)	\$255	(\$16)	(\$12)	\$38	(\$65)	(\$44)
Total Adjusted Debt	\$2,408	\$2,210	\$2,515	\$2,562	\$2,558	2316	\$2,317
(CFO Pre-W/C) / Debt	17%	24%	22%	18%	20%	24%	25%
(CFO Pre-W/C - Dividends) / Debt	15%	20%	20%	17%	19%	22%	22%
(CFO Pre-W/C - Dividends) / Capex	135%	166%	121%	90%	111%	105%	104%

Source: AEP; Moody's Financial Metrics

**Chart E**



### Kentucky Power chugging along

Kentucky Power Company (KYPCo, Baa2 senior unsecured) is a vertically integrated electric utility regulated by the Kentucky Public Service Commission (KY PSC). KYPCo owns about 1 GW of 100% coal-fired generating capacity. KYPCo's Baa2 issuer rating primarily reflects its stable financial profile, its reasonably constructive relationship with the KY PSC, and the potential rating constraints of its large capex spending, its single fuel source, and the economic conditions of its service area.

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Kentucky is considered to be in a deep protracted recession, in part due to its heavy exposure to the automotive industry. About half of KYPCo's volume sales in 2008 came from industrial users. Among the top 10 industrial customers, KYPCo's second-largest has a primary presence in automotive industry. Most of the other nine are involved in coal refining and mining, which is less cyclical, but also facing pressures.

KYPCo's key financial credit metrics have been reasonably consistent within its Baa2 senior unsecured rating category, but leave little cushion for a sustained deterioration in cash flows. For the last five-year, three-year and 12-month periods to September 2008, KYPCo's ratio of CFO pre-w/c to debt averaged about 17%, 16% and 20%, respectively. While these metrics showed some improvement for the latest 12-month period, KYPCo will need to maintain these financial metrics on a prospective basis.

Within the Baa2 universe, excluding KYPCo, CFO pre-w/c to debt averaged about 23%, 22% and 21% for the last five-year, three-year and 12-month periods to September 2008, respectively, while CFO pre-w/c interest coverage averaged about 4.7x, 4.4x and 4.5x. The peers for KYPCo within the Baa2 universe include Consumers Energy (Baa2 senior unsecured), Indianapolis Power & Light (Baa2 senior unsecured) and Entergy Arkansas (Baa2 senior unsecured). Within Kentucky, KYPCo is noticeably weaker than Kentucky Utilities (A2 senior unsecured) and Louisville Gas & Electric (A2 senior unsecured), which produced an average CFO pre w/c to debt ratio of about 26% over the past five years.

We view the regulatory environment in Kentucky as reasonably supportive to long-term credit stability, a material credit positive. We consider KYPCo a constructive panel. KYPCo has a rate base of about \$900 million and an authorized return on equity of 10.5%, established in March 2006. KYPCo currently has a monthly fuel-clause tracker (a credit positive) and an environmental surcharge rider, among other recovery mechanisms (e.g., demand-side management and system-sales riders).

KYPCo's cumulative long-term capital investment program is large for its size, almost doubling its existing rate base over the next few years. While we generally view rate-base investments positively, we would be concerned if KYPCo's spending plans resulted in a consistent negative free cash flow position that was primarily funded with internal or external debt. If this were to happen, KYPCo's financial profile could become stressed, given its Baa2-rating category.

**Table L**

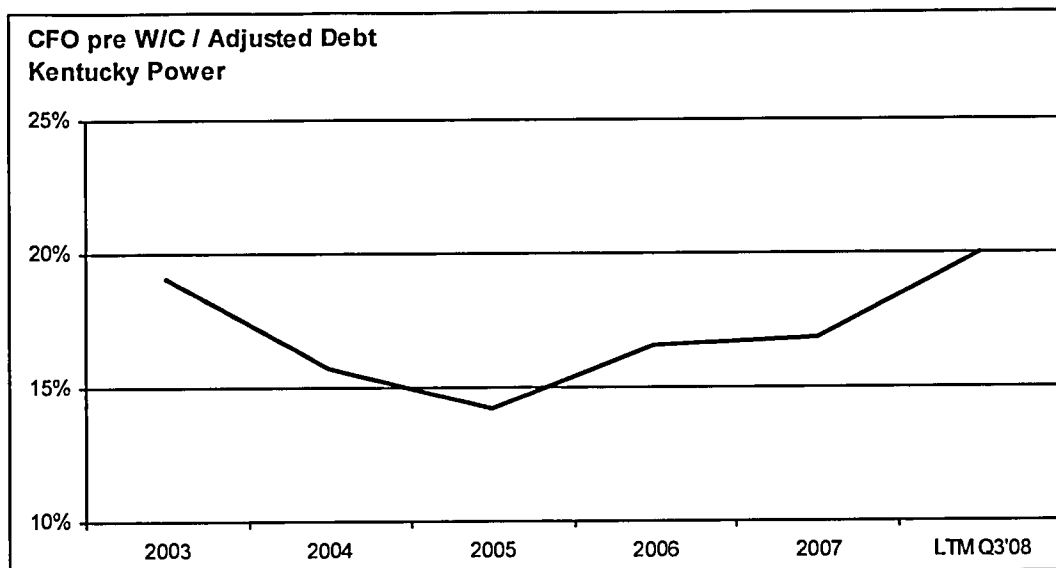
### Kentucky Power Company – Key Financial Profile

(\$in millions)	2003	2004	2005	2,006	2,007	LTM Q2'08	LTM Q3'08
Revenue	\$416	\$449	\$531	\$586	\$588	\$614	\$650
CFO	\$64	\$95	\$75	\$104	\$99	\$98	\$81
Capital Expenditure	\$84	\$39	\$59	\$80	\$71	\$104	\$118
Dividend	\$16	\$20	\$3	\$15	\$12	\$8	\$9
Free Cash Flow	(\$36)	\$36	\$13	\$9	\$16	(\$14)	(\$46)
Total Adjusted Debt	\$523	\$575	\$552	\$511	\$515	474	\$474
(CFO Pre-W/C) / Debt	17%	24%	22%	18%	20%	18%	25%
(CFO Pre-W/C - Dividends) / Debt	15%	20%	20%	17%	19%	16%	22%
(CFO Pre-W/C - Dividends) / Capex	135%	166%	121%	90%	111%	72%	104%

Source: AEP; Moody's Financial Metrics

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Chart F

**Public Service Oklahoma weathering the storms**

Public Service Company of Oklahoma (PSO; Baa1 issuer rating, stable outlook) is a vertically integrated electric utility primary regulated by the Oklahoma Corporation Commission (OCC).

The Baa1 senior unsecured rating primarily considers PSO's relatively strong financial profile, despite some recent weakness, in part due to the higher costs incurred with numerous ice storms. Prospectively, the rating incorporates a view that PSO will maintain a financial profile that it well within its existing rating category.

The rating also considers Oklahoma's supportive regulatory environment—we view the OCC as a long-term credit positive for PSO. But the rating also weighs Oklahoma's ongoing material recessionary pressures. PSO's near-term financing plans associated with its projected negative free cash flow balances, which is primarily related to its capital investment plans,<sup>10</sup> is a modest rating constraint at this time.

PSO's ratio of CFO pre-w/c to total adjusted debt has shown a negative trend in recent years, steadily falling from a five-year average of about 17% to about 13% for the 12 months to September 2008. While such metrics are considered somewhat weak for the Baa1 category, we expect an increase to about 20% over the near term. But if these metrics fail to attain these levels, the existing ratings could come under pressure.

PSO has a relatively large capital investment plan over the next few years. These investments are expected to materially outpace authorized cash inflows, which will result in some meaningful negative free cash flows. Successfully managing this investment program will be important for ratings, and we believe PSO will not be making any upstream dividend payments to its parent AEP for several years—a credit positive.

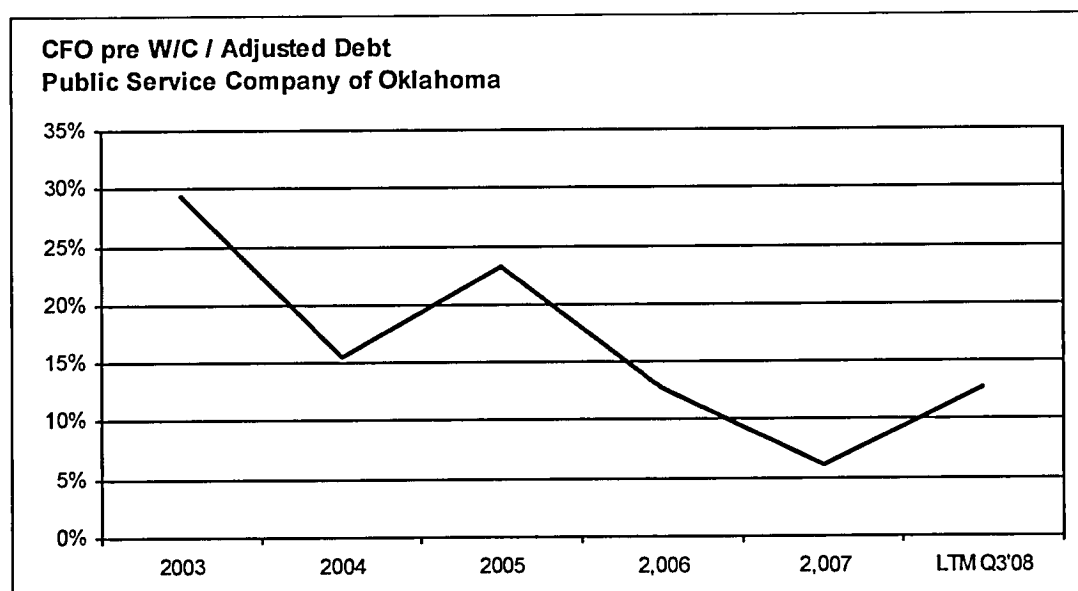
<sup>10</sup> We do not expect PSO to make upstream dividend payments over the near term.

## American Electric Power Company, Inc.

**Table M: PSO – Key Financial Profile**

<b>Public Service Company of Oklahoma</b>							
(\$ in millions)	2003	2004	2005	2,006	2,007	LTM Q2'08	LTM Q3'08
Revenue	\$1,103	\$1,048	\$1,304	\$1,442	\$1,396	\$1,495	\$1,598
CFO	\$170	\$128	\$86	\$175	\$124	\$149	\$105
Capital Expenditure	\$90	\$85	\$139	\$246	\$316	\$316	\$295
Dividend	\$30	\$35	\$37	\$0	\$0	\$0	\$0
Free Cash Flow	\$50	\$8	(\$90)	(\$71)	(\$192)	(\$167)	(\$190)
Total Adjusted Debt	\$601	\$750	\$763	\$844	\$1,093	\$950	\$950
(CFO Pre-W/C) / Debt	29%	16%	23%	13%	6%	16%	13%
(CFO Pre-W/C - Dividends) / Debt	24%	11%	18%	13%	6%	16%	13%
(CFO Pre-W/C - Dividends) / Capex	162%	96%	101%	44%	21%	48%	41%

Source: AEP; Moody's Financial Metrics

**Chart G****Re-calibrating the Texas T&D utilities**

AEP Texas Central (TCC, Baa2 senior unsecured) is a rate-regulated electric transmission and distribution utility serving about 753,000 customers in south-central Texas. AEP Texas North (TNC, Baa1 senior unsecured) is a rate-regulated electric transmission and distribution utility serving about 184,000 customers in north and west-central Texas. Both TCC and TNC are primarily regulated by the Public Utility Commission of Texas (PUCT).

Both companies are under review for possible downgrade. The reviews primarily reflect the expectation that both utilities' prospective financial profiles and key cash flow-related credit metrics may not be sufficient to justify their current ratings.

The reviews will focus primarily on TCC and TNC's financial profiles, authorized recovery mechanisms, and financing plans. In addition, the review for TCC will focus on how its reported and adjusted financials have

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been affected by about \$2.0 billion of Aaa-rated securitization bonds. The review will also be influenced, in part, on comparisons to numerous T&D peer utilities.

We anticipate that TCC's ratio of CFO pre-w/c to debt will not improve to the low-teens range for several more years, and that TNC's CFO pre-w/c to debt metrics, which have historically been relatively strong, will decline towards the mid-teens range for a sustained period. Moody's financial credit metrics include our standard GAAP adjustments, and include debt associated with TCC's securitization bonds, which represent the majority of debt but will not be affected by the review for possible downgrade.

**Table N****AEP Texas Central – Key Financial Profile**

(\$in millions)	2003	2004	2005	2006	2007	LTM Q2'08	LTM Q3'08
Revenue	\$1,748	\$1,213	\$793	\$665	\$809	\$823	\$819
CFO	\$362	\$305	-\$58	\$229	\$48	\$139	\$146
Capital Expenditure	\$136	\$110	\$183	\$275	\$228	\$237	\$275
Dividend	\$121	\$172	\$150	\$585	\$3	\$11	\$19
Free Cash Flow	\$105	\$23	(\$390)	(\$631)	(\$183)	(\$109)	(\$148)
Total Adjusted Debt	\$2,362	\$1,995	\$1,900	\$3,061	\$2,990	\$3,040	\$2,908
(CFO Pre-W/C) / Debt	11%	8%	5%	3%	2%	5%	7%
(CFO Pre-W/C - Dividends) / Debt	6%	0%	-3%	-16%	2%	5%	6%
(CFO Pre-W/C - Dividends) / Capex	103%	-3%	-29%	-182%	20%	62%	63%

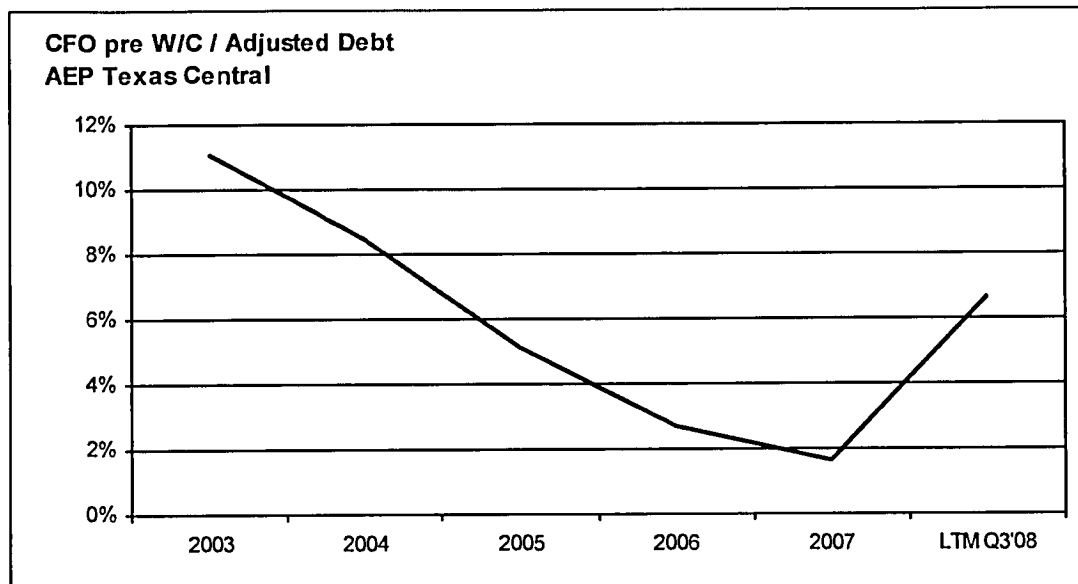
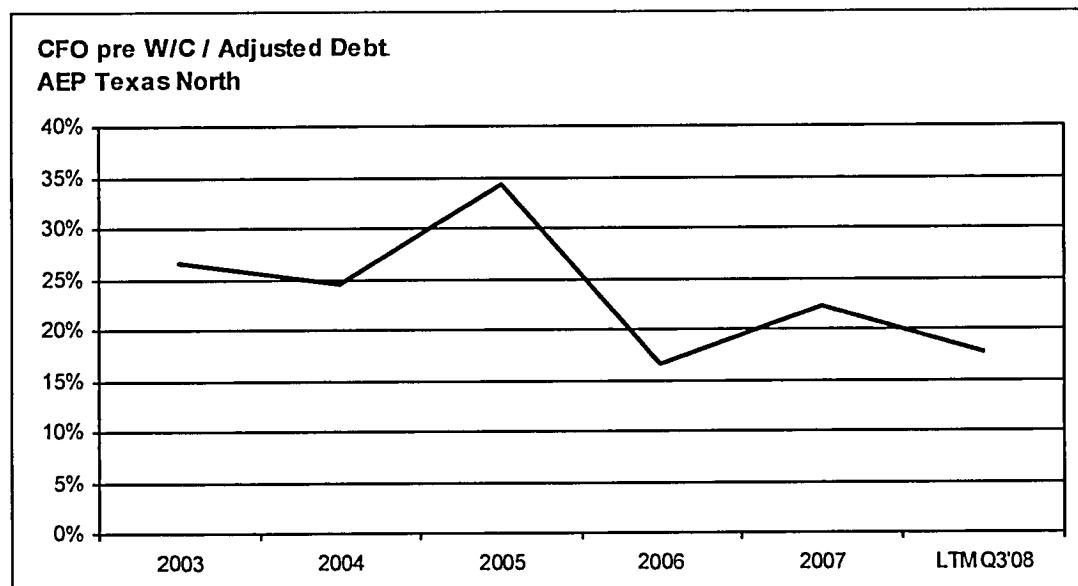
Source: AEP; Moody's Financial Metrics

**Table O****AEP Texas North – Key Financial Profile**

(\$in millions)	2003	2004	2005	2006	2007	LTM Q2'08	LTM Q3'08
Revenue	\$466	\$553	\$459	\$329	\$280	\$273	\$265
CFO	\$79	\$98	\$126	\$63	\$42	\$70	\$65
Capital Expenditure	\$48	\$37	\$64	\$72	\$89	\$105	\$120
Dividend	\$5	\$2	\$29	\$13	\$14	\$29	\$35
Free Cash Flow	\$26	\$59	\$33	(\$22)	(\$61)	(\$64)	(\$90)
Total Adjusted Debt	\$386	\$355	\$297	\$299	\$295	\$395	\$395
(CFO Pre-W/C) / Debt	27%	24%	34%	17%	22%	19%	18%
(CFO Pre-W/C - Dividends) / Debt	25%	24%	25%	12%	17%	11%	9%
(CFO Pre-W/C - Dividends) / Capex	202%	230%	113%	52%	58%	43%	30%

Source: AEP; Moody's Financial Metrics

## American Electric Power Company, Inc.

**Chart H****Chart I****Liquidity**

AEP's liquidity appears to be adequate over the next 12 months. Maintaining appropriate liquidity beyond 2009 will depend largely on continued access to the capital markets, however.

AEP's subsidiaries primarily meet their short-term borrowing needs through money pool arrangements, or by relying on the parent company's short-term borrowing capacity. Longer-term needs, such as major capital expenditures, are expected to be funded by debt issuances from the subsidiary itself.

AEP has four separate credit facilities that total \$3.9 billion, two of which are \$1.5 billion, five-year credit facilities, expiring in March 2011 and April 2012. These two facilities contain an adjusted debt-to-capitalization limit of 67.5%. AEP asserts that it remains in compliance. Each facility has a \$300 million letter of credit capacity, a \$500 million accordion feature, and a one-year extension option.

## American Electric Power Company, Inc.

These two facilities contain no material adverse change restrictions on drawings; no litigation representation provision at the time of borrowing; and a definition adjustment that excludes one of AEP's subsidiaries, AEP Texas Central, as a "significant subsidiary," to prevent cross-acceleration in the event of a default.

The other two credit facilities are \$627 million and \$337 million expiring in April 2011 and April 2009, respectively, with covenant restrictions similar to the primary five-year facilities.

AEP drew down \$2.0 billion in October 2008, and the credit facilities have used about \$681 million in support of commercial paper outstanding, and about \$439 million of LCs posted, leaving about \$2.7 billion of available capacity.

In 2009 and 2010, AEP has scheduled maturities of \$282 million and \$1.7 billion, respectively. For the 12 months to September 2008, AEP generated about \$3 billion in cash from operations, which covered about 80% of its roughly \$3.9 billion capital investment requirements and paid about \$650 million in shareholder dividends, resulting in about \$1.5 billion of negative free cash flow.

**Table P**

<b>Summary liquidity profile</b>					
	2007	LTM Q1'08	LTM Q2'08	LTM Q3'08	Oct 8, 08
Cash	\$178	\$155	\$218	\$338	\$1,885
Credit facility	\$3,000	\$3,000	\$4,000	\$3,919	\$3,919
Outstanding draws	\$ -	\$ -	\$ -	\$591	\$1,969
Posted L/C's	\$65	\$57	\$429	\$439	\$ 439
Commercial paper	\$659	\$409	\$698	\$701	\$ 681
Available Facility	\$2,276	\$2,534	\$2,873	\$2,188	\$830
CFO	\$2,639	\$2,916	\$2,867	\$3,062	na
Capital Exp.	\$3,778	\$3,649	\$3,662	\$3,858	na
Dividends	\$630	\$640	\$649	\$657	na
Free cash flow	\$(1,769)	\$(1,373)	\$(1,444)	\$(1,453)	na
Short term debt	\$1,167	\$409	\$705	\$1,302	na
Current maturities	\$1,017	\$1,156	\$794	\$907	na
Total maturities	\$2,184	\$1,565	\$1,499	\$2,209	na

Source: AEP



## American Electric Power Company, Inc.

## Appendix A: Holding Company Peer Group

	AEP	Southern Company	Mid- American	Xcel Energy	Duke Energy	Progress Energy	FirstEnergy
Rating	Baa2	A3	Baa1	Baa1	Baa2	Baa2	Baa3
<b>(CFO Pre-W/C) / Debt</b>							
FY 2003	14%	22%	10%	23%	N/A	15%	13%
FY 2004	18%	23%	11%	24%	N/A	15%	18%
FY 2005	15%	23%	11%	20%	21%	11%	21%
FY 2006	17%	21%	11%	19%	18%	21%	16%
FY 2007	15%	19%	12%	20%	34%	15%	14%
LTM Q3'08	15%	18%	13%	19%	25%	15%	16%
<b>(CFO Pre-W/C - Dividends) / Debt</b>							
FY 2003	10%	15%	10%	18%	N/A	10%	10%
FY 2004	14%	16%	11%	20%	N/A	10%	15%
FY 2005	11%	16%	11%	15%	10%	6%	17%
FY 2006	14%	14%	11%	15%	10%	14%	11%
FY 2007	11%	12%	12%	15%	25%	10%	10%
LTM Q3'08	12%	11%	13%	14%	18%	9%	12%
<b>(CFO Pre-W/C + Interest) / Interest Expense</b>							
FY 2003	3.6x	5.3x	2.7x	4.2x	N/A	3.6x	2.9x
FY 2004	3.8x	5.6x	2.5x	4.8x	N/A	3.5x	4.0x
FY 2005	3.6x	5.5x	2.5x	4.2x	4.2x	3.2x	4.6x
FY 2006	3.9x	4.8x	2.9x	3.9x	6.6x	4.1x	3.6x
FY 2007	3.5x	4.3x	2.9x	4.1x	6.4x	3.7x	3.4x
LTM Q3'08	3.6x	4.5x	3.1x	4.3x	5.6x	3.7x	4.3x
<b>Debt / Book Capitalization</b>							
FY 2003	59%	49%	76%	49%	N/A	59%	59%
FY 2004	53%	48%	75%	50%	N/A	57%	55%
FY 2005	52%	48%	72%	50%	44%	59%	55%
FY 2006	54%	49%	63%	49%	39%	53%	54%
FY 2007	56%	48%	62%	49%	33%	54%	56%
LTM Q3'08	56%	48%	61%	47%	38%	55%	58%

Source: Moody's Financial Metrics

## American Electric Power Company, Inc.

## Appendix B: Utility Subsidiary Peer Group

	CFO pre-WC/debt					
	Senior Unsecured	5 Year Average	3 year Average	2007	LTM Q2'08	LTM Q3'08
<b>Operating Companies</b>						
<b>AEP Virginia:</b>						
Appalachian Power Company	Baa2	16%	12%	13%	9%	13%
Alabama Power Company	A2	23%	21%	20%	20%	22%
Georgia Power Company	A2	23%	22%	19%	20%	21%
Duke Energy Carolinas, LLC	A3	25%	29%	33%	30%	27%
Progress Energy Carolinas, Inc.	A3	28%	27%	30%	31%	32%
Progress Energy Florida, Inc.	A3	23%	25%	19%	10%	11%
South Carolina Electric & Gas Co	A3	22%	24%	23%	21%	18%
Virginia Electric and Power Comp	Baa1	20%	19%	18%	15%	16%
<b>AEP Midwest:</b>						
Columbus Southern Power Company	A3	25%	23%	25%	27%	28%
Ohio Power Company	A3	20%	18%	17%	19%	17%
Indiana Michigan Power Company	Baa2	20%	20%	20%	24%	25%
Kentucky Power Company	Baa2	16%	16%	17%	18%	20%
Dayton Power & Light Company	A3	47%	44%	41%	46%	44%
Interstate Power and Light Company	A3	29%	30%	37%	33%	30%
Kansas City Power & Light Company	A3	23%	24%	25%	18%	15%
Northern States Power Company (MI)	A3	27%	26%	28%	27%	28%
Northern States Power Company (WI)	A3(P)	25%	23%	24%	30%	20%
Duke Energy Ohio, Inc.	Baa1	24%	24%	30%	41%	25%
<b>AEP Southwest:</b>						
Public Service Company of Oklahoma	Baa1	17%	14%	6%	16%	13%
Southwestern Electric Power Company	Baa1	22%	20%	15%	8%	14%
Mississippi Power Company	A1	35%	32%	37%	22%	20%
Oklahoma Gas & Electric Company	A2	29%	25%	22%	17%	17%
Kansas City Power & Light Company	A3	23%	24%	25%	18%	15%
Cleco Power LLC	Baa1	24%	20%	14%	12%	8%
Southwestern Public Service Company	Baa1	18%	16%	14%	15%	17%
Energys Arkansas, Inc.	Baa2(P)	27%	26%	27%	23%	17%
Energys Louisiana, LLC	Baa2	22%	21%	25%	11%	15%
Kansas Gas & Electric Co.	Baa2	21%	21%	20%	na	na
Energys Mississippi, Inc.	Baa3(P)	19%	19%	22%	28%	23%
<b>AEP Texas</b>						
AEP Texas North Company	Baa1	25%	24%	22%	19%	18%
AEP Texas Central Company	Baa2	6%	3%	2%	5%	7%
Southwestern Electric Power Company	Baa1	22%	20%	15%	8%	14%
Southwestern Public Service Company	Baa1	18%	16%	14%	15%	17%
El Paso Electric Company	Baa2	24%	25%	23%	22%	21%
CenterPoint Energy Houston Electric	Baa3	11%	13%	14%	14%	23%
Energys Gulf States Louisiana	Baa3	17%	16%	23%	25%	20%
Oncor Electric Delivery Company	Baa3	16%	16%	15%	16%	16%
Texas-New Mexico Power Company	Baa3	14%	11%	12%	14%	7%

Source: Moody's Financial Metrics

American Electric Power Company, Inc.

## Moody's Related Research

### Issuer Comment

- Moody's Comments on prospect of Ohio's re-regulation, August 2007

### Rating Methodology

- Global Regulated Electric Utilities March 2005 (91730)

### Industry Outlooks

- U.S. Investor Owned Electric Utilities, January 2009 (113690)
- US Investor Owned Electric Utilities Six Month Industry Update, July 2008 (109675)
- US Electric Utilities Sector, January 2008 (107004)
- US Coal Industry Outlook 2009, October 2008 (112070)
- US Coal Industry Outlook 2008, October 2007 (105372)

### Covenant Quality Assessments

- CQA: Appalachian Power, December 2007 (104432)
- CQA: Kentucky Power, September 2007 (104655)
- CQA: PS Oklahoma, November 2007 (105741)
- CQA: Southwestern Electric Power, February 2007 (102306)

### Special Comments

- Investor-Owned Electric Utilities in Ohio, February 2009 (114137)
- Carbon Dioxide: Regulating Emissions Following a Long and Winding Road, November 2008 (112822)
- U.S. Investor Owned Electric Utilities Somewhat Insulated (but not immune) from market stress, September 2008 (111891)
- Environmental Regulations Increase Capital Cost for Public Power Electric Utilities, June 2007 (103616)
- Regulatory Pressures Increase for US Electric Utilities, March 2007 (102322)
- Storm Clouds Gathering on the Horizon for US Electric Utilities Sector, August 2007 (103941)
- Moody's Findings on Corporate Governance, October 2004 (89113)
- CEO Compensation and Credit Risk, July 2005 (93592)
- Moody's Comments on the Back to Basics Strategy for the North American Electric Utility Sector, November 2006 (100660)
- US Corporate Governance: Reviewing 2007, Previewing 2008, December 2007 (106273)
- New Generating Capacity in a Carbon Constrained Environment, February 2008 (107453)

*To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.*

## American Electric Power Company, Inc.

Report number 114420

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**Moody's Investors Service**



Moody's Investors Service

**Credit Opinion: American Electric Power Company, Inc.**

Global Credit Research - 26 Jan 2010

Columbus, Ohio, United States

**Ratings**

Category	Moody's Rating
Outlook	Negative
Sr Unsec Bank Credit Facility	Baa2
Senior Unsecured	Baa2
Jr Subordinate	Baa3
Commercial Paper	P-2
<b>AEP Capital Trust I</b>	
Outlook	Stable
Preferred Shelf	(P)Baa3
<b>AEP Capital Trust II</b>	
Outlook	Stable
Preferred Shelf	(P)Baa3
<b>AEP Capital Trust III</b>	
Outlook	Stable
Preferred Shelf	(P)Baa3
<b>Appalachian Power Company</b>	
Outlook	Stable
Issuer Rating	Baa2
Senior Secured MTN	Baa1
Senior Unsecured	Baa2
Preferred Stock	Ba1

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**Key Indicators**

[1] American Electric Power Company, Inc.

	LTM 3Q 09	2008	2007	2006
(CFO Pre-W/C + Interest) / Interest Expense	3.4x	3.3x	3.5x	3.9x
(CFO Pre-W/C) / Debt	16.0%	13.4%	14.4%	17.0%
(CFO Pre-W/C - Dividends) / Debt	12.7%	10.5%	11.1%	13.5%
Debt / Book Capitalization	53.4%	58.9%	56.2%	54.5%

[1] All ratios calculated in accordance with the Regulated Electric and Gas Utilities Rating Methodology using Moody's standard adjustments

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

## **Opinion**

### **Rating Drivers**

Large, predominantly rate-regulated electric utility holding company a credit positive

Diversity of regulatory jurisdictions, geographic regions and service territories viewed positively

Financial profile and balance sheet need strengthening given challenging business and operating risks, including more stringent environmental mandates

Near-term liquidity profile appears adequate but sizable maturities in 2010 and 2011

Modest structural subordination issues arising given rating pressures at numerous operating subsidiaries

### **Corporate Profile**

American Electric Power Company (AEP - Baa2 senior unsecured) is a large electric utility holding company with rate-regulated utilities operating in 11 states. AEP owns approximately 38,000 MW's of generating assets, primarily coal. AEP is headquartered in Columbus, Ohio.

### **SUMMARY RATING RATIONALE**

AEP's Baa2 senior unsecured rating considers the diversity it enjoys from owning and operating nine rate-regulated electric utilities across 11 states. The rating also considers the consolidated financial profile of AEP, which does not maintain a material amount of parent holding company debt, a credit positive. AEP's rating is constrained, in part, by its relatively weak financial profile given its rating and the challenges associated with managing its large coal-fired generation fleet. In addition, all of AEP's service territories are experiencing severe economic recessionary pressures, a credit concern. A significantly reduced capital expenditure plan and a sizeable common equity infusion that occurred in early 2009 is beginning to show evidence that the financial profile will improve over the near-term.

### **DETAILED RATING CONSIDERATIONS**

#### **DIVERSITY OF RATE REGULATED CASH FLOWS**

AEP's businesses and assets are well diversified, although they are concentrated within the electric utility sector. AEP's utility subsidiaries are located in 11 different states, and are therefore regulated by 11 different regulatory authorities (the largest being Ohio, Texas and Virginia - ranked by rate base). These jurisdictions translate into good diversity in revenues (by state and operating utility), cash flows, assets, debt outstanding, customers and generation capacity. From a credit perspective, Moody's views this diversity as a meaningful credit strength due to the insulation that benefits the parent company from any unexpected adverse event or other negative development occurring at one of its companies or with one of its state service territories.

#### **SUPPORTIVE REGULATORY JURISDICTIONS A CREDIT POSITIVE**

AEP is exposed to eleven different state regulatory commissions which Moody's views favorably, due to their reasonably transparent rulemaking procedures and likelihood to settle as opposed to litigate rate cases. We observe that most of these commissions are appointed (Louisiana and Oklahoma are elected); that a majority of the states did not pursue a legislatively mandated form of deregulation (with the exception of Ohio, Texas, Virginia and Michigan - although the two latter states have pursued re-regulation), that fuel / purchased power costs trackers are allowed in some fashion in all states (except for Ohio, which is subject to a rate cap) and that most have approval authorities over securities issuances and M&A change of control (except Michigan). As a portfolio, these regulatory commissions are viewed as maintaining a relatively constructive relationship with the utilities they regulate and are considered a benefit to AEP's over-all business and risk profile.

#### **MAINTAINING FINANCIAL PROFILE KEY TO MAINTAINING RATINGS**

The vast majority of AEP's revenues, earnings, cash flows and assets are related to its numerous rate-regulated electric utility subsidiaries, which we view, in general, as having a relatively low over-all business and operating risk profile. We would be concerned if AEP finds it increasingly difficult to maintain its consolidated cash flow from operations before working capital adjustments (CFO pre-w/c) to total debt credit metric at a level that remains comfortably above 15%. For the twelve months ended September 2009, AEP reported a ratio of CFO pre-w/c to debt of 16% versus 13% in 2008 and 14% in 2007.

Prospectively, we expect AEP to continue to exhibit some improvement to its financial profile, despite the severe recessionary pressures being experienced in its many service territories. We viewed AEP's sizeable reductions in its capital expenditure plans, its O&M cost containment plans and a material infusion of new common equity (in April 2009) positively.

#### **LARGE CAPITAL EXPENDITURE PROGRAM**

Over the next few years, AEP is expecting to invest approximately \$10 billion into its business infrastructure. From a credit perspective, Moody's views investments in regulated rate-base positively, and we incorporate a view that regulators will provide meaningful and timely recovery for prudently incurred investments. Nevertheless, we remain cautious as to the scale and scope of capital expenditure plans of this size, due to the negative free cash flow that will be incurred over the next few years and the potential regulatory overhang associated with the ultimate impact on end-use customer rates. In our opinion, utilities that are embarking on a capital investment program of this size should also be redoubling their efforts to bolster their balance sheet and cash flow credit metrics, in an effort to create enough financial strength to weather potentially distressful environments related to uncertain economic conditions, volatility in commodity markets, regulatory changes or other unanticipated developments.

#### **COAL GENERATING ASSETS VULNERABLE TO SIGNIFICANT ENVIRONMENTAL LEGISLATION**

We observe the potential for significant environmental legislation, especially related to carbon dioxide emissions, as a material risk affecting AEP's coal-fired generating assets. Moody's incorporates a view that the timing of compliance requirements within any potential new legislation may be many years in the future and that the costs associated with any new legislation regarding emissions will generally be recovered through rates (either through existing fuel clause pass-through mechanisms or other incremental rate riders).

#### **Liquidity**

As of September 30, 2009, AEP had three separate credit facilities totaling \$3.6 billion; two of which are \$1.5 billion five year credit facilities - expiring in March 2011 and April 2012. These facilities contain a debt to capitalization limit of 67.5%. AEP asserts that it remains in compliance. There is a \$750 million letter of credit capacity (prior to final Bank of America litigation judgment, \$600 million after) on each facility (\$1.5 billion in total, \$1.2 billion after Bank of America resolution), a \$500 million accordion feature for each facility (for a total accordion of \$1.0 billion) and a one-year extension option.

There are no material adverse change restrictions on drawings, no litigation representation provision at the time of borrowing and a definition adjustment to exclude one of AEP's subsidiaries, AEP Texas Central, as a "significant subsidiary" to prevent cross-acceleration in the event of a default. AEP also has a \$627 million credit facility, expiring April 2011, that can be utilized for letter of credit or draws and has covenant restrictions similar to the primary 5-year facilities.

AEP has approximately \$1.7 billion of long term debt that will mature in 2010. We estimate that AEP will spend approximately \$2.5 billion in capital expenditures and approximately \$800 million in dividends over the next twelve months. As of September 30, 2009, AEP's credit facilities had approximately \$347 million utilized in support of commercial paper outstanding and roughly \$470 million of LC's posted, leaving approximately \$2.8 billion of capacity available. Combined with \$877 million of cash, total liquidity amounted to \$3.6 billion.

In 2010 and 2011, AEP has scheduled maturities of roughly \$1.5 billion and roughly \$625 million, respectively. For the twelve months ended September 2009, AEP generated approximately \$2.5 billion in cash from operations, made approximately \$3.8 billion capital investments and paid roughly \$727 million in shareholder dividends, resulting in roughly \$2.1 billion of negative free cash flow.

#### **Structural Considerations**

After considering the ratings for a number of AEP's utility operating subsidiaries, several of which are also rated in the Baa2 ratings category, there could be some structural subordination pressure for AEP to defend its Baa2 senior unsecured rating. Nevertheless, we see good diversity and low-risk business profile among its numerous operating utility subsidiaries, which could mitigate this issue.

#### **Rating Outlook**

The negative rating outlook reflects the ratings on a number of AEP's utility operating subsidiaries, the need to show a sustainable improvement to its cash flow generation in relation to its debt, and the increasing challenges with managing a diverse group of service territories which are all experiencing severe economic recessionary pressures. Prospectively, we viewed AEP's 2009 actions, which included a sizeable equity infusion, positively.

### What Could Change the Rating - Up

Rating upgrades appear unlikely over the near-term. Nevertheless, the outlook could be stabilized if AEP was successful in producing a stronger set of key financial credit metrics, including a ratio of CFO pre-w/c to debt in the high teen's on a sustainable basis.

### What Could Change the Rating - Down

AEP's ratings could be downgraded based on the structural subordination risks associated with the ratings of its subsidiaries. In addition, the ratings could be downgraded if AEP was to produce financial metrics that appear weak for its rating category, including a ratio of CFO pre-w/c to debt in the low teen's range. The ratings could also be downgraded if AEP experiences material set-backs with its numerous regulatory proceedings and sizeable construction program, which in turn are likely to impact its consolidated cash flow generation.

### Rating Factors

American Electric Power Company, Inc.

Regulated Electric and Gas Utilities	Aaa	Aa	A	Baa	Ba	B
Factor 1: Regulatory Framework (25%)				X		
Factor 2: Ability to Recover Costs and Earn Returns (25%)				X		
Factor 3: Diversification (10%)						
a) Market Position (5%)			X			
b) Generation and Fuel Diversity (5%)						X
Factor 4: Financial Strength, Liquidity & Financial Metrics (40%)						
a) Liquidity (10%)				X		
b) CFO pre-WC + Interest / Interest (7.5%) (3yr Avg)				X		
c) CFO pre-WC / Debt (7.5%) (3yr Avg)				X		
d) CFO pre-WC - Dividends / Debt (7.5%) (3yr Avg)				X		
e) Debt / Capitalization or Debt / RAV (7.5%) (3yr Avg)					X	
Rating:						
a) Methodology Implied Senior Unsecured Rating				Baa2		
b) Actual Senior Unsecured Rating				Baa2		



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**Credit Opinion: American Electric Power Company, Inc.**

**American Electric Power Company, Inc.**

Columbus, Ohio, United States

**Ratings**

Category	Moody's Rating
Outlook	Stable
Sr Unsec Bank Credit Facility	Baa2
Senior Unsecured	Baa2
Jr Subordinate Shelf	(P)Baa3
Commercial Paper	P-2
<b>AEP Capital Trust I</b>	
Outlook	Stable
Preferred Shelf	(P)Baa3
<b>AEP Capital Trust II</b>	
Outlook	Stable
Preferred Shelf	(P)Baa3
<b>AEP Capital Trust III</b>	
Outlook	Stable
Preferred Shelf	(P)Baa3

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**Key Indicators**

[1]

**American Electric Power Company, Inc.**

	LTM 9/30/07	2006	2005	2004
(CFO Pre-W/C + Interest) / Interest Expense	3.6x	3.9x	3.6x	3.8x
(CFO Pre-W/C) / Debt	16%	17%	15%	18%
(CFO Pre-W/C - Dividends) / Debt	12%	14%	11%	14%
(CFO Pre-W/C - Dividends) / Capex	56%	61%	63%	113%
Debt / Book Capitalization	55%	54%	52%	53%
EBITA Margin %	20%	19%	19%	18%

[1] All ratios calculated in accordance with the Global Regulated Electric Utilities Rating Methodology using Moody's standard adjustments.

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

**Opinion**

**Company Profile**

American Electric Power Company, Inc. (AEP) is a large utility holding company with electric utility operations serving approximately 5 million retail customers across eleven states (Arkansas, Indiana, Kentucky, Louisiana, Michigan, Ohio, Oklahoma, Tennessee, Texas, Virginia and West Virginia). The majority of AEP's operations are vertically integrated electric utilities that are primarily regulated by the respective state authorities in which they operate. In addition, AEP owns a sizeable barge and coal handling business, which is non-regulated, along with an energy trading and hedging operation and a small wholesale generation company. AEP is headquartered in

Columbus, Ohio.

AEP is primarily viewed as a rate-regulated electric utility holding company. The vast majority of its 2006 consolidated revenues (70%), cash flows (90%) and assets (94%) were associated with rate-regulated electric utility businesses. These operations are primarily conducted through eleven separate utility companies, seven of which (representing approximately 89% of AEP's total consolidated regulated utility revenues) remain vertically integrated. The four utilities which are not vertically integrated enjoy monopolistic electric transmission and distribution service territories. In addition, two of AEP's vertically integrated utilities (representing approximately 27% of AEP's total consolidated regulated revenues) have monopolistic service territories in Ohio, which is currently experiencing another round of legislative modification to the electric market framework.

AEP owns approximately 38 GW's of electric generation capacity. These GW's are diversified by fuel, geographic region and regulatory jurisdiction. Approximately 87% of this generation capacity (33GW's) is associated with vertically-integrated electric utilities. Another 12.2 GW's (or 32%) is associated with the Ohio-based regulated utilities, currently undergoing legislative intervention and market restructuring and roughly 5.1 GW's (or 13%) is considered non-regulated, or exposed to the wholesale open market, through AEP Generating Company. AEP generated approximately \$13 billion in revenues for the year ended 2007.

#### **Recent Developments:**

On January 30, 2008, Moody's changed the rating outlook on four of AEP's subsidiary operating utility companies to negative from stable. The utility subsidiaries include: Appalachian Power Company (APCo, Baa2 senior unsecured), Ohio Power Company (OPCo, A3 senior unsecured), Southwestern Electric Power Company (SWEPCO, Baa1 senior unsecured) and AEP Texas Central (AEP TCC, Baa2 senior unsecured). The negative rating outlooks primarily reflect the relatively weak, or weakening, financial profile for those entities relative to their current rating categories in the presence of a rising business and operating risk environment. In our opinion, unless the key financial credit metrics associated with these entities improves, ratings downgrades may materialize over the intermediate term horizon (12 to 18 months).

#### **Rating Rationale:**

AEP's Baa2 senior unsecured rating reflects a combination of credit assessments which are more fully described in our Global Regulated Electric Utilities Rating Methodology, published in March 2005. Moody's views AEP as a lower-risk utility holding company, where a majority of its business activities relate to rate-regulated electric utilities in states with relatively constructive regulatory authorities and where a reasonably strong diversity (in terms of geography and regulatory jurisdictions) benefits the consolidated financial profile over the long term. In addition, AEP has produced key financial credit metrics within the Baa-rating category on a relatively consistent basis over the past 3 and 5-year periods while at the same time generally lowering its overall business and operating risk profile through the disposition of more risky, non-regulated ventures and with the resolution of some outstanding litigation.

The most important drivers of AEP's rating and rating outlook are as follows:

#### **MAINTAINING STEADY AND PREDICTABLE FINANCIAL CREDIT RATIOS**

The vast majority of AEP's revenues, earnings, cash flows and assets are related to its numerous rate-regulated electric utility subsidiaries, which we view, in general, as having a relatively low over-all business and operating risk profile. Prospectively, we would be concerned if AEP finds it increasingly difficult to maintain its consolidated financial credit metrics at a level that remains comfortably above 15% CFO pre-W/C to debt. Moody's observes that the preliminary CFO pre-W/C to debt for year end 2007 appears to be very close to the 15% threshold, although we have not yet had the benefit of reading the financial footnotes that accompanied a recent earnings release.

#### **DIVERSITY OF OPERATIONS A CREDIT STRENGTH**

AEP's businesses and assets are well diversified, although they are concentrated within the electric utility sector. AEP's utility subsidiaries are located in 11 different states, and are therefore regulated by 11 different regulatory authorities (the largest being Ohio, Texas and Virginia - ranked by rate base). These jurisdictions translate into good diversity in revenues (by state and operating utility), cash flows, assets, debt outstanding, customers and generation capacity. From a credit perspective, Moody's views this diversity as a meaningful credit strength, due to the insulation that benefits the parent company from an unexpected adverse development or other negative development occurring at one of its companies or with one of its state service territories.

#### **REGULATORY ENVIRONMENTS GENERALLY CONSIDERED SUPPORTIVE**

AEP is exposed to eleven different state regulatory commissions: Indiana Utility Regulatory Commission; Kentucky Public Service Commission, Michigan Public Service Commission, Public Utility Commission of Ohio, Commonwealth of Virginia State Corporation Commission, Public Service Commission of West Virginia, Arkansas Public Service Commission, Public Utility Commission of Texas and Louisiana Public Service Commission. In

addition, AEP has a small utility operation in Tennessee. In general, Moody's views these state regulatory commissions favorably, due to their reasonably transparent rulemaking procedures and likelihood to settle as opposed to litigate rate cases. We observe that most of these commissions are appointed (Louisiana and Oklahoma are elected); that a majority of the states did not pursue a legislatively mandated form of deregulation (with the exception of Ohio, Texas, Virginia and Michigan), that fuel cost / purchased power costs trackers are allowed in some fashion (except for Ohio) and that most have approval authorities over securities issuances and M&A change of control (except Michigan). As a portfolio, these regulatory commissions are viewed as maintaining a relatively constructive relationship with the utilities they regulate and are considered a benefit to AEP's over-all business and risk profile.

#### **SUBSTANTIAL CAPITAL INVESTMENT PLAN RAISES NEAR-TERM RISKS**

Over the next three years (2008 - 2010), AEP is expecting to invest approximately \$11 billion into its business infrastructure and almost \$18 billion over the next five-year period. While we acknowledge that a significant portion of these investments can be considered aspirational and subject to various forms of regulatory pre-approvals before they become committed, this level of spending could clearly create financial pressure on the company.

The majority of the base capital plan relates to investments in generation, which excludes plans to build a new IGCC-plant in West Virginia and, over the much longer term, a new nuclear facility. In addition, Moody's observes that a significant portion of the base capital plan includes AEP's aspirations to build new high-voltage transmission lines, which are also long-term projects where meaningful spending is not expected to occur for some time. From a credit perspective, Moody's views investments in regulated rate-base positively, and we incorporate a view that regulators will provide meaningful and timely recovery for prudently incurred investments. Nevertheless, we remain cautious as to the scale and scope of capital expenditure plans of this size, due to the negative free cash flow that will be incurred over the next few years and the potential regulatory overhang associated with the ultimate impact on end-use customer rates. In our opinion, utilities that are embarking on a capital investment program of this size should also be redoubling their efforts to bolster their balance sheet and cash flow credit metrics, in an effort to create enough financial strength to weather potentially distressful environments related to economic conditions, volatility in commodity markets, regulatory changes or other unanticipated developments.

#### **OHIO REGULATORY ENVIRONMENT IN TRANSITION**

Ohio is currently experiencing a significant amount of potential legislative / regulatory intervention risk, where significant modifications are being contemplated regarding the current electric market framework. In our opinion, the ultimate resolution is not expected to be fully resolved for many years. As a result, electric utilities that operate in Ohio will be viewed as having a higher level of business and operating risk, due to the uncertainty associated with the ultimate outcome of any potential market modification or what form any legislation might take and the magnitude of any potential changes to business strategy, if any, that might unfold.

In our opinion, one of the best ways to mitigate against this uncertainty is to bolster and strengthen the balance sheet, and deploy a set of extremely conservative financial policies until more clarity becomes available. Moody's also notes that not all intervention is negative to credit quality, and, in our opinion, we view the current Ohio situation as being substantially less contentious than the recent intervention experienced in Illinois and Maryland within the last year. Moody's incorporates a view that the utilities in Ohio will most likely reach some form of negotiated agreement with the PUCO that essentially extends the current Rate Stabilization Plans, the bulk of which are scheduled to expire in December 2008, perhaps with some built-in rate increases that addresses legislator's desires to protect consumers from rate shocks and industrial consumers with some form of rate stability. As the situation in Ohio continues to evolve, Moody's will update our views regarding how we will incorporate these potential risks into our credit analysis as developments materialize.

#### **SHAREHOLDER REWARDS STRATEGIES VIEWED AS SHORT-SIGHTED**

Given the level of spending that AEP is anticipating, the continued increases in non-fuel operating and maintenance expenses, the volatility associated with natural gas fuel commodities, rising costs for coal and nuclear fuel, uncertainties associated with increasingly stringent environmental compliance mandates plus an aging workforce, Moody's views the company's current shareholder rewards strategies as being somewhat inconsistent with the risks facing the industry (in general) and AEP, specifically. While we do not dispute the board of director's need to maximize shareholder value, we remain concerned as to the fixed nature of the company's common stock dividend policy and dividend payout targets. In our opinion, the company already has very little "cushion" as a Baa2-rated company should a meaningfully adverse development materialize that negatively impacts its cash flows. We observe that several of AEP's peers appear to be positioned much more soundly within their given rating categories, although most fall within the overly-biased shareholder rewards classification, given the capital spending plans that are disclosed in the annual SEC 10-K filings. From a credit perspective, while Moody's views AEP's current shareholder rewards strategies as being neutral to the credit over the near-term, they could be viewed as harmful if unexpected negative developments were to materialize since we view AEP's common dividend as a fixed obligation.

#### **Liquidity:**

AEP maintains two separate credit facilities at the parent company, each \$1.5 billion where one matures in March 2011 and the other matures in April 2012. As of December 2007, there was approximately \$660 million of

commercial paper outstanding under these facilities and \$65 million of L/C's issued, leaving a total available capacity of approximately \$2.3 billion. Scheduled debt maturities appear to be reasonable, with roughly \$520 million expected to mature in 2008 and \$345 million maturing in 2009, the vast majority of which represent regulated utility debt maturities. The two credit facilities contain a single financial covenant, a 67.5% adjusted leverage test. As of December 2007, we believe the company was in compliance with that covenant and appears to have ample headroom. There are no ongoing material adverse change conditions.

AEP is expected to generate approximately \$9 billion of cash from operations over the next three years, invest roughly \$11 billion in capital expenditures and pay roughly \$2 billion in common dividends. This results in approximately \$4 billion of negative free cash flow, the vast majority of which is expected to be financed with additional debt. If AEP were unable to access the capital markets for some reason, its current committed bank facilities would appear to be adequate to provide sufficient liquidity, if needed.

#### **Financial Profile:**

AEP has produced, on average over the past 5 year and 3 year periods, a ratio of cash flow from operations pre working capital (CFO pre w/c) plus interest divided by interest of roughly 3.8x. For the latest twelve months ended September 2007, the ratio fell slightly to 3.6x, but is still considered within the Baa-rating category and appears appropriate for the Baa2-senior unsecured rating of AEP. Prospectively, Moody's incorporates a view that AEP will continue to produce a CFO pre w/c interest coverage ratio of over 3.5x for the intermediate-term horizon. In addition, AEP's ratio of CFO pre w/c to debt has averaged, over the past 5 year and 3 year periods, roughly 16.5%. This ratio also declined slightly over the latest twelve months ended September 2007 to approximately 15.5%. Prospectively, Moody's incorporates a view that AEP will be successful in producing a ratio of CFO pre w/c to debt over 15% for the intermediate term horizon. From a credit perspective, these key financial credit ratios are viewed as appropriate for a Baa2-rated utility holding company, albeit at the lower end of the Baa-rating category. Moody's views Entergy Corporation (Baa3 senior unsecured), First Energy (Baa3 senior unsecured), Duke Energy (Baa2 senior unsecured), Dominion Resources (Baa2 senior unsecured), Progress Energy (Baa2 senior unsecured), Xcel Energy (Baa1 senior unsecured), MidAmerican Energy (Baa1 senior unsecured) and Southern Company (A3 senior unsecured) as comparable peers for AEP.

#### **Corporate Governance:**

AEP has important governance strengths that outweigh any weaknesses; however, we believe the impact on the rating is limited at this time. The board appears to have a good framework for corporate governance, for example, implementing a robust board evaluation process. Like some other utilities, the board has a fairly structured approach to corporate governance (e.g., a large number of committees) which lends obvious strength in its ability to focus on proper detail, but also may carry some risk of inadequate overall board integration.

Director succession at AEP may prove challenging as five outside directors, including the chair of the audit committee, are within one to three years of the board's mandatory retirement age of 72. This includes one director Moody's does not consider independent - E.R. Brooks, the retired chairman and CEO of Central and South West Corporation, which merged with AEP in June 2000 - plus four directors we do view as independent. These upcoming director changes present some potential transition risks for the board since the retiring directors have built up considerable institutional memory and there have been few new directors added to the board in recent years. A less risky director transition process might allow for the recruitment of two to four new directors, over a two year period, providing an opportunity for some transfer of company knowledge from long-tenured directors limiting the material loss of institutional memory for the board overall, particularly, at a time when major decisions may be made with respect to building new base load generation facilities.

#### **Rating Outlook:**

The stable rating outlook for AEP is primarily based on our views regarding the company's intermediate and longer-term strategic plans, the diversity of its cash flow generation from rate-regulated electric utility companies, and a reasonably predictable financial profile that is expected to maintain key financial credit metrics, including cash flow to debt in the mid-teen's range.

#### **What Could Change the Rating - Up**

The ratings could be upgraded if AEP were to improve its financial profile and its key financial credit ratios on a sustainable basis. This would include improving its ratio of CFO pre w/c to debt to the high-teen's (from the current mid-teens) and CFO pre w/c interest coverage closer to roughly 4x (from the current 3.5x range).

#### **What Could Change the Rating - Down**

Ratings downgrades could occur if the financial profile were to deteriorate to where the key financial credit ratios resulted in CFO pre w/c in the low teens and CFO pre w/c interest coverage fell closer to 3x. Separately, ratings could be downgraded if AEP's over-all business and risk profile were to increase without a corresponding improvement to its financial profile. A more contentious environment in Ohio, or other negative or contentious regulatory developments could pressure the rating; the outcome of various environmental mandates or operation problems at AEP's major generating stations would also be viewed negatively from a credit perspective.

## Rating Factors

### American Electric Power Company, Inc.

#### Select Key Ratios for Global Regulated Electric Utilities

Rating	Aa	Aa	A	A	Baa	Baa	Ba	Ba
Level of Business Risk	Medium	Low	Medium	Low	Medium	Low	Medium	Low
CFO pre-W/C to Interest (x) [1]	>6	>5	3.5-6.0	3.0-5.7	2.7-5.0	2-4.0	<2.5	<2
CFO pre-W/C to Debt (%) [1]	>30	>22	22-30	12-22	13-25	5-13	<13	<5
CFO pre-W/C - Dividends to Debt (%) [1]	>25	>20	13-25	9-20	8-20	3-10	<10	<3
Total Debt to Book Capitalization (%)	<40	<50	40-60	50-75	50-70	60-75	>60	>70

[1] CFO pre-W/C, which is also referred to as FFO in the Global Regulated Electric Utilities Rating Methodology, is equal to net cash flow from operations less net changes in working capital items

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**Global Power  
U.S. & Canada  
Credit Analysis**

**American Electric Power Company,  
Inc.**

**Ratings**

Security Class	Current Rating
IDR	BBB
Senior Unsecured	BBB
Jr. Sub. Debentures	BBB-
Short-Term IDR/CP	F2

**Outlook**

Stable

**Financial Data**

American Electric Power Company, Inc.  
(\$ Mil.)

	LTM	
	9/30/08	12/31/07
Revenues	14,065	13,180
Gross Margin	8,310	8,213
Cash from Operations	2,611	2,313
Operating EBITDA	3,588	3,867
Total Capitalization	26,155	23,908
ROE (%)	14.30	11.20
Capex/Depreciation (%)	274.4	247.8

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**Related Research**

- *Ohio Power Co., Oct. 21, 2008*
- *Columbus Southern Power Co., Oct. 21, 2008*
- *Appalachian Power Co., June 3, 2008*
- *Kentucky Power Co., May 1, 2008*
- *Southwestern Electric Power Co., April 8, 2008*
- *Public Service Co. of Oklahoma, March 6, 2008*
- *Indiana Michigan Power Co., Feb. 26, 2008*
- *AEP Texas North Co., Feb. 7, 2008*
- *AEP Texas Central Co., Dec. 11, 2007*

**Rating Rationale**

- Fitch Ratings affirmed the ratings of American Electric Power Company, Inc. (AEP) on Nov. 10, 2008. AEP's ratings take into consideration the company's stable cash flow generation and earnings base from the regulated utility operations, generally balanced regulatory environments and solid liquidity position.
- AEP's consolidated credit metrics are consistent with utility parent peers in the 'BBB' rating category, with adjusted EBITDA-to-interest at 5.3 times (x) and funds flow coverage at 4.8x for the 12-month period ended Sept. 30 2008. Debt leverage, as measured by the ratio of debt to total capitalization, was 58.1% for the same time period.
- Rating concerns primarily relate to AEP's exposure to carbon legislation, given the company's large coal-fired generation fleet; regulatory lag in several service territories; and weakening economies in several service territories, particularly Ohio, Michigan and Kentucky. In addition, there is uncertainty regarding the transition to market-based rates in Ohio, which has AEP's largest share of utility operations.
- The Stable Outlook reflects Fitch's expectation that AEP will continue to benefit from the stable financial profiles of its regulated subsidiaries, as well as an overall continuation of generally balanced regulatory environments, which include a constructive outcome to the rate filings in Ohio for Ohio Power Co. (OPC, rated 'BBB'/Stable Outlook) and Columbus Southern Power Co. (CSP, rated 'BBB+' /Stable). Fitch also incorporates the view that AEP will be able to access debt and equity markets to supplement internal cash flow in 2009, albeit at a higher cost of capital.

**Key Rating Drivers**

- In the normal course of business, there are no expected events that could lead to a positive rating action.
- An inability to recover significant environmental compliance investments, exposure to carbon legislation and a deterioration of regulatory relations could negatively impact ratings.

**Recent Developments**

**Capital Expenditures Update**

AEP recently announced it was reducing its 2009 capital expenditure budget to \$2.6 billion, a decrease of approximately \$750 million from previous forecasts. Capital expenditures for 2008 are likely to approximate 2007 levels at around \$3.5 billion. The decision to reduce discretionary capital spending is related to the disruption in the capital markets. Major components of the decrease include reduced spending in generation, environmental and distribution segments. However, capital spending will likely pick up once again when management believes the capital markets are viable. As yet, the company does not expect to lower 2010 capital expenditures.

**Transmission Update**

AEP continues to pursue significant transmission projects. This is consistent with the corporate goals of leading the development of America's high-voltage transmission system.

***Pioneer Transmission LLC***

On Aug 11, 2008, AEP and Duke Energy Corporation (Duke) formed a joint venture to build and own 240 miles of 765-kilovolt (kV) line extending from AEP's Rockport station in Evansville, Ind., with Duke's Greentown substation near Kokomo, Ind.. The project is expected to cost approximately \$1 billion, with final costs dependent on the routing of the line, equipment and commodity costs. AEP's share would be 50% of the total. In-service date will be determined by the Midwest Independent System Operator (MISO) and PJM Interconnection LLC (PJM) planning process, with the earliest possible completion in the 2014–2015 timeframe. The next steps are submitting a proposal to MISO and PJM for consideration in their transmission expansion plans and filing with the Federal Energy Regulatory Commission (FERC) for rate approval (2009).

***Tallgrass Transmission LLC***

In July 2008, Electric Transmission America (ETA) signed an agreement with OGE Energy Corp. to form Tallgrass Transmission. ETA is a 50/50 joint venture between AEP and MidAmerican Energy Holdings Co. (MEHC) to build transmission outside of the Electric Reliability Council of Texas (ERCOT). ETA proposes to build approximately 170 miles of 765-kV lines extending from the Kansas-Oklahoma border north to Woodward, Okla., which will link into OGE Energy's station at Woodward and then extend west to a new station that will be built near Guymon, Okla. The project is expected to cost approximately \$500 million and be in service by 2013. Next steps include: Southwest Power Pool (SPP) approval (2009), FERC formula rate filing (late 2008), SPP cost allocation filing (2009) and siting approval (2009).

***Prairie Wind Transmission LLC***

In May 2008, ETA signed an agreement with Westar Energy to form Prairie Wind Transmission LLC (PWT). PWT is a 50/50 joint venture that is proposing to build approximately 230 miles of 765-kV lines extending from Wichita, Kan., west to a substation northeast of Dodge City, Kan., and then south to the Kansas border from Medicine Lodge, Kan.. The project is expected to cost approximately \$600 million and be in service by 2013. Next steps include: SPP approval (2009), FERC formula rate filing (late 2008), SPP cost allocation filing (2009) and siting approval (2009).

**Regulatory Update**

***Ohio Update***

Following the passage of electric restructuring legislation in Ohio in May 2008, CSP and OPC filed electric security plans (ESP) with the Public Service Commission of Ohio (PUCO) in July 2008. The ESP essentially replaces the current rate stabilization plan (RSP), which has been in effect since Jan. 1, 2006, during a transition period to market

**Rate Case Activity**

Operating Co.	Jurisdiction	Annual Rate (\$ Mil.)	Projected Effective Date of Rate Increase Request
Appalachian Power	Virginia	168	November 2008
Public Service company of Oklahoma	Oklahoma	117	February 2009
Indiana Michigan Power Company	Indiana	80	June 2009

Source: Company reports.



pricing in Ohio that is set to expire on Dec. 31, 2008. Within the parameters of the ESP, the Ohio utilities requested an annual rate increase through Jan, 1, 2012, approximating 15% per year beginning 2009. As part of the ESP filing, a significant portion of the requested increase results from the implementation of a fuel cost recovery mechanism (fuel costs; purchased power costs, including mandated renewable energy; variable production costs; and gains and losses on the sale of emissions allowances). The requested increase would also recover costs associated with environmental upgrades (effective 2009), provider of last resort (POLR) charges, and automatic increases for unexpected costs and reliability (effective 2010). A PUCO decision on the ESP filing is expected by the end of the year or early 2009. If the PUCO order on the ESP is not acceptable to AEP, the Ohio utilities will have the ability to pursue a market-rate option plan (MRO) in mid-2009. The likely result for an interim period is a continuation of the utility's current RSP. In Fitch's view, the credit ratios of the Ohio utilities will likely remain robust irrespective of the outcome of the ESP/MRO debate.

### Generation Update

#### *Stall Plant Update*

The Louisiana Public Service Commission (PSC) order for plant approval was received in September 2008. Southwestern Electric Power Co. (SWEPCO) received the Louisiana air permit in March 2008. The Arkansas proceeding is currently suspended pending the outcome in Louisiana. The Texas order approving the plant was issued in March 2007.

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### Generation Update

Operating Co.	Project Name	Location	Total Projected Fuel Cost (\$ Mil.)	Capacity Type	Commercial (MW)	Operating Date
PSO	Southwestern	Oklahoma	56	Gas	150	2008
PSO	Riverside	Oklahoma	58	Gas	150	2008
SWEPCO	Stall	Louisiana	378	Gas	500	2010
SWEPCO	Turk	Arkansas	1,522	Coal	600	2012

Source: Company reports.

#### *Turk Plant Update*

The plant received approval from Louisiana, Arkansas and Texas. The company received its air permit approval from the Arkansas Department of Environmental Quality in November 2008, as well as from the U.S. Army Corps of Engineers later this year. SWEPCO's 73% ownership portion of the construction costs approximate \$1.1 billion. Upon receipt of the necessary permits, AEP will be able to start construction on the Turk plant immediately.

#### *Outage at Cook Nuclear Power Plant*

On Sept. 20, 2008, Unit 1 of the Cook Plant experienced some unexpected and dramatic vibrations. The 1,030-megawatt (MW) nuclear unit shut itself off. Initial inspections and disassembly of the main turbine revealed the vibrations were likely caused by a broken low-pressure turbine blade. The vibration also caused a hydrogen leak, resulting in a fire in the main generator that caused minimal damage to the facility. The turbine rotors and other major components were shipped to the original manufacturers for engineering analysis and repair. AEP expects to have a return-to-service schedule and cost estimates for the unit in early December. Cook Unit 1 has three low-pressure turbines manufactured by Seimens and one General Electric high-pressure turbine and main generator. The turbines causing the vibration were installed in 2006 and are under warranty from the vendor. The warranty provides for the replacement of the turbines if

the damage was caused by a defect in the design or assembly of the turbines. A root cause analysis of the event is being completed by Seimens and an independent party.

Since AEP dispatches its units in the pool on a stack, the Cook outage should not have an impact on customers' service, and the rate impact of more-expensive replacement power should be covered under insurance and warranty payments. However, the outage does limit the amount of gigawatt-hours the company can put into the overall marketplace, both retail and off-system, which can impact earnings. Cook Unit 2 (1,070 MW) continues to operate at full power.

The related operating and maintenance (O&M) expense and the costs associated with the repair and bringing the unit back online should be covered by vendor warranties and AEP's participation in the Nuclear Electric Insurance Limited (NEIL) insurance program. Additionally, the company has property damage insurance with a \$1 million deductible, as well as business interruption insurance that will begin paying \$3.5 million a week after 12 weeks of the event.

### Liquidity

On Oct. 8, 2008, AEP drew down an additional \$1.4 billion from its credit facilities to bolster its cash position during the current volatility in the financial marketplace. The company has approximately \$4 billion in credit facilities, with staggered maturities from April 2009 through April 2012. As of Oct. 28, 2008, AEP has net available liquidity of \$2.7 billion, including cash on hand of \$1.4 billion. When market conditions improve, AEP plans to repay the amounts drawn under the credit facilities, re-enter the commercial paper market and issue other long-term debt. If there is not an improvement in access to external capital, the company should have adequate liquidity to support its planned business operations and construction program through 2009. The company plans to re-finance at a minimum the remaining \$180 million of debt due in 2008 and the \$300 million of debt due in 2009, with additional debt issuances if market conditions are satisfactory or through current available liquidity. AEP also intends to hold operating and maintenance expenses flat at \$3.3 billion in 2009 to preserve liquidity in a challenging credit environment.

### Liquidity

(\$ Mil., As of Oct. 28, 2008)

	Amount	Maturity
<b>Credit Facilities<sup>a</sup></b>		
Revolving Credit Facility	1,500	March 2011
Revolving Credit Facility	1,454	April 2012
Revolving Credit Facility	627	April 2011
Revolving Credit Facility	338	April 2009
<b>Total Credit Facilities</b>	<b>3,919</b>	—
AEP Cash and Investments	1,366	—
Draw on Credit Facilities	(1,969)	—
Commercial Paper Outstanding	(178)	—
Letters of Credit Issued	(439)	—
<b>Net Available Liquidity</b>	<b>2,699</b>	—

<sup>a</sup>The revolving credit agreements contain a covenant that requires AEP to maintain debt to total capitalization at or below 67.5%

Source: Company reports.

### Capital Structure

(As of Oct. 15, 2008)

	Amount	%
Long-Term Debt	13,282	49.50
Short-Term Debt	2,440	9.10
Preferred Stock	61	0.20
Hybrid Issuances	158	0.60
Equity	10,917	40.70
<b>Total</b>	<b>26,858</b>	<b>100.00</b>

Source: Company reports.

**Financial Summary — American Electric Power Company, Inc.<sup>a</sup>**

(\$ Mil., Fiscal Years Ended Dec. 31)

	LTM Ended 9/30/08	2007	2006	2005	2004	2003
<b>Fundamental Ratios (x)</b>						
Funds from Operations (FFO)/Interest Expense	4.8	4.4	4.9	3.1	3.8	4.3
Cash Flow from Operations (CFO)/Interest Expense	4.8	4.2	5.0	3.8	4.4	3.9
Debt/FFO	5.9	5.6	4.5	8.5	5.7	5.5
Operating EBIT/Interest Expense	3.4	3.0	3.0	2.7	2.6	2.9
Operating EBITDA/Interest Expense	5.3	5.0	5.1	4.7	4.3	4.5
Debt/Operating EBITDA	4.2	3.8	3.4	3.9	3.7	4.0
Common Dividend Payout (%)	45.2	58.1	59.3	68.8	51.5	570.0
Internal Cash/Capital Expenditures (%)	55.2	47.2	58.9	53.0	117.5	120.9
Capital Expenditures/Depreciation (%)	274.4	247.8	251.1	189.7	135.7	108.6
<b>Profitability</b>						
Adjusted Revenues	14,065	13,180	12,500	12,022	13,966	14,455
Net Revenues	8,310	8,213	7,827	7,487	7,521	7,845
Operating and Maintenance Expense	3,954	3,867	3,639	3,649	3,611	3,673
Operating EBITDA	3,588	3,591	3,451	3,075	3,200	3,471
Depreciation and Amortization Expense	1,289	1,435	1,405	1,267	1,248	1,251
Operating EBIT	2,299	2,156	2,046	1,808	1,952	2,220
Gross Interest Expense	684	719	672	659	742	772
Net Income for Common	1,459	1,089	1,002	814	1,089	110
Operating Maintenance Expense % of Net Revenues	47.6	47.1	46.5	48.7	48.0	46.8
Operating EBIT % of Net Revenues	27.7	26.3	26.1	24.2	26.0	28.3
<b>Cash Flow</b>						
Cash Flow from Operations	2,611	2,313	2,673	1,833	2,551	2,269
Change in Working Capital	42	(163)	61	442	467	(253)
Funds from Operations	2,569	2,476	2,612	1,391	2,084	2,522
Dividends	(660)	(633)	(594)	(560)	(561)	(627)
Capital Expenditures	(3,537)	(3,556)	(3,528)	(2,404)	(1,693)	(1,358)
Free Cash Flow	(1,586)	(1,876)	(1,449)	(1,131)	297	284
Net Other Investment Cash Flow	(76)	(202)	(122)	55	(40)	(612)
Net Change in Debt	1,757	1,835	1,420	(91)	(2,229)	(727)
Net Change in Equity	134	144	99	(25)	7	1,133
<b>Capital Structure</b>						
Short-Term Debt	1,302	660	18	10	23	326
Long-Term Debt	13,890	13,123	11,669	11,845	11,865	13,568
Total Debt	15,192	13,783	11,687	11,855	11,888	13,894
Hybrid Equity	46	46	46	46	95	103
Common Equity	10,917	10,079	9,412	9,088	8,515	7,874
Total Capital	26,155	23,908	21,145	20,989	20,498	21,871
Total Debt/Total Capital (%)	58.1	57.7	55.3	56.5	58.0	63.5
Hybrid Equity/Total Capital (%)	0.2	0.2	0.2	0.2	0.5	0.5
Common Equity/Total Capital (%)	41.7	42.2	44.5	43.3	41.5	36.0

<sup>a</sup>Numbers are adjusted to exclude interest, principal payments and amortization on utility tariff bonds. LTM – Latest 12 months. Operating EBIT – Operating income before total reported state and federal income tax expense. Operating EBITDA – Operating income before total reported state and federal income tax expense plus depreciation and amortization expense. Note: Numbers may not add due to rounding. Long-term debt includes trust preferred securities.

Source: Company reports, Fitch Ratings.

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# American Electric Power Company, Inc.

## Full Rating Report

### Ratings

Long-Term IDR	BBB
Senior Unsecured	BBB
Short-Term IDR	F2
Commercial Paper	F2

IDR – Issuer Default Rating.

### Rating Outlook

Negative

### Financial Data

#### American Electric Power Company, Inc.

(\$ Mil.)	12/31/12	12/31/11
Revenue	14,638	14,858
EBITDA	4,777	4,661
FCF	(419)	(108)
Total Adjusted Debt	19,225	19,222
FFO	3,571	3,086
Capex	3,025	2,767
FFO/Debt (%)	18.57	16.05
EBITDA/Interest (x)	4.23	4.36

### Related Research

Fitch Affirms AEP & Units; Outlook Negative for AEP, Kentucky Power, & Ohio Power Company (February 2013)

### Key Rating Drivers

**Increased Business Risk Profile:** American Electric Power Company, Inc.'s (AEP) risk profile will increase with the pending transfer of approximately 8,900 MW of generating capacity from its Ohio-based regulated subsidiary Ohio Power Company (OPCO, BBB+/Negative) to a higher risk competitive merchant generation status. Power prices are unlikely to recover over the intermediate term and AEP will likely earn lower profits after the end of the transition period.

**Credit Metrics Pressured:** Fitch Ratings expects 2015 FFO-based leverage and interest coverage ratio to be around 15% and 3.5x, respectively — levels modestly below Fitch's guidelines for the 'BBB' Issuer Default Rating (IDR). In the post-2015 restructuring period, Fitch expects some improvement as the transition process is complete. In addition, the corporate separation alters AEP's capital structure as debt at OPCO is replaced with debt issued at the parent or a nonregulated subsidiary, and will likely require greater liquidity support to more intensively hedged volume and commodity risk.

**Supporting Merchant Generating Business:** AEP will need to financially support its new independent power generation business by providing cash collateral for its electricity trading and fuel needs and selling its output through long-term sale agreements and in PJM-operated wholesale electricity market. Fitch expects low electricity prices in the PJM, at least over the rating horizon. AEP plans to keep low debt at the new venture, which has higher risk profile due to the merchant nature of the business and lack of long-term power sale contracts, resulting in exposure to the volatile wholesale electricity market.

**Large Capex Program:** AEP's regulated and nonregulated electric generation capacity is largely coal based and faces increased environmental investment. AEP is also committing significant capital to new transmission projects. These investments will strain credit metrics over the 2013–2015 rating horizon. Fitch expects average annual capex through 2015 to be between \$3.6 billion and \$3.8 billion, significantly higher than historical levels.

**Uncertainty Over Long-Term Leverage:** The corporate separation order in Ohio will alter the capital structure at AEP with expected less-than-proportional debt retirement at OPCO, and additional debt at AEP and the newly formed independent generating business. New environmental regulations, lower capacity utilization factor, and a low electricity commodity price environment will adversely affect long-term performance of these assets.

**Transferring Capacity to Regulated Subsidiaries:** State regulatory approval of the transfer of more than 2,400 MW to AEP's two regulated subsidiaries — Kentucky Power Company (KPCO, BBB-/Negative) and Appalachian Power Company (APCO, BBB-/Stable) — at the net book value in a low power plant pricing environment is a strategy execution risk.

### Rating Sensitivities

**Negative Rating Actions:** A sustainable decline in FFO-to-debt and FFO-to-interest ratios to below 3.5x and 16%, respectively, will result in a negative rating action.

**Positive Rating Actions:** A rating upgrade is unlikely at this time.

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## Financial Overview

### Liquidity and Debt Structure

AEP has strong liquidity, with approximately \$3.7 billion of total liquidity available under its respective credit agreements at March 31, 2013. The total liquidity includes \$179 million of cash and cash equivalents, and \$3.5 billion is available under \$4.5 billion in consolidated revolving credit facilities, of which \$1.75 billion is maturing in June 2016 and additional \$1.75 billion will mature in June 2017. The remaining \$1.0 billion in the credit facility established to fund OPCO maturities will expire in 2015. The current level of liquidity is sufficient to meet its short-term debt obligations — \$1.8 billion due in 2013.

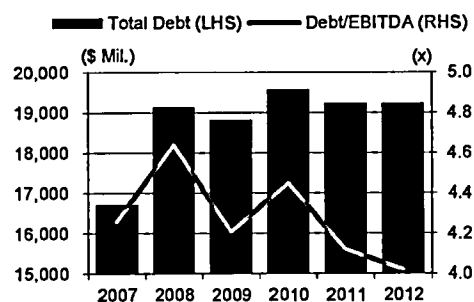
### Debt Maturities and Liquidity

(\$ Mil., At Dec. 31, 2012)

Debt Maturities	
2013	1,792
2014	995
2015	1,405
2016	939
2017	1,724
Cash and Cash Equivalents	279
Undrawn Committed Facilities	2,798
<b>Total Liquidity</b>	<b>3,077</b>

Source: Company reports, Fitch analysis.

### Total Debt and Leverage



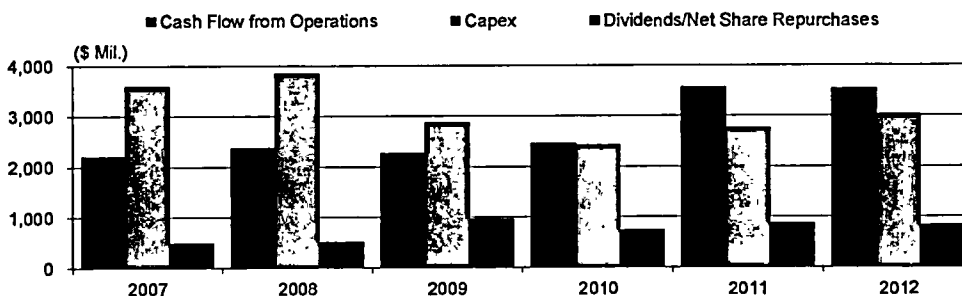
Source: Company reports, Fitch.

### Cash Flow Analysis

Extension of the federal bonus depreciation rules helped consolidated cash flow from operations over the last two years, primarily by reducing the cash tax expenses at the utility level. Fitch financial models recognize the benefits from bonus depreciation on cash flows, but Fitch bases its financial forecasts and rating assignments on normalized depreciation and tax schedules.

Capex is set to increase with the implementation of more stringent environmental regulations for the coal plants and the dividend payout ratio over historical levels. The company will spend approximately \$3.6 billion–\$3.8 billion annually in capex on a consolidated level, of which

### CFO and Cash Uses



Source: Company reports, Fitch.

### Related Criteria

Corporate Rating Methodology (August 2012)  
 Short-Term Ratings Criteria for Non-Financial Corporates (August 2012)  
 Rating North American Utilities, Power, Gas, and Water Companies (May 2011)

approximately \$700 million will be spent on new transmission rate base annually. Fitch expects negative FCF will largely be debt financed.

## Peer and Sector Analysis

### Peer Group

Issuer	Country
<b>BBB+</b> Duke Energy Corporation	United States
<b>BBB</b> PPL Corporation	United States
<b>BBB-</b> FirstEnergy Corp.	United States

Source: Fitch.

### Issuer Rating History

Date	LT IDR (FC)	Outlook/Watch
Feb. 22, 2013	BBB	Negative
Feb. 27, 2012	BBB	Stable
Feb. 28, 2011	BBB	Stable
Jan. 26, 2010	BBB	Stable
Nov. 10, 2008	BBB	Stable
April 17, 2007	BBB	Stable
April 24, 2006	BBB	Stable
Dec. 6, 2005	BBB	Stable
March 11, 2003	BBB	Stable
Oct. 9, 2001	BBB+	Stable
June 1, 2000	BBB+	Stable

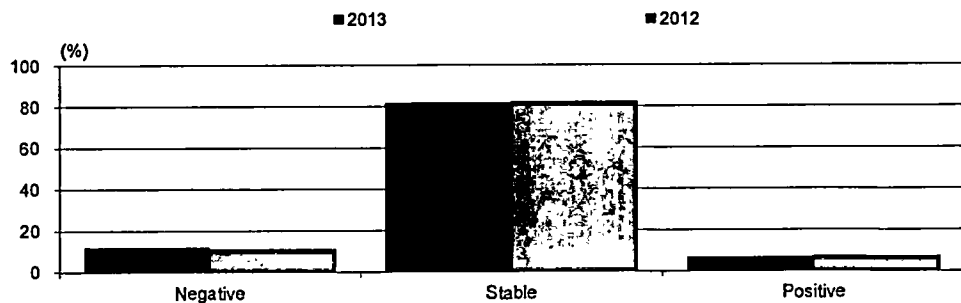
LT IDR – Long-term Issuer Default Rating.  
FC – Foreign currency.  
Source: Fitch.

### Peer Group Analysis

	American Electric Power Company, Inc.	Duke Energy Corporation	PPL Corporation	FirstEnergy Corp.
LTM as of	12/31/12	12/31/12	12/31/12	12/31/12
Long-Term IDR	BBB	BBB+	BBB	BBB-
Outlook	Negative	Stable	Stable	Stable
<b>Financial Statistics (\$ Mil.)</b>				
Revenue	14,638	19,624	12,286	15,213
EBITDA	4,777	6,236	4,209	3,720
FCF	(419)	(2,009)	(1,191)	(1,655)
Total Adjusted Debt	19,225	39,264	17,760	19,652
Funds Flow from Operations	3,571	5,040	3,057	2,236
Capex	(3,025)	(5,501)	(3,120)	(3,004)
<b>Credit Metrics (x)</b>				
EBITDA/Gross Interest Coverage	4.23	4.17	4.15	3.54
Debt/FFO	5.38	7.79	5.81	8.79
Debt/EBITDA	4.02	6.30	4.22	5.28
FFO Interest Coverage	4.16	4.37	4.01	3.13
Capex/Depreciation (%)	172.96	230.75	283.64	201.07
IDR – Issuer Default Rating. Source: Company reports, Fitch.				

Fitch expects credit metrics for AEP to decline further with the implementation of the corporate separation order in Ohio, a large construction program at its utility subsidiaries, and a higher dividend payout ratio, reflecting the Negative Outlook. Duke Energy Corporation's IDR benefits from 2012 rate increases in the Carolinas, a 2013 rate increase in Florida, and a positive settlement for its integrated gasification combined cycle (IGCC) facility in Indiana, but credit metrics will remain aligned to its IDR even during increased environmental-related capital spending. PPL Corporation's IDR reflects the transition to a more stable and low-risk business profile and strong metrics for its current IDR. Environmental-related capex will remain a challenge over the rating horizon. First Energy Corporation's IDR was downgraded, reflecting regulatory changes in Ohio and additional risk from reliance on a more volatile merchant generation business for its cash flow needs.

### Sector Outlook Distribution



Source: Fitch.

The Rating Outlook for AEP is Negative, reflecting regulatory changes in Ohio that will increase business and financial risk for AEP on a consolidated basis. Fitch's outlook for utility parent companies (UPC) is stable. UPCs with significant merchant generation operations and regulated utilities with significant wholesale sales will continue to face a challenging environment, with most regional power markets suffering from excess capacity and weak power prices.

## Key Rating Issues

### Corporate Separation Order in Ohio

In October 2012, the Ohio State Public Utility Commission (PUCO) approved OPCO's corporate separation order, under which it will transfer its generating assets at net book value to AEP Generating Resources Company (AEP Gen), a subsidiary of AEP. The transfer of largely coal-fired generating assets in a low electricity commodity price environment with increasing environmental compliance costs to AEP's nonregulated business will increase the business risk at AEP.

### Ohio Plant Transfers and Termination of Interconnection Agreement

The AEP East Company received the Federal Energy Regulatory Commission's (FERC) approval in April 2013 for full separation of OPCO's generating assets from its distribution and transmission operations. The approval includes transfer of about 8,900 MW of generating capacity to AEP Gen. The company has also requested termination of an interconnection agreement and approval of a power coordination agreement between its subsidiaries APCO, Indiana Michigan Power Company (IMPCO), and KPCO, where each subsidiary will be responsible for acquiring its own power needs. KPCO's need for additional generating resources will be satisfied by the transfer of about 800 MW of capacity from OPCO.

### Ohio Electric Security Plan

In January 2013, the PUCO upheld its August 2012 order, including implementation of retail stability rider (RSR). The PUCO issued a regulatory order in August 2012 adopting OPCO's modified new electric security plan (ESP) through May 2015. The ESP allowed the continuation of the fuel adjustment clause, adopted a 12% earnings threshold for significantly excessive earnings test (SEET), and established a nonbypassable distribution investment rider (DIR) with certain caps. The DIR is capped at \$366 million through May 2015. As part of the ESP decision, the PUCO ordered OPCO to conduct an initial energy-only auction for 60% of the standard service offer (SSO) load with delivery beginning in June 2014 through May 2015.

### Ohio Customer Choice

Retail competition was introduced in Ohio as part of the market restructuring. About 51% of its retail load had switched as of December 2012, representing approximately \$235 million in gross margin from the loss of retail customers under the Ohio Customer Choice program. However, the financial impact was muted, as the lost margins are partially recoverable by collection of capacity revenue, off-system sales, deferral of unrecovered capacity, and RSR.



**Securitization of Regulatory Assets in West Virginia and Ohio**

West Virginia passed securitization legislation in March 2012 allowing the West Virginia Public Service Commission (WVPS) to establish framework to securitize certain deferred expanded net energy charge (ENEC) balances and other ENEC-related assets. AEP's West Virginia subsidiaries have approximately \$470 million in ENEC deferred balances. Intervenors recommended securitization of \$370 million in January 2013, and company management is in settlement discussions with intervenors. The company's Ohio-based utility filed with the PUCO in August 2012 to approve a deferred asset recovery rider balance of about \$287 million. Securitization of these assets will improve consolidated cash flows.

## Organizational Structure

### Organizational Structure — American Electric Power Co., Inc. (\$ Mil., As of Dec. 31, 2012)

American Electric Power, Inc. IDR: BBB																																																																																																																																																																																																																	
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<table border="1"> <thead> <tr> <th colspan="3">Appalachian Power Co. IDR: BBB-</th> <th colspan="3">Ohio Power Co. IDR: BBB</th> <th colspan="3">AEP Texas Central Co. 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IDR – Issuer Default Rating. NR – Not rated. Note: Issuances in italics are securitization bonds not included in Fitch's analysis.

Source: Company filings, Bloomberg, and Fitch.

## Definitions

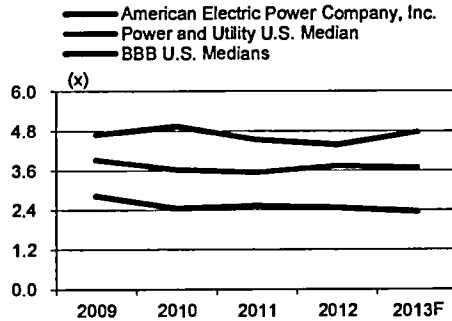
- **Leverage:** Gross debt plus lease adjustment minus equity credit for hybrid instruments plus preferred stock divided by FFO plus gross interest paid plus preferred dividends plus rental expense.
- **Interest Coverage:** FFO plus gross interest paid plus preferred dividends divided by gross interest paid plus preferred dividends.
- **FFO/Debt:** FFO divided by gross debt plus lease adjustment minus equity credit for hybrid instruments plus preferred stock.

Fitch's expectations are based on the agency's internally produced, conservative rating case forecasts. They do not represent the forecasts of rated issuers individually or in aggregate. Key Fitch forecasts assumptions include:

- Adjusted retail revenues 3%.
- Increased interest rate on new borrowings by 50 bps over the management assumption.
- Debt funded equity infusion in APCO and KPCO.
- \$100 million in annual DRIP contributions was assumed.

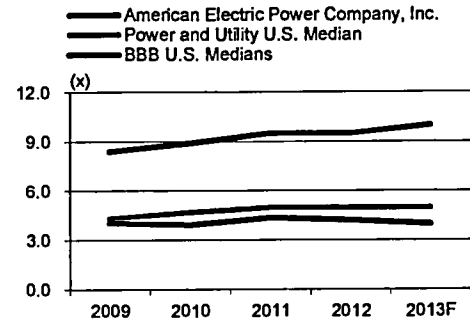
## Key Metrics

### Leverage: Total Adjusted Debt/Op. EBITDAR



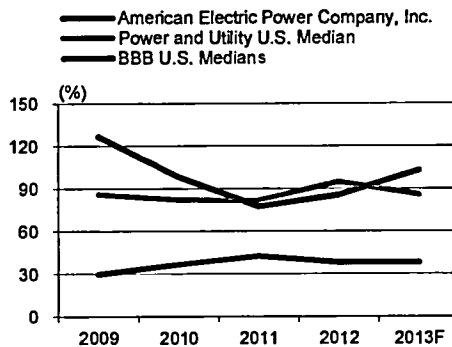
F – Forecast  
Source: Company reports, Fitch.

### Interest Coverage: Op EBITDA/ Gross Interest Expense



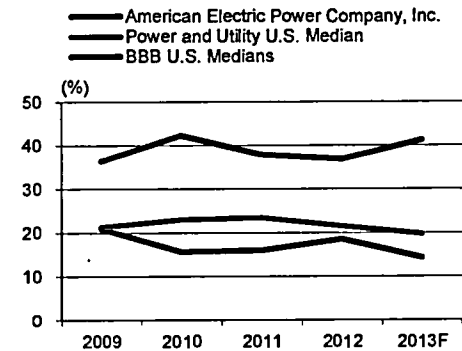
F – Forecast  
Source: Company reports, Fitch.

### Capex/CFO



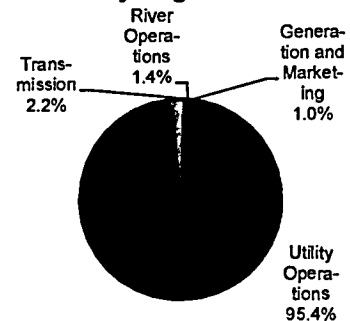
F – Forecast  
Source: Company reports, Fitch.

### FFO/Debt



F – Forecast  
Source: Company reports, Fitch.

### 2012 EBIT by Segment



Source: Company data, Fitch.

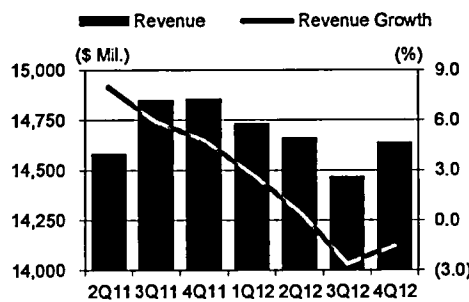
## Company Profile

AEP is one of the largest investor-owned electric utility holding companies in the U.S. Its electric utility operating subsidiaries provide electricity generation, transmission, and distribution services to more than five million customers in Arkansas, Indiana, Kentucky, Louisiana, Michigan, Ohio, Oklahoma, Tennessee, Texas, Virginia, and West Virginia. The company owns and operates about 37,600 MW of generating capacity. The company also owns and operates a commodity transportation business with about 18 million tons of annual capacity.

AEP acquired BlueStar Energy Holdings, Inc. and its retail electricity supply business, BlueStar Energy Solutions, for \$70 million in March 2012. The company operates as AEP Energy providing electricity to retail customers in Ohio, Illinois, and other nonregulated electricity retail markets.

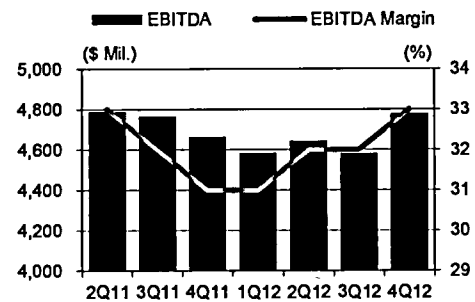
## Business Trends

### Revenue Dynamics



Source: Company reports, Fitch.

### EBITDA Dynamics



Source: Company reports, Fitch.

## Pension Analysis

### Pension Analysis

(%)	2012	2011
PBO (Under)/Over Funded Status (\$ Mil.)	(509)	(686)
Pension Funded Analysis	90.22	86.22
Estimated Pension Outflows/(FFO+Pension Contribution)	3.94	4.80

Source: Company reports, Fitch analysis.

## Financial Summary — American Electric Power Company, Inc.

(\$ Mil., Fiscal Years Ended Dec. 31)	2008	2009	2010	2011	2012
<b>Fundamental Ratios (x)</b>					
FFO/Interest Expense	3.47	4.58	3.76	3.89	4.16
CFO/Interest Expense	3.17	3.06	3.20	4.33	4.12
FFO/Debt (%)	14.13	21.00	15.73	16.05	18.57
Operating EBIT/Interest Expense	2.35	2.57	2.44	2.80	2.68
Operating EBITDA/Interest Expense	3.76	4.06	3.94	4.36	4.23
Operating EBITDAR/(Interest Expense + Rent)	2.82	3.07	3.01	3.30	3.24
Debt/Operating EBITDA	4.64	4.21	4.45	4.12	4.02
Common Dividend Payout (%)	47.83	55.86	68.04	46.26	72.76
Internal Cash/Capital Expenditures (%)	45.80	55.19	71.07	102.03	88.16
Capital Expenditures/Depreciation (%)	249.35	175.46	145.38	165.99	172.96
<b>Profitability</b>					
Adjusted Revenues	14,193	13,238	14,173	14,858	14,638
Net Revenues	8,438	8,707	9,144	9,246	9,358
Operating and Maintenance Expense	3,925	3,825	4,274	4,104	4,077
Operating EBITDA	4,120	4,471	4,393	4,661	4,777
Depreciation and Amortization Expense	1,542	1,638	1,666	1,667	1,749
Operating EBIT	2,578	2,833	2,727	2,994	3,028
Gross Interest Expense	1,095	1,102	1,116	1,069	1,129
Net Income for Common	1,380	1,357	1,211	1,941	1,259
Operating and Maintenance Expense % of Net Revenues	46.52	43.93	46.74	44.39	43.57
Operating EBIT % of Net Revenues	30.55	32.54	29.82	32.38	32.36
<b>Cash Flow</b>					
Cash Flow from Operations	2,372	2,265	2,456	3,559	3,522
Change in Working Capital	(330)	(1,686)	(620)	473	(49)
Funds From Operations	2,702	3,951	3,076	3,086	3,571
Dividends	(666)	(761)	(827)	(900)	(916)
Capital Expenditures	(3,845)	(2,874)	(2,422)	(2,767)	(3,025)
FCF	(2,139)	(1,370)	(793)	(108)	(419)
Net Other Investment Cash Flow	155	20	11	156	(114)
Net Change in Debt	2,169	(442)	402	(104)	473
Net Equity Proceeds	159	1,728	93	28	83
<b>Capital Structure</b>					
Short-Term Debt	1,976	126	1,346	1,650	981
Long-Term Debt	17,151	18,683	18,212	17,572	18,244
<b>Total Debt</b>	<b>19,127</b>	<b>18,809</b>	<b>19,558</b>	<b>19,222</b>	<b>19,225</b>
Total Hybrid Equity and Minority Interest	31	31	30	1	—
Common Equity	10,693	13,140	13,622	14,664	15,237
<b>Total Capital</b>	<b>29,851</b>	<b>31,980</b>	<b>33,210</b>	<b>33,887</b>	<b>34,462</b>
Total Debt/Total Capital (%)	64.08	58.82	58.89	56.72	55.79
Total Hybrid Equity and Minority Interest/Total Capital (%)	0.10	0.10	0.09	—	—
Common Equity/Total Capital (%)	35.82	41.09	41.02	43.27	44.21

Source: Company reports, Fitch analysis.

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

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# MOODY'S INVESTORS SERVICE

## Credit Opinion: American Electric Power Company, Inc.

Global Credit Research - 29 Jun 2011

Columbus, Ohio, United States

### Ratings

Category	Moody's Rating
Outlook	Stable
Sr Unsec Bank Credit Facility	Baa2
Senior Unsecured	Baa2
Jr Subordinate	Baa3
Commercial Paper	P-2
<b>AEP Capital Trust I</b>	
Outlook	Stable
Pref. Shelf	(P)Baa3
<b>AEP Capital Trust II</b>	
Outlook	Stable
Pref. Shelf	(P)Baa3
<b>AEP Capital Trust III</b>	
Outlook	Stable
Pref. Shelf	(P)Baa3
<b>Appalachian Power Company</b>	
Outlook	Stable
Issuer Rating	Baa2
Senior Unsecured	Baa2
Pref. Stock	Ba1

### Contacts

Analyst	Phone
William Hunter/New York	212.553.1761
William L. Hess/New York	212.553.3837

### Key Indicators

[1] American Electric Power Company, Inc.

	LTM 3/31/2011	2010	2009	2008
(CFO Pre-W/C + Interest) / Interest Expense	4.1x	3.9x	4.0x	3.4x
(CFO Pre-W/C) / Debt	18%	17%	18%	13%
(CFO Pre-W/C - Dividends) / Debt	14%	13%	14%	10%
Debt / Book Capitalization	50%	50%	53%	58%

[1] All ratios calculated in accordance with the Global Regulated Electric Utilities Rating Methodology using Moody's standard adjustments.

Note: For definitions of Moody's most common ratio terms please see the accompanying [User's Guide](#).

### Opinion

#### Rating Drivers

Holding company for primarily rate-regulated utilities operating in diversified regulatory environments that provide a strong foundation to investment grade credit rating

Near-term liquidity profile appears adequate

Recent improvement to financials appear to be stabilized with mid-to high teens range cash flow metrics

Material exposure to coal-fired generation requires some repositioning of generation fleet

Ohio still a net credit positive with market restructuring in its second decade

## Corporate Profile

American Electric Power Company, Inc. (AEP, Baa2 senior unsecured / stable outlook) is a large electric utility holding company with rate-regulated utilities operating in 11 states. AEP owns approximately 37,000 MW of generating assets, primarily coal fired. AEP is headquartered in Columbus, Ohio.

## Recent Developments

On March 3, 2011, Moody's changed the rating outlook for CSPCo to negative from stable due to the proposed merger with its affiliate, Ohio Power, as combined metrics are more consistent with Ohio Power's ratings category of Baa1. In terms of timing of any ratings action, Moody's would expect to move CSPCo to a review for possible downgrade once the proposed transaction's procedural schedule is established and testimony is filed, and for any downgrade to occur once the necessary merger approvals are attained. We currently expect the merger to be completed by year-end 2011. On June 9, 2011, AEP announced an initial plan to comply with proposed clean air regulations by (i) reducing coal-fired capacity by 7,000 MW, with 6,000 MW of retirements and 1,000 MW of refueling to natural gas, (ii) building 1,200 MW of new natural gas capacity and (iii) installing emissions reduction equipment on 10,000 MW of coal-fired plants (all numbers are approximate). The cost would be \$6-8 billion over the remainder of the decade, and AEP is advocating a delayed implementation of regulation, citing the impact on jobs. Moody's expects the plan will be subject to continued negotiation with rate-makers and politicians, but in our opinion, the costs of environmental compliance will largely be recoverable in rates in regulated jurisdictions.

## SUMMARY RATING RATIONALE

AEP's Baa2 senior unsecured rating considers the diversity associated with owning and operating nine rate-regulated electric utilities across 11 states. The rating also considers the consolidated financial profile of AEP, which does not maintain a material amount of parent holding company debt, a credit positive. Over the past two years, AEP's consolidated financial metrics support the Baa2 rating, with the ratio of cash flow from operations adjusted for changes in working capital (CFO pre-w/c) to debt averaging roughly 17% and debt to capitalization near 51%. The Baa2 rating also considers the increasing challenges associated with managing a large fleet of coal-fired generation assets (whose operating costs are expected to rise) and service territories experiencing sluggish recoveries from the 2008/2009 recession.

## DETAILED RATING CONSIDERATIONS

### - DIVERSITY OF RATE REGULATED CASH FLOWS

AEP's businesses and assets are well diversified, although they are concentrated within the electric utility sector. AEP's utility subsidiaries are located in 11 different states, and are therefore regulated by 11 different regulatory authorities (the largest ranked by rate base being Texas, West Virginia, Virginia, Indiana and Ohio). These jurisdictions translate into good diversity in revenues (by state and operating utility), cash flows, assets, debt outstanding, customers and generation capacity. From a credit perspective, Moody's views AEP's size and diversity as a meaningful credit strength, providing the parent company a degree of insulation from any unexpected adverse event or other negative development occurring at one of its companies or with one of its state service territories.

### - GENERALLY SUPPORTIVE REGULATORY JURISDICTIONS

AEP is exposed to 11 different state regulatory commissions that Moody's generally views favorably due to reasonably transparent rulemaking procedures and good suite of recovery mechanisms. We observe that most of these commissions are appointed (Louisiana and Oklahoma are elected); that a majority of the states did not pursue a legislatively mandated form of deregulation (with the exception of Ohio, Texas, Virginia and Michigan - although the two latter states have more recently pursued re-regulation), that fuel / purchased power costs trackers are allowed in some fashion in all states (except for Ohio, which is subject to a rate cap with a deferral mechanism) and that most have approval authorities over securities issuances and M&A change of control (except Michigan). As a portfolio, these regulatory commissions are viewed as maintaining a relatively constructive relationship with the utilities they regulate and are considered a benefit to AEP's over-all business and risk profile.

### - MAINTAINING FINANCIAL PROFILE KEY TO MAINTAINING RATINGS

The vast majority of AEP's revenues, earnings, cash flows and assets are related to its numerous rate-regulated electric utility subsidiaries, which we view, in general, as having a relatively low over-all business and operating risk profile. We would be concerned if AEP finds it increasingly difficult to maintain its consolidated CFO pre-w/c to debt credit metrics at a level that remains comfortably within the mid-teens range. For years ended 2010 and 2009, AEP reported a ratio of CFO pre-w/c to debt of roughly 17%, up from the approximate 14% range produced in 2008 and 2007.

Prospectively, we expect AEP to continue to exhibit stability in its financial profile, despite still lingering recessionary pressures being experienced in many of its service territories and rising costs associated with its generation fleet. We incorporate a view that AEP will continue to produce a ratio of CFO pre-w/c to debt near 17% (15% excluding the impact of bonus depreciation) over the near to intermediate term horizon.

### - LARGE CAPITAL EXPENDITURE PROGRAM

Over the next few years, AEP is expecting to invest approximately \$10 billion into its infrastructure, including sizeable investments in transmission and environmental compliance. We view investments in regulated rate-base positively for the credit profile, and we incorporate a view that most regulators will provide meaningful and timely recovery for prudently incurred investments. Nevertheless, we remain cautious as to the scale and scope of capital expenditure plans of this size, due to the negative free cash flow that will be incurred over the next few years and the potential regulatory overhang associated with the ultimate impact on end-use customer rates. In our opinion, utilities that are embarking on a capital investment program of this size should also be redoubling their efforts to bolster their balance sheet and cash flow credit metrics, in an effort to create enough financial strength to weather potentially distressful environments related to uncertain economic conditions, volatility in commodity markets, regulatory changes or any other unanticipated developments.

### - COAL GENERATING ASSETS REPRESENT SIGNIFICANTLY LONGER-TERM VULNERABILITY

We believe the likelihood for incremental environmental legislation and increasingly stringent mandates as representing a material risk affecting AEP's coal-fired generating assets and overall corporate strategy. However, Moody's incorporates a view that the timing of compliance



requirements with any new laws or proposals will be incurred over many years and that the costs associated with any new legislation regarding emissions will generally be recovered through rates (either through existing fuel clause pass-through mechanisms or other incremental rate riders). As a result, recent EPA rules and proposals are not viewed as a material credit negative over the near-term horizon. Nonetheless, eventual plant closures will require replacement capacity and/or additional transmission capacity for imported power.

#### **- OHIO REGULATORY ENVIRONMENT A NET CREDIT POSITIVE**

Ohio is both a unique state from a regulatory perspective and very important to AEP. The state pursued deregulation to a point and permitted some stranded cost recovery, but also allowed utilities to remain vertically integrated and pursued a form of quasi regulation via an ongoing requirement for Electric Security Plan (ESPs, which can vary considerably from utility to utility). Although AEP's (distribution-only) rate base in Ohio is its fifth largest at approximately \$1.9 billion, the combined assets of its Ohio operating companies, at over \$13 billion, are the largest within the AEP system.

Despite the continuing uncertainty associated with a decade old restructuring Initiative, we continue to view the Ohio regulatory environment as a relatively supportive and transparent jurisdiction. The PUCO provides a good suite of recovery mechanisms and flexible, company-specific restructuring frameworks for the utilities in the state, a credit positive. We consider Ohio to be a quasi-regulated environment, similar to Texas, but we note that the Ohio model is untested with respect to plant abandonments. We do not view the current round of market restructuring as a credit negative due to our view that the matter will be resolved, at a minimum, in a credit neutral basis.

Our positive views of the Ohio regulatory environment are based in part on the existing regulatory framework. For example, AEP's current ESP (expiring 12/31/2011) provides near term clarity for cost and investment recovery and allows companies to maintain reasonably good cash flows and financial profiles, in our opinion. Ohio provides fuel pass-through mechanisms, which specifically permit the recoverability of potential future carbon costs, a credit positive. In addition, special riders allow for recovery of other costs and investments such as transmission costs, future carrying cost of environmental investments incurred from 2001 through 2008, gridSmart programs and provider-of-last-resort (POLR) expenses, although some of these costs are being re-evaluated by the PUCO due to an Ohio Supreme Court remand.

#### **Liquidity**

AEP's liquidity is good. As of March 31, 2011, AEP had syndicated credit facilities totaling \$2.954 billion, expiring in April 2012 and June 2013. These facilities contain an adjusted debt to capitalization limit of 67.5%, and AEP reports that it remains in compliance, with an adjusted ratio of 53% at March 31, 2011. There is a combined \$1.35 billion of letter of credit sub-limits under the facilities, a \$500 million accordion feature for each facility (for a total accordion of \$1.0 billion). There are no material adverse change or material litigation restrictions on drawings. Default provisions exclude payment defaults and insolvency/bankruptcy of subsidiaries that are not significant subsidiaries per the SEC definition (AEP Texas Central is also effectively excluded as a significant subsidiary due to a definitional adjustment).

For year 2010, AEP generated approximately \$3.2 billion in Moody's-adjusted cash from operations, made approximately \$2.5 billion in capital investments and paid roughly \$824 million in dividends, resulting in roughly \$220 million of negative free cash flow.

Including securitization bonds, AEP has approximately \$600 million of long-term debt due in 2011, \$630 million due in 2012 and \$1.9 billion due in 2013. Over the next two years, we estimate that AEP will spend approximately \$2.9 billion annually in capital expenditures and approximately \$850 million in dividends annually. At March 31, 2011, AEP's credit facilities had approximately \$813 million utilized in support of commercial paper outstanding and \$125 million of LCs posted, leaving approximately \$2.1 billion of capacity available. Combined with \$625 million of cash, total liquidity amounted to roughly \$2.7 billion.

#### **Structural Considerations**

After considering the ratings for a number of AEP's utility operating subsidiaries, several of which are also rated in the Baa2 ratings category, there could be some structural subordination pressure for AEP to defend its Baa2 senior unsecured rating, at least over the longer-term horizon. However, we see good diversity and a low-risk business profile among its numerous operating utility subsidiaries, which should continue to mitigate this potential issue. A downgrade of Columbus Southern Power would not be considered as material enough to change our views regarding AEP's Baa2 rating at this time. Nevertheless, rating upgrades at certain other subsidiaries, including Appalachian Power and Indiana-Michigan Power (both rated Baa2 senior unsecured) would materially benefit the credit positioning of AEP.

#### **Rating Outlook**

The stable rating outlook reflects the good credit profiles of AEP's diverse portfolio of electric utility operating subsidiaries. We believe AEP will continue to demonstrate a reasonably conservative approach towards its financial policies, leading to continued improvements in its cash flow generation in relation to debt. A stronger balance sheet is viewed as a material credit positive for AEP, as it helps mitigate numerous challenges over the longer-term horizon. These challenges include managing a diverse group of service territories which are all still experiencing some severe post economic recessionary pressures, along with a sizeable coal-fired generating fleet (including one plant in advanced stages of construction) and a single nuclear generating plant.

#### **What Could Change the Rating - Up**

Ratings upgrades appear unlikely over the near term, primarily due to the rating positions of AEP's numerous subsidiary operating utilities. While the diversification of these numerous subsidiaries benefits the over-all credit profile, we observe that a majority of the utility subsidiaries appear to be well positioned within the Baa1 and Baa2 rating categories. Nevertheless, if AEP were successful in producing a stronger set of key financial credit metrics, including a ratio of CFO pre-w/c to debt near 20% on a sustainable basis, ratings could be upgraded. The recent performance of achieving almost 18 % in 2009 and 17% in 2010 (15% after adjusting for bonus depreciation) has been noted.

#### **What Could Change the Rating - Down**

AEP's ratings could be downgraded based on the structural subordination risks associated with the ratings of its subsidiaries, particularly its larger subsidiaries in Virginia and Ohio. In addition, the ratings could be downgraded if AEP were to produce financial metrics that appear too weak for its existing rating category, including a ratio of CFO pre-w/c to debt in the low teens range. The ratings could also be downgraded if AEP were to experience material set-backs with its various regulatory proceedings, or if a more contentious regulatory / political relationship materialized or if its capital investment program were financed aggressively with debt, which in turn would likely impact its consolidated cash flow generation financial metrics.

**Rating Factors**

**American Electric Power Company, Inc.**

Regulated Electric and Gas Utilities Industry [1][2]	Current 12/31/2010		Moody's 12-18 month Forward View* As of June 2011	
	Measure	Score	Measure	Score
<b>Factor 1: Regulatory Framework (25%)</b>				
a) Regulatory Framework		Baa		Baa
<b>Factor 2: Ability To Recover Costs And Earn Returns (25%)</b>				
a) Ability To Recover Costs And Earn Returns		Baa		Baa
<b>Factor 3: Diversification (10%)</b>				
a) Market Position (5%)		A		A
b) Generation and Fuel Diversity (5%)		B		B
<b>Factor 4: Financial Strength, Liquidity And Key Financial Metrics (40%)</b>				
a) Liquidity (10%)		Baa		Baa
b) CFO pre-WC + Interest/ Interest (3 Year Avg) (7.5%)	3.8x	Baa	3.0 - 4.0x	Baa
c) CFO pre-WC / Debt (3 Year Avg) (7.5%)	16.1%	Baa	14 - 18%	Baa
d) CFO pre-WC - Dividends / Debt (3 Year Avg) (7.5%)	12.6%	Baa	10 - 13%	Baa
e) Debt/Capitalization (3 Year Avg) (7.5%)	53.6%	Baa	45 - 50%	Baa
<b>Rating:</b>				
a) Indicated Rating from Grid		Baa2		Baa2
b) Actual Rating Assigned		Baa2		Baa2

\* THIS REPRESENTS MOODY'S FORWARD VIEW; NOT THE VIEW OF THE ISSUER; AND UNLESS NOTED IN THE TEXT DOES NOT INCORPORATE SIGNIFICANT ACQUISITIONS OR DIVESTITURES

[1] All ratios are calculated using Moody's Standard Adjustments. [2] As of 12/31/2010(L); Source: Moody's Financial Metrics



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Utilities, Power, and Gas  
U.S. and Canada  
Full Rating Report

## American Electric Power Co., Inc.

### Ratings

Security Class	Current Rating
IDR	BBB
Senior Unsecured Debt	BBB
Junior Subordinated Debentures	BB+
Short-Term IDR/Commercial Paper	F2

IDR – Issuer default rating.

### Rating Outlook

Stable

### Financial Data

American Electric Power Co. (\$ Mil.)	12/31/10	12/31/09
Revenues	14,427	13,489
Gross Margin	9,151	8,714
Funds from Operations	2,881	3,550
Operating EBITDA	4,131	4,198
Total Debt	16,868	16,214
Total Capitalization	30,551	29,415
Capex/Depreciation (%)	157.1	191.2

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### Related Research

#### Applicable Criteria

- *Corporate Rating Methodology, Aug. 16, 2010*
- *Parent and Subsidiary Rating Linkage, July 14, 2010*
- *Utilities Sector Notching and Recovery Ratings, March 16, 2010*
- *U.S. Power and Gas Comparative Operating Risk (COR) Evaluation and Financial Guidelines, Aug. 22, 2007*
- *Credit Rating Guidelines for Regulated Utility Companies, July 31, 2007*

### Rating Rationale

- **Rating Affirmation:** Fitch affirmed the ratings of American Electric Power Co., Inc. (AEP) on Feb. 28, 2011.
- **Stable Credit Profile:** AEP's ratings are supported by regulatory and geographic diversification via ownership of nine rated electric utility subsidiaries. Additionally, the company has generally balanced regulatory environments, a solid competitive position with a fleet of low-cost coal-fired assets, and a relatively low-risk strategy of investing in transmission assets.
- **Consistent Credit Metrics:** Consolidated credit metrics are consistent with Fitch's 'BBB' issuer default rating (IDR) guidelines. AEP's recent financial performance has been bolstered by base rate increases in Kentucky and West Virginia, favorable weather across the company's service territories, effective cost-control measures, and continued improvement in the economy, particularly in the industrial sector. AEP's ratios of EBITDA to interest and funds from operations to interest were 4.4x and 4.30x, respectively, for the year ended Dec. 31, 2010. Consolidated leverage, as measured by the ratio of debt to EBITDA, was 4.1x for the same time period. AEP has modest levels of parent debt.
- Fitch forecasts AEP's consolidated credit metrics will remain at or near current levels through 2014. This analysis takes into account previously received and planned rate increases, normalized weather, and continued economic recovery.
- **Credit Concerns:** Fitch is primarily concerned about AEP's exposure to emissions regulations and legislation, given the company's large coal-fired generation fleet. Additional concerns include regulatory uncertainty in Ohio regarding the pending electric security plan (ESP) filing at AEP Ohio (Columbus Southern Power [CSP], IDR 'BBB+'/Stable and Ohio Power Co. [OPC], IDR 'BBB'/'Positive) and increased customer switching in CSP's commercial sector. Additional concerns include ongoing permitting litigation and merchant price risk issues surrounding Southwestern Electric Power Co.'s (SWEPCO, IDR 'BBB'/'Stable) Turk coal plant construction project. The uncertainty related to the termination of the AEP East power pool is of additional concern.
- **Environmental Legislation:** Fitch notes that Ohio Senate Bill 221, which was enacted in May 2008, specifically provides Ohio electric utilities with the ability to recover carbon-related environmental costs, which reduces exposure to carbon in this state. However, several AEP jurisdictions, including Arkansas, Louisiana, and Oklahoma, have no automatic environmental cost recovery clause or law in place.

### Key Ratings Drivers

- Diversity of regulatory jurisdictions.
- Conservative utility management strategy.
- Low parent-level debt.
- Consolidated credit metrics consistent with 'BBB' guidelines.
- Issues at the Turk coal plant.

- Exposure to emissions regulations and legislation.
- ESP filing in Ohio.
- Uncertainty surrounding termination of AEP East power pool.

## Recent Developments

### Turk Litigation

AEP is in the midst of ongoing litigation related to Turk's air and water permits. Fitch is mostly concerned about the wetlands permit. The Sierra Club, the Audubon Society, and other parties have filed complaints with the Federal District Court, the U.S. Army Corps of Engineers, and the U.S. Department of the Interior, among others, and received a temporary restraining order and preliminary court injunction to stop the construction of Turk. The 8th Circuit Court issued a temporary injunction against Turk, which was lifted and then reinstated in December 2010. The complaints are specifically directed toward the water intake and river crossing associated with the transmission lines.

SWEPCO is reviewing alternatives to assuage these complaints and lift the injunction. On March 30, 2011, SWEPCO and the city of Hope, AR, signed a short-term agreement to provide start-up water during the construction of Turk. This agreement does not violate the federal court's preliminary injunction mentioned above. However, by drawing water from the Hope facility, SWEPCO can maintain its current construction schedule. The agreement expires on Dec. 31, 2012, and the water supplied will allow the plant to perform start-up and testing activities but will not support full operations once the unit is completed. (Please refer to the full rating report on SWEPCO, dated April 27, 2011, for further details on Turk.)

### Electric Security Plan in Ohio

On Jan. 27, 2011, AEP Ohio filed a petition with the Public Utilities Commission of Ohio (PUCO) to establish a new ESP for the period of Jan. 1, 2012–May 31, 2014. In addition, the companies filed a \$93.8 million joint distribution rate case in February of this year. The PUCO is expected to rule on the ESP and distribution case no later than the fourth quarter of this year.

An additional issue that has recently arisen in Ohio is the increased customer switching in CSP's southern commercial jurisdiction. This amount was, in total, about 3% in 2010 and is expected to grow to 17% in 2011. This equates to approximately 6% of AEP Ohio's total load and 1.5% of total AEP load. However, the higher shopping levels, coupled with the three-year ESP plans, could place pressure on the operating efficiencies of the Ohio utilities over the longer term.

### AEP East Power Pool

On Jan. 4, 2011, Appalachian Power Co. (APCo) made a filing with the Virginia State Corporation Commission (VSCC) that detailed the AEP East pool members' (Appalachian Power CO. [APCo], IDR 'BBB-'/Stable; Indiana Michigan Power Co. [I&M], IDR 'BBB-'/Stable; Kentucky Power Co. [KPC], IDR 'BBB-'/Stable; CSP; and OPC) intent to terminate the interconnection agreement. The pool members now have a three-year time frame in which to work out a settlement and new arrangement. The decision to evaluate the pool was initially raised by regulatory concerns, particularly from Virginia, that the current pool arrangement resulted in a lack of transparency. At this time, Fitch believes it is unlikely the new arrangements to replace the current pool will have material credit rating impacts. Fitch will continue to monitor developments.

**Bonus Depreciation**

AEP expects to generate about \$1.1 billion of cash through accelerated depreciation during the 2011–2013 period. Management has not specified how it intends to use the cash but has indicated it is reviewing several options, including reducing parent-level debt and/or funding pension expense and a lawsuit settlement. Fitch recognizes the temporary nature of bonus depreciation cash flows and normalizes cash flows for bonus depreciation tax deferrals in its analysis.

**Transmission Update**

AEP continues to view transmission investments as significant growth opportunities both within and outside of the company's traditional service territories. Currently, the strategy is based on three major platforms: Electric Transmission Texas (ETT), AEP Transmission Co. (AEP Transco), and several joint-venture projects. In Fitch's view, the transmission projects are positive to the credit profile of AEP because of the low-risk nature of the business and the above-average Federal Energy Regulatory Commission (FERC) incentive ROEs.

**ETT**

ETT is a joint-venture company with MidAmerican Energy Holdings Co. (MEHC, IDR 'BBB+' /Stable) that was established to fund, own, and operate electric transmission assets in the Electricity Reliability Council of Texas (ERCOT). ETT's current rate base is \$412 million. This is expected to grow as follows: \$473 million in 2011, \$778 million in 2012, and \$1.35 billion in 2013, when the first Competitive Renewable Energy Zone (CREZ) projects come online.

ETT's assigned CREZ projects are estimated to cost a total of approximately \$1.1 billion, including seven double-circuit 345-kV transmission lines (around \$750 million), eight major 345-kV stations, and several series compensation installations (about \$350 million). The Public Utilities Commission of Texas certificate of convenience and necessity (CCN) proceedings are currently underway. ETT received CCN approval on three CREZ lines, and one more is expected during the first half of 2011. There are additional projects in the pipeline of approximately \$1.6 billion, with around 822 miles of lines and 28 substations with in-service dates through 2017.

**AEP Transco**

In September 2010, AEP Transco filed a formula rate settlement with the FERC, requesting an ROE of 11.49% in the Pennsylvania New Jersey Maryland Interconnection (PJM) and 11.2% in the Southwest Power Pool. AEP Transco's application for public utility status was approved by the PUCO in December 2010. No filings were required in Oklahoma and Michigan. Additional AEP Transco applications are on file in West Virginia, Indiana, and Kentucky. Currently, the company has \$50 million invested in the three states with baseline capital spending targets of \$160 million in 2011 and \$350 million in 2012.

Major projects identified include a substation in Ohio (at a cost of \$250 million) and line extensions in the other states. The company will pursue regulatory approvals in other states in 2011, including Arkansas, Louisiana, West Virginia, Virginia, Indiana, and Kentucky. Fitch expects capital spending will increase commensurately in these states for 2012 and beyond as these approvals are received.

## Joint Ventures

### Transmission Joint Ventures

Project Name	Partners	Route	Total Cost	AEP Share	Estimated Completion Date	FERC Incentives	Update
Potomac-Appalachian Transmission Highline (PATH)	Allegheny Energy, Inc. ('BBB-' / Stable)	275 miles from WV to MD	\$2.1 billion	\$700 million	June 2015	Cash return on CWIP; 14.3% ROE; recovery of all prudent costs incurred prior to development; recovery of abandonment costs.	Applications have been withdrawn for PATH following PJM announcement that the project had been suspended.
Prairie Wind Transmission (PWT)	MEHC, Westar Energy, Inc.	110 miles in KS	\$225 million	\$56 million	2013-2014	Cash return on CWIP; 12.8% ROE; recovery of all prudent costs incurred prior to construction; recovery of abandonment costs.	Project was approved as an SPP Priority Project in April 2010. Siting permit application filed in February 2011.
Pioneer Transmission	Duke AEP, Electric Transmission America, Exelon Corp.	Up to 240 miles in IN 420 miles in IL, OH, and IN	Up to \$1 billion	Up to \$500 million	2016 (Est.)	Cash return on CWIP; 12.54% ROE; recovery of all prudent costs incurred prior to construction; recovery of abandonment costs.	MISO has included Pioneer in its proposed Extra High Voltage plan. Project is still waiting to receive MISO and PJM approval.
RITELine Project			\$1.6 billion	\$327 million	2018	Parties plan to file with the FERC in first-half 2011.	MOU executed in October 2010.

AEP – American Electric Power Co., Inc. FERC – Federal Energy Regulatory Commission. CWIP – Construction work in progress. MEHC – MidAmerican Energy Holdings Co. SPP – Southwest Power Pool. MISO – Midwest Independent System Operator. MOU – Memorandum of understanding. Source: Company reports.

### New Projects

#### RITELine Project

AEP, MEHC, and Exelon Corp. executed a memorandum of understanding (MOU) in October 2010 for the development of the Reliability Interregional Transmission Extension Line (RITELine) project. The proposed 765-kV transmission line extends approximately 420 miles between Illinois and Indiana. The total project cost is currently estimated to be \$1.6 billion.

AEP and MidAmerican Energy Co. (MEC, a subsidiary of MEHC) executed an MOU in October 2010 for the development of a new MEC project, a proposed 765-kV line that extends approximately 180 miles between Iowa and Illinois. The estimated project cost is currently \$650 million.

### Liquidity and Debt Structure

AEP has a sufficient short-term liquidity position, with approximately \$2.5 billion of net available liquidity as of Dec. 31, 2010, including \$294 million of cash on hand. The company has credit facilities totaling \$3.4 billion, of which two \$1.5 billion credit facilities support its commercial paper program. The revolving credit agreements contain a covenant that requires AEP to maintain a debt to total capitalization at or below 67.5% and expire in April 2012 and June 2013. In March 2011, AEP extinguished

## AEP Debt Structure

(\$ Mil., as of Dec. 31, 2010)

	Amount	% of Total
Short-Term Debt	1,346	4.4
Long-Term Debt	15,522	50.8
<b>Total Debt</b>	<b>16,868</b>	<b>55.2</b>
Preferred Stock	61	0.2
Common Equity	13,622	44.6
<b>Total Capitalization</b>	<b>30,551</b>	<b>100.0</b>

Source: Company reports.

its \$478 million credit facility supporting its variable-rate demand notes.

Consolidated debt maturities over the next several years are considered manageable and are as follows: \$616 million in 2011, \$540 million in 2012, and \$1.3 billion in 2013. The next parent-only maturity is in 2015, when \$243 million of senior notes becomes due. Fitch expects maturing debt to

be funded through a mix of internal cash generation and external refinancings.

AEP's 2011 capital-spending budget is approximately \$2.6 billion, with \$2.9 billion projected in 2012. Major projects and investments include transmission projects and environmental compliance. Capital-expenditure financing is anticipated to be met through a combination of internally generated cash and external debt issuances.



## Financial Summary — American Electric Power Co., Inc.

(\$ Mil., Fiscal Years Ended Dec. 31)

	2010	2009	2008	2007	2006
<b>Fundamental Ratios (x)</b>					
FFO/Interest Expense	4.0	4.9	3.9	4.1	4.6
CFO/Interest Expense	3.6	3.5	3.7	3.9	4.7
FFO/Debt (%)	17.1	21.9	15.9	16.9	21.2
Operating EBIT/Interest Expense	2.8	2.9	2.7	2.8	2.9
Operating EBITDA/Interest Expense	4.4	4.6	4.2	4.7	4.9
Operating EBITDAR/(Interest Expense + Rent)	4.0	4.2	3.9	4.3	4.4
Debt/Operating EBITDA	4.1	3.9	4.4	4.0	3.5
Common Dividend Payout (%)	68.0	55.9	47.8	—	—
Internal Cash/Capital Expenditures (%)	71.9	56.5	47.1	46.1	58.9
Capital Expenditures/Depreciation (%)	157.1	191.2	279.8	254.9	251.1
<b>Profitability</b>					
Adjusted Revenues	14,180	13,245	14,201	13,141	12,500
Net Revenues	9,151	8,714	8,446	8,174	7,827
Operating and Maintenance Expense	4,274	3,825	3,925	3,867	3,639
Operating EBITDA	4,131	4,198	3,834	3,626	3,525
Depreciation and Amortization Expense	1,493	1,460	1,358	1,395	1,405
Operating EBIT	2,611	2,713	2,453	2,209	2,100
Gross Interest Expense	949	921	904	779	726
Net Income for Common	1,211	1,357	1,380	1,089	1,002
Operating and Maintenance Expense % of Net Revenues	46.7	43.9	46.5	47.3	46.5
Operating EBIT % of Net Revenues	28.5	31.1	29.0	27.0	26.8
<b>Cash Flow</b>					
Cash Flow from Operations	2,514	2,338	2,454	2,273	2,673
Change in Working Capital	(367)	(1,212)	(207)	(163)	61
Funds from Operations	2,881	3,550	2,661	2,436	2,612
Dividends	(827)	(761)	(666)	(633)	(594)
Capital Expenditures	(2,345)	(2,792)	(3,800)	(3,556)	(3,528)
Free Cash Flow	(658)	(1,215)	(2,012)	(1,916)	(1,449)
Net Other Investment Cash Flow	(119)	(24)	40	(202)	(122)
Net Change in Debt	402	(442)	2,169	1,835	1,420
Net Equity Proceeds	93	1,728	159	144	99
<b>Capital Structure</b>					
Short-Term Debt	1,346	126	1,976	660	18
Long-Term Debt	15,522	16,088	14,786	13,741	12,309
Total Debt	16,868	16,214	16,762	14,401	12,327
Total Hybrid Equity and Minority Interest	61	61	61	61	61
Common Equity	13,622	13,140	10,693	10,079	9,412
Total Capital	30,551	29,415	27,516	24,541	21,800
Total Debt/Total Capital (%)	55.2	55.1	60.9	58.7	56.5
Total Hybrid Equity and Minority Interest/Total Capital (%)	0.2	0.2	0.2	0.2	0.3
Common Equity/Total Capital (%)	44.6	44.7	38.9	41.1	43.2

Operating EBIT — Operating income before total reported state and federal income tax expense. Operating EBITDA — Operating income before total reported state and federal income tax expense plus depreciation and amortization expense. Notes: 1. Numbers may not add due to rounding. 2. Numbers are adjusted to exclude interest, principal payments, and amortization on utility tariff bonds.

Source: Company reports and Fitch Ratings.

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# MOODY'S

## INVESTORS SERVICE

### Credit Opinion: American Electric Power Company, Inc.

Global Credit Research - 17 Apr 2013

Columbus, Ohio, United States

#### Ratings

Category	Moody's Rating
Outlook	Stable
Senior Unsecured	Baa2
Jr Subordinate Shelf	(P)Baa3
Commercial Paper	P-2
<b>AEP Texas North Company</b>	
Outlook	Stable
Issuer Rating	Baa2
<b>Appalachian Power Company</b>	
Outlook	Stable
Issuer Rating	Baa2
Senior Unsecured	Baa2
<b>Indiana Michigan Power Company</b>	
Outlook	Stable
Issuer Rating	Baa2
Senior Unsecured	Baa2
<b>Southwestern Electric Power Company</b>	
Outlook	Stable
Issuer Rating	Baa3
Senior Unsecured	Baa3

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#### Key Indicators

[1]American Electric Power Company, Inc.

	2012	2011	2010	2009
(CFO Pre-W/C + Interest) / Interest Expense	4.5x	4.3x	3.9x	4.0x
(CFO Pre-W/C) / Debt	19%	18%	17%	18%
(CFO Pre-W/C - Dividends) / Debt	15%	14%	13%	14%
Debt / Book Capitalization	47%	48%	50%	53%

[1] All ratios calculated in accordance with the Global Regulated Electric Utilities Rating Methodology using Moody's standard adjustments.

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

#### Opinion

#### Rating Drivers

Two significant transitions - environmental compliance and Ohio restructuring

Ohio orders provide reasonable cash flow stability in a multi-year transition

Diversity of regulatory environments and service territories provides strong foundation to investment grade credit rating

Financial metrics currently appropriate but could be pressured with a higher percentage of deregulated revenues

Near-term liquidity profile appears adequate

### **Corporate Profile**

American Electric Power Company, Inc. (AEP, Baa2 senior unsecured, stable outlook), headquartered in Columbus, Ohio, is a large electric utility holding company with rate-regulated utility subsidiaries operating in 11 states. AEP owns or leases approximately 38,000 megawatts (MW) of generating assets, primarily coal fired. The breakdown of megawatt hour (MWh) sales in 2012 was approximately 27% residential, 24% commercial, 28% industrial, 20% wholesale (with a substantial portion under cost-based long-term contracts) and 1% other .

### **SUMMARY RATING RATIONALE**

AEP's Baa2 senior unsecured rating is based on the size and diversity associated with owning and operating 10 rate-regulated electric utilities across 11 states, financial metrics that over the past several years have supported the rating, a consolidated financial profile that is balanced and includes a very moderate amount of parent holding company debt, and adequate liquidity. These positive factors are balanced against risks associated with a transition to deregulated generation in Ohio by June 2015, an expectation of higher levels of parent level debt on a transitional basis, a change in business mix that will increase the financial metrics threshold for the current rating over time, and material increases in capital expenditures to meet environmental mandates and extend the life of the Cook nuclear plant.

### **DETAILED RATING CONSIDERATIONS**

#### **OHIO COMPETITIVE GENERATION WILL DRIVE A CHANGE IN BUSINESS MIX AT THE PARENT**

Ohio's decision to move all of the state's utilities to competitive generation by the middle of the current decade will change AEP's business mix. AEP has estimated that the assets of its unregulated businesses will increase from 5% of total to about 14% after the Ohio transition is complete. We believe the range of cash flow from unregulated operations could be in the 13-18% range. While this percentage is not out of line with AEP's peers, those companies have mostly been taking steps to decrease their unregulated businesses, and the differential between the ratings of their holding company debt and the average rating of their utility operating company debt is higher than for AEP.

In 2012, AEP's separately reporting regulated subsidiaries represented 92.3% of its consolidated gross margin. The remaining 7.7% is primarily from AEP's unregulated river barge operations, its rapidly growing regulated transmission business under AEP Transmission Holding Company, LLC, its unregulated retail energy business (small but growing, especially within Ohio), and a currently very small unregulated generation portfolio that will grow with the expected transition of approximately 8,900 MW of capacity to unregulated status in 2015 .

It is our expectation that, post-transition, growth investments at AEP will be mostly in regulated businesses, and that the regulated percentage of the business mix will increase over time.

#### **CONSTRUCTIVE REGULATORY OUTCOMES IN OHIO AFTER SOME BUMPS IN 2012**

Ohio has historically been AEP's most important jurisdiction, and Ohio Power Company (OPCo, senior unsecured Baa1, stable) represented almost 30% of AEP's consolidated gross margin in 2012. Although the regulatory process included a period of uncertainty after a previously approved Electric Security Plan (ESP) for 2012 to mid-2015 was reversed, OPCo received four orders from the Public Utilities Commission of Ohio (PUCO) that should provide reasonable stability of cash flows during a transition to full competitive generation by June 2015. The new orders, some of which have been appealed to the Supreme Court of Ohio, addressed OPCo's capacity charges and fuel deferrals accrued under the prior ESP. PUCO also approved a new ESP, including cost of service for June 2012 through May 2015, that eliminated some barriers for customers to switch electric suppliers that had been a point of contention in the prior, reversed ESP. PUCO also approved OPCo's requested plan for corporate separation and the transfer of capacity to affiliates. Some of the deferrals related to these orders may be

securitized - Ohio enacted securitization legislation in December 2011.

The July 2012 capacity order set a price of about \$189 per megawatt per day (MW-day) for the capacity that OPCo maintains for customers who switch suppliers during the transition period. Competitive retail electric suppliers (CRES providers) will pay AEP the adjusted PJM auction-based rate, and the difference between what is received (from CRES providers and from a rate mechanism in the new ESP described below) and what is accrued will create a capacity deferral asset that is to be recovered in rates after June 2015 over a three year period or as determined by PUCO at the time of the related filing.

Under the new ESP, approved in August 2012, OPCo's rates for providing its portion of Standard Service will be based on a frozen non-fuel generation charge and a fuel adjustment clause reflecting actual costs. OPCo will procure an increasing percentage of Standard Service energy through a competitive bid, and Standard Service will be fully competitive (energy and capacity) by June 2015. The new ESP provides additional cash to OPCo via a Retail Stability Rider (RSR) - a charge on each MWh delivered (regardless of supplier), equal to approximately \$190 million per year. Of this charge, OPCo will apply approximately \$47 million per year towards reducing the capacity deferral. The remainder of the RSR will be transferred to AEP's new competitive generation subsidiary. As part of the new ESP, PUCO determined that corporate separation into an Ohio wires company (OPCo will retain that business) and a competitive generation company is in the public interest. Among other things, this separation is based on PUCO's understanding that plants will be transferred at book value.

We have historically viewed the Ohio regulatory environment as reasonably supportive, leading to a Factor 1 scoring in the Baa range for OPCo. Events surrounding PUCO's February 2012 revocation of a December 2011 order approving an ESP-related Stipulation Agreement had caused concerns that OPCo's regulatory framework might be heading toward less consistency and greater unpredictability, that PUCO might want to "reserve" market capacity for use in Ohio, and that communication between the utility and regulator was sub-optimal at a time when many sensitive decisions needed to be made regarding the transition to market. The orders in the second half of 2012 have alleviated many of these concerns and appear to give OPCo and AEP a reasonable transition period to market-based generation in Ohio. During the transition, it will be important to see that OPCo is continuing on its expected path of lower business and regulatory risk, since its metrics will weaken.

#### **SUBSTANTIAL RETIREMENTS AND CAPEX DUE TO ENVIRONMENTAL MANDATES AND SIZABLE LIFE CYCLE MANAGEMENT PROJECT AT NUCLEAR PLANT**

AEP retired Conesville Unit 3 (165 MW) in late 2012 and has announced retirements of 5,476 MW of coal fired generation (14% of total capacity) in 2013-2016, with the largest portion taking place at Ohio Power Company (OPCo, Baa1 senior unsecured, stable outlook, about 1,923 MW), Appalachian Power Company (APCo, Baa2 senior unsecured, stable outlook, about 1,270 MW), and Kentucky Power Company (KPCO, Baa2 senior unsecured, stable outlook, about 800 MW). The primary driver is the Mercury and Air Toxics Standard (MATS) - long-expected, with final rules announced in February 2012. AEP has announced that the plants will be retired by or during 2016, but we believe most of the retirements will occur in early 2015, unless they would cause local/regional capacity constraints.

AEP's projected total capex of \$3.6 billion in 2013 and \$3.8 billion in each of 2014 and 2015 represents a substantial increase over unadjusted capex of \$2.8 billion in 2011 and \$3.1 billion in 2012. In the near term, environmental retrofits and transmission will be the largest drivers of the increase.

AEP's February 2013 forecast for environmental capital expenditure for MATS and other expected mandates is \$4-5 billion from 2013-2020 (excluding allowance for funds used during construction, or AFUDC), a \$2-3 billion reduction from its previously published forecast, with all but about \$770 million at the regulated subsidiaries. The primary driver to the reduction in environmental capex is the recently approved modification to AEP's October 2007 Consent Decree, a document mapping out the steps AEP will take to meet federally mandated emission standards. Under the modified Consent Decree, which the U.S. District Court of the Southern District of Ohio approved in February 2013, AEP moved up the date of its emissions reductions at both its 1,300 MW Rockport units in exchange for the right to install dry sorbent injection (DSI) pollution control systems, rather than the previously approved, more costly, flue-gas desulfurization (FGD) system. Both DSI systems must be installed by April 2015, and can be used through 2025 for Unit 1 and 2028 for Unit 2. The modified Consent Decree also provides for the retirement or refueling of its 500 MW Tanners Creek Unit 4, and the retrofit, retirement, repowering, or refueling of its 800 MW Big Sandy Unit 2 (AEP plans to retire the unit). Finally, AEP agreed to cease burning coal and retire or refuel its 585 MW Muskingum Unit 5 plant. All retrofits, retirements, repowering, and refueling listed above must be completed by the end of 2015.

The largest portion of AEP's environmental capex is expected to be spent at Southwestern Electric Power Company (Baa3, stable outlook, \$1.4 - 1.8 billion) and OPCo (\$0.8 - 1.1 billion). Of the \$4-5 billion, AEP forecasts about \$ 544 million in 2013 and \$760 million in 2014, with the bulk of the remainder in 2015-2016. This schedule presumes that AEP will be successful in obtaining state-level and potentially even federal-level extensions for MATS compliance. If AEP is not successful, the schedule may be accelerated, which could stress intermediate term metrics.

The Donald C. Cook Nuclear Power Plant Life Cycle Management Project (LCM Project) was a condition to the NRC's extension of the two Cook units' licenses from 2014 and 2017, respectively, to 2034 and 2037, respectively. Current project cost estimates fall in the \$1.2 billion range excluding AFUDC, to be spent through 2018 for various required capital upgrades. The Cook plant is owned by Indiana & Michigan Power (I&M, senior unsecured Baa2, stable). In the spring of 2012, I&M filed a petition with its regulators seeking approval for the LCM Project, for which the utility had spent \$176 million as of 12/31/12. Once approved, I&M expects to recover the Indiana portion of these costs through a rider. In January 2013, the Michigan regulator approved \$850 million of costs to be deferred through 2018 (with a return on CWIP). The primary differences relative to the proposed budget were due to an approximately \$140 million net reduction in the project contingency (additional costs above the contingency would require state regulatory approval) and a determination that approximately \$180 million of 2011-2012 costs could not be included, as they were outside the six year statutory limit on approval to defer costs. Rate treatment to recover the 2011-2012 costs will be determined in a conventional rate case.

Overall, we have decreased our projections for AEP's capex over the next several years. We expect that AEP's subsidiaries will be successful in obtaining reasonably timely recovery for the capital and operating expenditures associated with environmental compliance and plant upgrades.

#### DMIVERSITY OF RATE REGULATED CASH FLOWS

AEP's electric utility operations are diversified in terms of regulatory jurisdictions (11 states) and service territory economies. The eastern utilities are a bit more than twice as large as the western utilities in terms of gross margin contribution. The largest states ranked by utility gross margin are Ohio, Indiana, Texas, Virginia, West Virginia, Indiana, and Oklahoma. These jurisdictions translate into quite good diversity in revenues (by state and operating utility), cash flows, assets and customers. From a credit perspective, we view AEP's size and diversity as meaningful credit strengths, as they provide the parent company a degree of insulation from any unexpected negative development occurring at one of its companies, with one of its state regulators or in one state's economy. During the past two years of tepid recovery from the recession in the US, AEP's western service territories, with their greater leverage to the energy economy, have registered a much stronger recovery than those in the east, which have generally been more challenged. Overall, AEP's (non-normalized) KWh sales fell 1.1% in 2012, after increasing 4.9% in 2011 and 5.3% in 2010 but falling 11.2% in 2009. Retail sales in 2012 declined across the board, with residential sales registering the steepest decline (4.3%), due to milder weather and conservation.

In light of the asset transfers and substantial planned capex, continued regulatory support will be important to AEP's rating.

#### PARENT LEVEL DEBT WILL INCREASE IN THE INTERMEDIATE TERM

OPCo's corporate separation and divestiture plan, which was approved by PUCO on 10/17/12, includes the transfer of certain units at the Amos and Mitchell coal fired plants totaling 2,400 MW to utility affiliates APCo and KPCo at net book value (approximately \$2 billion). The remainder of OPCo's generation assets will be transferred at book value (approximately \$3.1 billion of capitalization net of deferred taxes and certain items) to AEP's new unregulated subsidiary, AEP Generation Resources Inc (AGR). Initially, AGR is expected to be capitalized with a combination of about 60-65% equity and 35-40% debt that is either guaranteed by AEP or borrowed by AEP and on-lent to AGR. After these transactions, AEP on a stand-alone basis will have about \$1.1 billion of additional parent level debt. Parent debt will increase to about \$2.2 billion from \$1.1 billion at 12/31/12 and to about 10% of consolidated debt from about 5% at 12/31/12.

Debt at the parent could be higher if the transfer of the Amos and Mitchell plants were not approved, although this is not our current expectation. APCo and KPCo have made filings at their respective state commissions and at FERC requesting permission to purchase the Amos and Mitchell assets at book value. State commission hearings are scheduled for May through mid-July while FERC hearings are expected for later in the year. We expect that those hearings will include a robust discussion of whether book value is the appropriate price for the capacity that APCo and KPCo will acquire. AEP's goal is to have all necessary approvals in place in time to effectuate the asset transfers on 12/31/13. APCo and KPCo are both short of capacity and are located in coal-friendly states -

Virginia, West Virginia and Kentucky. If the assets were not transferred to APCO and KPCO, they would remain at AGR, in which case we estimate that there would be an additional \$1 billion of debt at the parent or guaranteed by the parent. Under this scenario, total parent level debt could increase to about \$3.0 billion and to about 15% of consolidated debt.

It is our understanding that the expected increase in parent debt will be an interim financing solution that will be refinanced at AGR on a stand-alone basis in the near-to-intermediate term, causing the percentage of parent to total debt to revert to around 5%. If it is indeed transitional, the increase in AEP holding company debt is not expected to have implications for downward notching of AEP debt relative to the average of its subsidiaries' ratings. However, if the parent company debt is higher than expected or it became evident that AGR debt will be financed at the parent level (or based on parent support) on a permanent or quasi-permanent basis, AEP's ratings could be pressured, especially given the increased share of unregulated generation and retail sales in its overall business mix.

#### MAINTAINING THE FINANCIAL PROFILE IS KEY TO MAINTAINING RATINGS

AEP's financial metrics in 2009 through 2012 were significantly higher than those registered in 2007-2008. The ratio of CFO Pre-WC plus interest to interest and the ratio of CFO Pre-WC to debt improved from 3.4x and 13.5%, respectively, in 2008 to 3.9x and 17.1%, respectively in 2010, 4.3x and 18.4%, respectively in 2011, and 4.5x and 19.5%, respectively for 12/31/12. Recent cash flow metrics are robust for the rating category (CFO Pre-WC to debt for a mid-Baa utility typically ranges from 16-19%), but some of this improvement can be attributed to utilization of bonus depreciation. Debt/Capitalization also decreased to 46.6% at 12/31/12 from 58.1% at 12/31/08, due in part to a total of \$2.0 billion in equity issuances in 2009-2012. Prospectively, AEP's metrics are likely to weaken toward the lower end of the mid-Baa range in the near term with the expiration of bonus depreciation and a plan to increase the dividend payout ratio to 60-70% from 50-60% over time. Post-transition, AEP will need to demonstrate metrics that are toward the higher end of its rating category given the impact of an expansion of its unregulated merchant operations on its overall business profile. Factors that could challenge AEP during this period include adverse rulings from the Ohio Supreme Court on elements of the new ESP currently being reviewed by the court, adverse rulings from state regulators concerning the transfer of the Amos and Mitchell plants, higher than anticipated regulatory lag in the recovery of environmental and nuclear capex or in other rate matters, and power prices materially lower than current forward curves (which would impact off-system sales that are expected to increase based on customer switching in Ohio).

#### HOLDING COMPANY NOTCHING CONSIDERATIONS

Despite AEP's structural subordination relative to the debt of its subsidiaries, we do not notch AEP's rating down below the Baa2 senior unsecured rating that is assigned to the majority of its operating subsidiaries, based on the diversity and stability of those subsidiaries' cash flows, in addition to the relatively modest debt level at the parent company (about 5% at 12/31/12). Structural subordination pressure on the rating could increase if parent level debt materially increased on a permanent basis or if there were downgrades at material subsidiaries. Conversely, rating upgrades at material subsidiaries would benefit credit positioning of AEP.

#### Liquidity

We consider AEP's liquidity to be adequate based on its two syndicated revolving credit facilities totaling \$3.5 billion that were upsized and extended in January 2013. The first revolver is a \$1.75 billion facility (upsized from \$1.5 billion) expiring June 2016, and the other is a \$1.75 billion facility expiring in July 2017. Both revolving facilities permit same-day borrowing and have a combined letter of credit sub-limit of \$1.35 billion. They contain a covenant requiring that AEP's consolidated debt to capitalization (as defined) will not exceed 67.5% (AEP states it is in compliance with the covenant as of 12/31/12). AEP is not required to make a representation with respect to either material adverse change or material litigation in order to borrow under the facility. Default provisions exclude payment defaults and insolvency/bankruptcy of subsidiaries that are not significant subsidiaries per the SEC definition (in general, this would exclude subsidiaries representing less than 10% of assets or income, but AEP Texas Central and Southwestern Electric Power Company are also effectively excluded as significant subsidiaries due to definitional adjustments in the credit facilities). Also in January 2013, AEP put into place a \$1 billion delayed draw term loan facility due in May 2015, and the full amount of this facility remains undrawn. AEP has stated that the purpose of the facility is to fund certain maturities at OPCo during the transition to competitive generation. In June 2012, AEP renewed its \$700 million accounts receivable securitization (down from \$750 million), of which only the \$315 million multi-year portion is included as an available source in Moody's liquidity testing.

As of 12/31/12, AEP had \$279 million of cash on hand and approximately \$2.8 billion of availability under its two

syndicated revolving credit facilities after giving effect to \$321 million of commercial paper outstanding and \$131 million of issued letters of credit .

On a consolidated basis for the 12 months ended 12/31/12, AEP generated approximately \$4.1 billion in cash from operations, made approximately \$3.0 billion in capital investments and net asset purchases and paid about \$916 million in dividends, resulting in roughly \$180 million of positive free cash flow . Including securitization bonds, puttable bonds and other amortizations, AEP has debt maturities of approximately \$1.79 billion in 2013, and \$995 million in 2014 . Over the next two years, we estimate that AEP will generate roughly \$4.1 billion annually in cash from operations, spend about \$3.9 billion annually in capital expenditures and pay approximately \$925-950 million in dividends annually, yielding negative free cash flow of about \$750 million per year.

### Rating Outlook

The stable rating outlook reflects the good credit profiles of AEP's diverse portfolio of electric utility operating subsidiaries. We believe AEP will continue to demonstrate a reasonably conservative approach towards its financial policies through this period, particularly with respect to the transition in Ohio and expected environmental and nuclear spending, leading to cash flow generation in relation to debt that will be appropriate for its evolving business mix.

### What Could Change the Rating - Up

Ratings upgrades appear unlikely over the near term, primarily due to our view that the gradual change in business mix will ratchet upwards the metrics threshold for maintaining the Baa2 unsecured rating. Nevertheless, if there were ratings upgrades at AEP's larger operating utilities and/or AEP were successful in producing a stronger set of key financial credit metrics on a sustainable basis, including a ratio of CFO Pre-WC plus interest of at least 4.5x, a ratio of CFO Pre-WC to debt in the low 20% range and debt to capitalization of around 45%, ratings could be upgraded.

### What Could Change the Rating - Down

AEP's rating could be downgraded if a more contentious regulatory / political environment were to materialize in Ohio or other important jurisdictions; for instance, if regulatory decisions for any material subsidiary challenged our assumption that environmental and nuclear capex costs will be recovered on a reasonably timely basis. Ratings could also be downgraded if concerns about structural subordination were heightened due to material additional permanent debt at the parent as percentage of total, or if the ratings of its larger subsidiaries (which are mostly in the Baa2/Baa1 range) were downgraded. In addition, ratings could be downgraded if AEP's financial metrics were weaker or more volatile than expected during the transition period, including a ratio CFO Pre-WC to debt in the low teens range.

### Rating Factors

American Electric Power Company, Inc.

Regulated Electric and Gas Utilities Industry [1][2]	Current 12/31/2012		Moody's 12-18 month Forward View* As of April 2013
	Measure	Score	
<b>Factor 1: Regulatory Framework (25%)</b>			
a) Regulatory Framework		Baa	Baa
<b>Factor 2: Ability To Recover Costs And Earn Returns (25%)</b>			
a) Ability To Recover Costs And Earn Returns		Baa	Baa
<b>Factor 3: Diversification (10%)</b>			
a) Market Position (5%)		A	A
b) Generation and Fuel Diversity (5%)		B	B
<b>Factor 4: Financial Strength, Liquidity And Key Financial Metrics (40%)</b>			



a) Liquidity (10%)		Baa		Baa
b) CFO pre-WC + Interest/ Interest (3 Year Avg) (7.5%)	4.2x	Baa	3.9 - 4.3x	Baa
c) CFO pre-WC / Debt (3 Year Avg) (7.5%)	18%	Baa	15 - 18%	Baa
d) CFO pre-WC - Dividends / Debt (3 Year Avg) (7.5%)	14%	Baa	11 - 14%	Baa
e) Debt/Capitalization (3 Year Avg) (7.5%)	48%	Baa	45 - 49%	Baa
Rating:				
a) Indicated Rating from Grid		Baa2		Baa2
b) Actual Rating Assigned		Baa2		Baa2

\* THIS REPRESENTS MOODY'S FORWARD VIEW; NOT THE VIEW OF THE ISSUER; AND UNLESS NOTED IN THE TEXT DOES NOT INCORPORATE SIGNIFICANT ACQUISITIONS OR DVESTITURES

[1] All ratios are calculated using Moody's Standard Adjustments. [2] As of 12/31/12; Source: Moody's Financial Metrics

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# MOODY'S

## INVESTORS SERVICE

### Credit Opinion: American Electric Power Company, Inc.

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Global Credit Research - 15 Mar 2012

*Columbus, Ohio, United States*

#### Ratings

Category	Moody's Rating
Outlook	Stable
Senior Unsecured	Baa2
Jr Subordinate	Baa3
Commercial Paper	P-2
<b>Appalachian Power Company</b>	
Outlook	Stable
Issuer Rating	Baa2
Senior Unsecured	Baa2
<b>Ohio Power Company</b>	
Outlook	Stable
Issuer Rating	Baa1
Senior Unsecured	Baa1
Pref. Shelf	(P)Baa3
<b>Indiana Michigan Power Company</b>	
Outlook	Stable
Issuer Rating	Baa2
Senior Unsecured	Baa2
Pref. Stock	Ba1

#### Contacts

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#### Key Indicators

##### [1] American Electric Power Company, Inc.

	2011	2010	2009	2008
(CFO Pre-W/C + Interest) / Interest Expense	4.3x	3.9x	4.0x	3.4x
(CFO Pre-W/C) / Debt	18%	17%	18%	13%
(CFO Pre-W/C - Dividends) / Debt	14%	13%	14%	10%
Debt / Book Capitalization	48%	50%	53%	58%

[1] All ratios calculated in accordance with the Global Regulated Electric Utilities Rating Methodology using Moody's standard adjustments.

*Note: For definitions of Moody's most common ratio terms please see the accompanying [User's Guide](#).*

#### Opinion

## **Rating Drivers**

Utility holding company undergoing two significant transitions - environmental compliance and Ohio restructuring

Primarily rate-regulated utilities provide a strong foundation to investment grade credit rating

Diversity in regulatory environments and service territory economies

Environmental regulations will cause significant plant closings and retro-fit capital expenditures

Reversal of Ohio stipulation settlement creates uncertainty

Financial metrics currently appropriate for the rating category but could be pressured with a higher percentage of deregulated revenues

Near-term liquidity profile appears adequate

## **Corporate Profile**

American Electric Power Company, Inc. (AEP, Baa2 senior unsecured, stable outlook), headquartered in Columbus, Ohio, is a large electric utility holding company with rate-regulated utilities operating in 11 states. AEP owns approximately 39,000 MW of generating assets, primarily coal fired. Sales in KWh break down as approximately 29% residential, 24% commercial, 28% industrial, 18% wholesale (with a substantial portion under cost-based long-term contracts) and 1% other.

## **SUMMARY RATING RATIONALE**

AEP's Baa2 senior unsecured rating is based on the size and diversity associated with owning and operating ten rate-regulated electric utilities across 11 states, financial metrics that over the past several years have supported the rating, a consolidated financial profile that is balanced and includes a very moderate amount of parent holding company debt, and adequate liquidity. These positive factors are balanced against risks associated with a transition to deregulated generation in Ohio, a gradual change in business mix that will increase the financial metrics threshold for the current rating over time, and material increases in capital expenditures to meet environmental mandates.

## **DETAILED RATING CONSIDERATIONS**

### **SUBSTANTIAL RETIREMENTS AND CAPEX DUE TO ENVIRONMENTAL MANDATES**

AEP has announced retirements of 5,100 MW of coal fired generation (13% of total capacity), with the largest portion taking place at Ohio Power Company (OPCo, Baa1 senior unsecured, stable outlook, about 2,500 MW) and Appalachian Power Company (APCo, Baa2 senior unsecured, stable outlook, about 1,300 MW). The primary driver is the Mercury and Air Toxics Standard (MATS) - long-expected, with final rules announced in late 2011. Most of the retirements are expected to occur at the end of 2014, unless they would cause local/regional capacity constraints.

AEP's February 2012 forecast for environmental capital expenditures for MATS and other expected mandates is \$5.9-6.9 billion from 2012-2020 (excluding allowance for funds used during construction, or AFUDC), down from a June 2011 forecast of \$6-8 billion. The largest portion is expected to be spent at Indiana Michigan Power Company (Baa2, stable outlook, 25%) and Southwestern Electric Power Company (Baa3, stable outlook, 21%). Of the \$5.9-6.9 billion, AEP forecasts about \$0.5 billion will be spent in 2012. Moody's believes the heaviest expenditures will be in 2013-2016, which presumes that AEP will be successful in obtaining state-level and potentially even federal-level extensions for compliance. If AEP is not successful, the schedule may be accelerated, which could stress intermediate term metrics.

We expect that AEP's subsidiaries will be successful in obtaining reasonably timely recovery for the capital and operating expenditures associated with their environmental upgrades.

### **BUMPY TRANSITION TO COMPETITIVE GENERATION IN OHIO**

Although AEP had filed an Electric Security Plan (ESP) in Ohio in early 2011 based the retention of regulated generation assets, it eventually entered a Stipulation Agreement in September 2011 that was negotiated and signed by 23 parties, including the staff of the Public Utilities Commission of Ohio (PUCO), and approved with modifications

by the PUCO in December 2011. The Stipulation Order approved the merger of Columbus Southern Company into OPCo (which occurred in late December 2011) as well as a plan to separate OPCo into an Ohio wires company (OPCo will retain that business) and a competitive generation company, AEP Generation Resources Inc. (AGR). AEP filed applications with FERC in February 2012 to execute various parts of the transition plan, including the transfer of two plants from OPCo to APCo and Kentucky Power Company (KPCo, Baa2, stable outlook) at a total asset value of about \$2.2 billion. After retirements and proposed transfers, AGR would have about 9,000 MW of capacity, of which 64% is coal fired and scrubbed.

The Stipulation Agreement provided a transition to market by setting gradually increasing limits in 2012-2015 on the percentage of customers who could switch generation providers while paying a (much lower) capacity payment based on a PJM capacity auction price. Customer switching above those levels would have been discouraged by the much higher cost-based capacity payment that the competitive generation supplier would pay and, most likely, pass along to the customer. These provisions would have helped provide some clarity and stability of cash flows during the transition period. The Stipulation Agreement also increased and re-designed generation rates, while decreasing certain other rate components.

In 2012 the PUCO modified and then rescinded its December 2011 order, creating uncertainty. In its January 2012 modification, the PUCO materially expanded the customers who could switch at the lower capacity price, which decreased the clarity of cash flows. On February 23, 2012, the PUCO rescinded its December order, which it stated would permit the PUCO to start the process over. Reasons cited for the rescission included the severe (above 30%) and unexpected rate impact of the rate re-design on certain customer classes, and OPCo's FERC filing to sell its ownership share in Amos Unit 3 and the Mitchell plant to APCo and KPCo, which the PUCO has stated was a surprise. In the meantime, OPCo was ordered to re-establish its prior rate structure, under which the capacity payments that OPCo would receive from competitive suppliers for all switching customers decreased from the cost-based \$255 per MW-day to about \$110 per MW-day for from 1/1/12 through 5/31/12 and to about \$17 per MW-day for 6/1/12 through 5/31/13. AEP has estimated the negative earnings impact in 2013 at about \$220 million, in the absence of other rate modifications by the PUCO. On March 7, 2012, the PUCO provided an expedited ruling that set a limit on the switching customers that would qualify for the \$110 per MW-day capacity rate, with customers above the limit paying \$255 per MW-day.

We have historically viewed the Ohio regulatory environment as reasonably supportive, leading to a Factor 1 scoring of mid-Baa for OPCo. Recent events cause concern that OPCo's regulatory framework may be heading toward less consistency and greater unpredictability. The customer complaints that were one catalyst for the PUCO rescission indicate both the non-acceptance of higher rates and a failure by both AEP and the PUCO staff to gauge the impact of the Stipulation Agreement on each affected rate class. The PUCO's expressed surprise at the proposed sale of assets to APCo and KPCo contrasts to AEP's discussions of capacity transfers on investor calls starting in September 2011 and indicates sub-optimal communication between the utility and regulator at a time when many sensitive decisions need to be made regarding the transition to market. While the PUCO's stated intent is to enforce the terms of the Stipulation Agreement and the PUCO's orders, including any contractually agreed terms about how generation would be bid into the market, the implication that AEP's Generation Resources' de-regulated assets could be limited to the Ohio market is also cause for concern.

However, OPCo's ESP filing is ongoing and may yet be resolved in a manner that provides stability of cash flows during the transition to market-based rates. Recent public filings indicate AEP will propose an ESP that does not create a two-tier capacity pricing system with limits on the less expensive tier, but rather a non-bypassable generation stability charge similar in concept to one that the PUCO approved for Duke Energy Ohio, Inc. (Baa1, stable outlook). Statements by the PUCO and its March 7 order indicate a current intention to resolve the ESP prior to 6/1/12.

We view the transition period as extremely important to OPCo and to AEP, as OPCo represented about 31% of AEP's Cash from Operations before Working Capital changes (CFO Pre-W/C) in 2011. A higher portion of unregulated business in AEP's mix (AEP estimates that unregulated assets will increase from about 4% of total to about 14%; however, we do not have clarity on the anticipated unregulated margin and cash flow) will tend to require somewhat higher cash flow to debt metrics to maintain the current rating in light of the expected higher overall business risk for the company. In AEP's recently announced financing plan, this strengthening of 3 year average metrics would occur as a result of strong Cash from Operations, essentially stable with the 2011 level, combined with an essentially flat dividend, the expectation of about \$100 million/year from dividend reinvestments, and a very limited increase in debt other than securitization debt. Factors that materially decreased our expectations of consolidated cash flow relative to consolidated debt during the transition period could negatively impact ratings.

## DIVERSITY OF RATE REGULATED CASH FLOWS

AEP's electric utility operations are diversified in terms of regulatory jurisdictions (11 states) and service territory economies. The eastern utilities are a bit more than twice as large as the western utilities in terms of gross margin contribution. The largest states ranked by utility gross margin are Ohio, Indiana, Texas, Virginia, West Virginia and Oklahoma. These jurisdictions translate into quite good diversity in revenues (by state and operating utility), cash flows, assets and customers. From a credit perspective, Moody's views AEP's size and diversity as a meaningful credit strengths, as they provide the parent company a degree of insulation from any unexpected negative development occurring at one of its companies, with one of its state regulators or in one state's economy. During the past two years of tepid recovery from the recession in the US, AEP's western service territories, with their greater leverage to the energy economy, have registered a much stronger recovery than those in the east, which have generally been more challenged. Overall, AEP's KWh sales grew 4.9% in 2011 and 5.3% in 2010 after falling 11.2% in 2009.

In light of substantial planned Capex, continued regulatory support will be important to AEP's rating.

## MAINTAINING THE FINANCIAL PROFILE IS KEY TO MAINTAINING RATINGS

AEP's financial metrics in 2009-2011 were significantly higher than in 2007-2008. The ratio of CFO Pre-WC plus interest to interest and the ratio of CFO Pre-WC to debt improved from 3.4x and 13.5%, respectively, in 2008 to 3.9x and 17.1%, respectively, in 2010 and 4.3x and 18.4%, respectively, in 2011. Debt/Capitalization decreased to 47.8% at 12/31/2011 from 58.1% at 12/31/2008 due in part to a total of \$1.9 billion on equity issuances in 2009-2011. Prospectively, AEP will need to exhibit a financial profile that continues to be consistent with its rating category and that transitions, during the next three years of what we assume will be a gradual deregulation in Ohio, to a financial profile that is robust for its rating category. We expect AEP's CFO Pre-WC to debt to remain solidly in the high teens over the next 2-3 years. Factors that could challenge AEP during this period include adverse regulatory decisions on the re-filed ESP in Ohio, the impacts of capacity prices, power prices and a recently expanded retail business on replacement revenues for customers who switch generation suppliers, and regulatory decisions throughout the AEP system related to environmental Capex and other general rate matters.

## HOLDING COMPANY NOTCHING CONSIDERATIONS

Despite AEP's structural subordination relative to the debt of its subsidiaries, Moody's does not notch AEP's rating down below the Baa2 senior unsecured rating assigned to the majority of the operating subsidiaries, based on the diversity and stability of cash flows, in addition to the relatively modest debt level at the parent company (about 8% at 12/31/11). Structural subordination pressure on the rating could increase if parent level debt increased materially or if there were downgrades of material subsidiaries. Conversely, rating upgrades at material subsidiaries would benefit the credit positioning of AEP.

## Liquidity

AEP's liquidity is adequate. AEP has two syndicated credit facilities totaling \$3.25 billion that were renewed and extended in mid-2011. One is a \$1.5 billion facility expiring June 2015. The other is a \$1.75 billion facility (upsized from \$1.5 billion) expiring in July 2016. The combined letter of credit sub-limits under these facilities is \$1.35 billion. The facilities contain a covenant requiring that AEP's consolidated debt to capitalization (as defined) will not exceed 67.5% (AEP states the actual ratio was 51.1% at 12/31/11, indicating substantial headroom). AEP is not required to make a representation with respect to either material adverse change or material litigation in order to borrow under the facility. Default provisions exclude payment defaults and insolvency/bankruptcy of subsidiaries that are not significant subsidiaries per the SEC definition (in general, this would exclude subsidiaries representing less than 10% of assets or income, but AEP Texas Central and Southwestern Electric Power Company are also effectively excluded as significant subsidiaries due to definitional adjustments in the credit facilities). Also in 2011, AEP allowed a \$478 million letter of credit facility to expire but renewed its \$750 million accounts receivable securitization (only the multi-year portion of the latter is included as an available source in Moody's liquidity testing).

As of 12/31/11, AEP had \$221 million of cash on hand and approximately \$2.1 billion of availability under the syndicated revolving credit facilities after giving effect to \$967 million of commercial paper outstanding and \$134 million of issued letters of credit.

For the 12 months ended 12/31/11, AEP generated approximately \$4.3 billion in cash from operations, made approximately \$3.1 billion in capital investments and net asset purchases and paid about \$900 million in dividends,

resulting in roughly \$300 million of positive free cash flow.

Including securitization bonds and other amortizations, AEP has approximately \$690 million of maturing long-term debt due in 2012, \$1.7 billion in 2013, and \$1.3 billion in 2014. Over the next two years, we estimate that AEP will generate roughly \$3.5 billion annually in cash from operations, spend about \$3.3 billion annually in capital expenditures and pay approximately \$900-925 million in dividends annually, yielding negative free cash flow of about \$700 million per year.

### Rating Outlook

The stable rating outlook reflects the good credit profiles of AEP's diverse portfolio of electric utility operating subsidiaries. We believe AEP will continue to demonstrate a reasonably conservative approach towards its financial policies throughout this period of transition in Ohio and environmental spending, leading to continued improvements in its cash flow generation in relation to debt.

### What Could Change the Rating - Up

Ratings upgrades appear unlikely over the near term, primarily due to our view that the gradual change in business mix will ratchet upward the metrics threshold for the Baa2 unsecured rating. Nevertheless, if AEP were successful in producing a stronger set of key financial credit metrics on a sustainable basis, including a ratio of CFO Pre-WC plus interest of at least 4.5x, a ratio of CFO Pre-WC to debt in the low 20% range and debt to capitalization of around 45%, ratings could be upgraded.

### What Could Change the Rating - Down

AEP's ratings could be downgraded if the regulatory environment in Ohio showed further deterioration or if a more contentious regulatory / political environment materialized in other important jurisdictions, for instance if regulatory decisions for any material subsidiary challenged our assumption that environmental Capex costs will be recovered on a reasonably timely basis. Ratings could also be downgraded if concerns about structural subordination were heightened due to material additional debt at the parent as percentage of total, or if the ratings of its larger subsidiaries (which are mostly in the Baa2/Baa1 range) were downgraded. In addition, ratings could be downgraded if AEP's financial metrics were weaker or more volatile than expected during the transition period, including a ratio CFO Pre-WC to debt in the low-to mid teens range or debt to capitalization above about 50%.

### Rating Factors

#### American Electric Power Company, Inc.

Regulated Electric and Gas Utilities Industry [1][2]	Current 12/31/2011		Moody's 12-18 month Forward View* As of March 2012
	Measure	Score	
<b>Factor 1: Regulatory Framework (25%)</b>			
a) Regulatory Framework		Baa	Baa
<b>Factor 2: Ability To Recover Costs And Earn Returns (25%)</b>			
a) Ability To Recover Costs And Earn Returns		Baa	Baa
<b>Factor 3: Diversification (10%)</b>			
a) Market Position (5%)		A	A
b) Generation and Fuel Diversity (5%)		B	B
<b>Factor 4: Financial Strength, Liquidity And Key Financial Metrics (40%)</b>			
a) Liquidity (10%)		Baa	Baa
b) CFO pre-WC + Interest/ Interest (3 Year Avg) (7.5%)	4.1x	Baa	3.7 - 4.0x Baa

c) CFO pre-WC / Debt (3 Year Avg) (7.5%)	18%	Baa	16 - 19%	Baa
d) CFO pre-WC - Dividends / Debt (3 Year Avg) (7.5%)	14%	Baa	12 - 14%	Baa
e) Debt/Capitalization (3 Year Avg) (7.5%)	50%	Baa	45 - 52%	Baa
<b>Rating:</b>				
a) Indicated Rating from Grid		Baa2		Baa2
b) Actual Rating Assigned		Baa2		Baa2

\* THIS REPRESENTS MOODY'S FORWARD VIEW; NOT THE VIEW OF THE ISSUER; AND UNLESS NOTED IN THE TEXT DOES NOT INCORPORATE SIGNIFICANT ACQUISITIONS OR DIVESTITURES

[1] All ratios are calculated using Moody's Standard Adjustments. [2] As of 12/31/2011; Source: Moody's Financial Metrics

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# MOODY'S

## INVESTORS SERVICE

### Credit Opinion: American Electric Power Company, Inc.

Global Credit Research - 17 Oct 2012

Columbus, Ohio, United States

#### Ratings

Category	Moody's Rating
Outlook	Stable
Senior Unsecured	Baa2
Jr Subordinate	Baa3
Commercial Paper	P-2
<b>Appalachian Power Company</b>	
Outlook	Stable
Issuer Rating	Baa2
Senior Unsecured	Baa2
<b>Ohio Power Company</b>	
Outlook	Stable
Issuer Rating	Baa1
Senior Unsecured	Baa1
<b>Indiana Michigan Power Company</b>	
Outlook	Stable
Issuer Rating	Baa2
Senior Unsecured	Baa2
<b>Southwestern Electric Power Company</b>	
Outlook	Stable
Issuer Rating	Baa3
Senior Unsecured	Baa3

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#### Key Indicators

[1] American Electric Power Company, Inc.

	LTM (6/30/12)	2011	2010	2009
(CFO Pre-W/C + Interest) / Interest Expense	4.6x	4.3x	3.9x	4.0x
(CFO Pre-W/C) / Debt	19%	18%	17%	18%
(CFO Pre-W/C - Dividends) / Debt	15%	14%	13%	14%
Debt / Book Capitalization	47%	48%	50%	53%

[1] All ratios calculated in accordance with the Global Regulated Electric Utilities Rating Methodology using Moody's standard adjustments.

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

## **Opinion**

### **Rating Drivers**

Two significant transitions - environmental compliance and Ohio restructuring

Recent Ohio orders provide reasonable cash flow stability in a multi-year transition

Diversity in the regulatory environments and service territories of its primarily regulated utility subsidiaries provide a strong foundation to investment grade credit rating

Financial metrics currently appropriate for the rating category but could be pressured with a higher percentage of deregulated revenues

Near-term liquidity profile appears adequate

### **Corporate Profile**

American Electric Power Company, Inc. (AEP, Baa2 senior unsecured, stable outlook), headquartered in Columbus, Ohio, is a large electric utility holding company with rate-regulated utilities operating in 11 states. AEP owns or leases approximately 38,000 megawatts (MW) of generating assets, primarily coal fired. The breakdown of megawatt hour (MWh) sales in 2011 was approximately 29% residential, 23% commercial, 28% industrial, 18% wholesale (with a substantial portion under cost-based long-term contracts) and 1% other.

### **SUMMARY RATING RATIONALE**

AEP's Baa2 senior unsecured rating is based on the size and diversity associated with owning and operating ten rate-regulated electric utilities across 11 states, financial metrics that over the past several years have supported the rating, a consolidated financial profile that is balanced and includes a very moderate amount of parent holding company debt, and adequate liquidity. These positive factors are balanced against risks associated with a transition to deregulated generation in Ohio by June of 2015, a change in business mix that will increase the financial metrics threshold for the current rating over time, and material increases in capital expenditures to meet environmental mandates.

### **DETAILED RATING CONSIDERATIONS**

#### **A TRANSITION PATH TO COMPETITIVE GENERATION IN OHIO AFTER A BUMPY PERIOD**

Although the process included a period of uncertainty after a previously approved Electric Security Plan (ESP) for 2012 to mid-2015 was reversed, OPCo received four orders from the Public Utilities Commission of Ohio (PUCO) that provide a reasonable stability of cash flows during a transition to full competitive generation by June 2015. The new orders, some of which are subject to re-hearing, addressed OPCo's capacity charges, fuel deferrals accrued under the prior ESP (ESP 1, which covered the period 2009-2011), and approved a new ESP (ESP 2), including cost of service for June 2012 through May 2015. They also eliminated some barriers in the prior orders for customers to switch electric suppliers, and set a framework for consideration of OPCo's requested corporate separation and the transfer of capacity to affiliates. OPCo is important to AEP as it provided about 30% of gross profit and 28% of CFO Pre-WC for the 12 months ended 6/30/12.

The July 2012 capacity order set a price of about \$189 per megawatt per day (MW-day) for the capacity that OPCo maintains for customers who switch suppliers during the transition period. Competitive retail electric suppliers (CRES providers) will pay AEP the adjusted PJM auction-based rate, which is only about \$20 per MW-day, \$34 per MW-day and \$154 per MW-day for the 12 months ending May 31 of 2013, 2014 and 2015, respectively. The difference between what is received (from the CRES providers and from a rate mechanism in ESP 2 described below) and what is accrued will create a capacity deferral asset that is to be recovered in rates after June 2015 over a three year period or as determined by PUCO at the time of the related filing. Based on OPCo's peak demand of about 10,200 MW and our assumption that OPCo loses 45% of its load in year 1, rising to 60% in years 2 and 3, we calculate that the capacity deferral asset will increase to a high point of about \$500 million in June 2015.

Under ESP 1, OPCo deferred (with a return based on weighted average cost of capital) its fuel costs in excess of a capped annual increase amount, which resulted in a deferral balance of \$506 million at 12/31/2011. In August 2012, PUCO approved the recovery of deferred fuel costs over seven years (with a debt-only return) and

encouraged OPCo to seek securitization . This securitization and recovery will help to offset the capacity deferrals on a cash basis, though the resulting securitization debt will be included in OPCo's consolidated metrics (we typically look at metrics with and without securitization debt).

Under ESP 2, approved in August 2012, OPCo's rates for providing its portion of Standard Service will be based on a frozen non-fuel generation charge and a fuel adjustment clause reflecting actual costs. OPCo will procure an increasing percentage of Standard Service energy through a competitive bid , notably 60% starting June 2014, and 100% starting January 2015. Standard Service will be fully competitive (energy and capacity) by June 2015. ESP 2 provides additional cash to OPCo via a Retail Stability Rider (RSR) - a charge on each MWh delivered (regardless of supplier) equal to \$3.50 through May 2013 and \$4.00 thereafter. On a full year basis, \$4 on OPCo's approximate 48 million MWh delivered in 2011 equates to about \$190 million per year. Of this charge, OPCo will apply \$1 per MWh (about \$48 million per year) to reducing the capacity deferral. As part of the ESP, PUCO determined that corporate separation into an Ohio wires company (OPCo will retain that business) and a competitive generation company, AEP Generation Resources Inc. (AGR), is in the public interest. This separation is based on PUCO's understanding that plants will be transferred at book value, including a transfer of the Amos and Mitchell plants to APCo and Kentucky Power Company (KPCo, Baa2, stable outlook), and that inter-company charges from AGR to OPCo will be governed by FERC . ESP 2 also provides a rider for investment in distribution assets up to a capped amount per year (credit positive as it reduces lag in recovery of costs), and a placeholder for a generation rider (leaving open the possibility that even as a wires company, OPCo might be able to receive an approval to build a plant and pass through the costs in rates).

OPCo filed a corporate separation and divestiture plan with PUCO, which was approved on 10/17/12.

We have historically viewed the Ohio regulatory environment as reasonably supportive, leading to a Factor 1 scoring in the Baa range for OPCo. Events surrounding PUCO's February 2012 revocation of a December 2011 order approving an ESP-related Stipulation Agreement had caused concerns that OPCo's regulatory framework might be heading toward less consistency and greater unpredictability, that PUCO might want to "reserve" market capacity for use in Ohio, and that communication between the utility and regulator was sub-optimal at a time when many sensitive decisions needed to be made regarding the transition to market. The recent orders have alleviated many of these concerns and appear to give AEP a reasonable transition period to market-based generation in Ohio. Assuming that power prices during this period are not materially below current forward levels, we believe that total margins earned by OPCo and AGR will trend downward only slightly during the period, while operating cash flows will be somewhat weaker before giving effect to the securitization proceeds. The overall impact on AEP's metrics should be muted. One area of remaining concern about the Ohio regulatory environment is the concept of a generation rider placeholder, which we view as negative for AEP, since AGR will be an unregulated supplier in the market.

#### **SUBSTANTIAL RETIREMENTS AND CAPEX DUE TO ENVIRONMENTAL MANDATES**

AEP retired Sporn 5 (450 MW) in late 2011 and has announced retirements of 4,660 MW of coal fired generation (12% of total capacity) in 2012-2016 , with the largest portion taking place at Ohio Power Company (OPCo, Baa1 senior unsecured, stable outlook, about 2,000 MW) and Appalachian Power Company (APCo, Baa2 senior unsecured, stable outlook, about 1,300 MW). The primary driver is the Mercury and Air Toxics Standard (MATS) - long-expected, with final rules announced in February 2012. AEP has announced that the plants will be retired by or during 2016, but we believe most of the retirements will occur in early 2015, unless they would cause local/regional capacity constraints.

AEP's February 2012 forecast for environmental capital expenditures for MATS and other expected mandates is \$5.9-6.9 billion from 2012-2020 (excluding allowance for funds used during construction, or AFUDC), with all but about \$900 million at the regulated subsidiaries. The largest portion is expected to be spent at Indiana Michigan Power Company (Baa2, stable outlook, 25%) and Southwestern Electric Power Company (Baa3, stable outlook, 21%). Of the \$5.9-6.9 billion, AEP forecasts about \$0.5 billion will be spent in 2012, \$1 billion in 2013 and \$1.1 billion in 2014, with the bulk of the remainder in 2015-2016. This schedule presumes that AEP will be successful in obtaining state-level and potentially even federal-level extensions for MATS compliance. If AEP is not successful, the schedule may be accelerated, which could stress intermediate term metrics.

We expect that AEP's subsidiaries will be successful in obtaining reasonably timely recovery for the capital and operating expenditures associated with their environmental upgrades.

#### **DIVERSITY OF RATE REGULATED CASH FLOWS**

AEP's electric utility operations are diversified in terms of regulatory jurisdictions (11 states) and service territory

economies. The eastern utilities are a bit more than twice as large as the western utilities in terms of gross margin contribution. The largest states ranked by utility gross margin are Ohio, Indiana, Texas, Virginia, West Virginia and Oklahoma. These jurisdictions translate into quite good diversity in revenues (by state and operating utility), cash flows, assets and customers. From a credit perspective, we view AEP's size and diversity as meaningful credit strengths, as they provide the parent company a degree of insulation from any unexpected negative development occurring at one of its companies, with one of its state regulators or in one state's economy. During the past two years of tepid recovery from the recession in the US, AEP's western service territories, with their greater leverage to the energy economy, have registered a much stronger recovery than those in the east, which have generally been more challenged. Overall, AEP's (non-normalized) KWh sales grew 3.9% for the first 6 months of 2012 (with the strongest growth in the wholesale segment), 4.9% in 2011 and 5.3% in 2010 after falling 11.2% in 2009. However, AEP reports that weather-normalized retail sales increased only 0.3% in the first 6 months of 2012, and (non-normalized) industrial sales in that period decreased by 2%.

In light of substantial planned Capex, continued regulatory support will be important to AEP's rating.

#### MAINTAINING THE FINANCIAL PROFILE IS KEY TO MAINTAINING RATINGS

AEP's financial metrics in 2009 through mid-2012 were significantly higher than in 2007-2008. The ratio of CFO Pre-WC plus interest to interest and the ratio of CFO Pre-WC to debt improved from 3.4x and 13.5%, respectively, in 2008 to 3.9x and 17.1%, respectively, in 2010, 4.3x and 18.4%, respectively, in 2011 and 4.6x and 19.4%, respectively, for LTM 6/30/12. Recent cash flow metrics are robust for the rating category (CFO Pre-WC to Debt for a mid-Baa utility typically ranges from 16-19%), but some of this improvement can be attributed to bonus depreciation. Debt/Capitalization also decreased to 47.4% at 6/30/12 from 58.1% at 12/31/2008, due in part to a total of \$1.9 billion in equity issuances in 2009-2011. Prospectively, AEP's metrics are likely to weaken toward the lower end of the mid-Baa range in the near term with the expiration of bonus depreciation. Over the next 2 ½ years of gradual deregulation in Ohio, AEP will need to regain metrics that are toward the higher end of its rating category, given the addition of unregulated merchant operations to its overall business profile. Factors that could challenge AEP during this period include adverse regulatory decisions in re-hearings on ESP 2, higher than anticipated regulatory lag in the recovery of environmental Capex or in other rate matters, and power prices materially lower than current forwards (which would impact off-system sales that are expected to increase based on customer switching in Ohio).

#### HOLDING COMPANY NOTCHING CONSIDERATIONS

Despite AEP's structural subordination relative to the debt of its subsidiaries, we do not notch AEP's rating down below the Baa2 senior unsecured rating that is assigned to the majority of its operating subsidiaries based on the diversity and stability of those subsidiaries' cash flows, in addition to the relatively modest debt level at the parent company (about 7% at 6/30/12). Structural subordination pressure on the rating could increase if parent level debt increased materially on a permanent basis or if there were downgrades at material subsidiaries. Conversely, rating upgrades at material subsidiaries would benefit the credit positioning of AEP.

#### Liquidity

AEP's liquidity is considered adequate. AEP has two syndicated credit facilities totaling \$3.25 billion that were renewed and extended in mid-2011. One is a \$1.5 billion facility expiring June 2015. The other is a \$1.75 billion facility (upsized from \$1.5 billion) expiring in July 2016. The facilities permit same-day borrowing and have a combined letter of credit sub-limit of \$1.35 billion. The facilities contain a covenant requiring that AEP's consolidated debt to capitalization (as defined) will not exceed 67.5% (AEP states the actual ratio was 50% at 6/30/12, indicating substantial headroom). AEP is not required to make a representation with respect to either material adverse change or material litigation in order to borrow under the facility. Default provisions exclude payment defaults and insolvency/bankruptcy of subsidiaries that are not significant subsidiaries per the SEC definition (in general, this would exclude subsidiaries representing less than 10% of assets or income, but AEP Texas Central and Southwestern Electric Power Company are also effectively excluded as significant subsidiaries due to definitional adjustments in the credit facilities). In June 2012, AEP renewed its \$700 million accounts receivable securitization (down from \$750 million), of which only the \$315 million multi-year portion is included as an available source in Moody's liquidity testing.

As of 6/30/12, AEP had \$297 million of cash on hand and approximately \$2.5 billion of availability under its two syndicated revolving credit facilities after giving effect to \$550 million of commercial paper outstanding and \$167 million of issued letters of credit.

On a consolidated basis for the 12 months ended 6/30/12, AEP generated approximately \$4.3 billion in cash from operations, made approximately \$3.2 billion in capital investments and net asset purchases and paid about \$900 million in dividends, resulting in roughly \$200 million of positive free cash flow. Including securitization bonds, put bonds and other amortizations, AEP has approximately \$200 million of maturing long-term debt due in the remainder of 2012, \$1.9 billion in 2013, and \$1.2 billion in 2014. Over the next two years, we estimate that AEP will generate roughly \$4.1 billion annually in cash from operations, spend about \$3.9 billion annually in capital expenditures and pay approximately \$925-950 million in dividends annually, yielding negative free cash flow of about \$750 million per year.

### Rating Outlook

The stable rating outlook reflects the good credit profiles of AEP's diverse portfolio of electric utility operating subsidiaries. We believe AEP will continue to demonstrate a reasonably conservative approach towards its financial policies throughout this period, particularly with respect to the transition in Ohio and expected environmental spending, leading to cash flow generation in relation to debt that will be appropriate for its evolving business mix.

### What Could Change the Rating - Up

Ratings upgrades appear unlikely over the near term, primarily due to our view that the gradual change in business mix will ratchet upward the metrics threshold for maintaining the Baa2 unsecured rating. Nevertheless, if AEP were successful in producing a stronger set of key financial credit metrics on a sustainable basis, including a ratio of CFO Pre-WC plus interest of at least 4.5x, a ratio of CFO Pre-WC to debt in the low 20% range and debt to capitalization of around 45%, ratings could be upgraded.

### What Could Change the Rating - Down

AEP's ratings could be downgraded if a more contentious regulatory / political environment were to materialize in Ohio or other important jurisdictions; for instance, if regulatory decisions for any material subsidiary challenged our assumption that environmental Capex costs will be recovered on a reasonably timely basis. Ratings could also be downgraded if concerns about structural subordination were heightened due to material additional permanent debt at the parent as percentage of total, or if the ratings of its larger subsidiaries (which are mostly in the Baa2/Baa1 range) were downgraded. In addition, ratings could be downgraded if AEP's financial metrics were weaker or more volatile than expected during the transition period, including a ratio CFO Pre-WC to debt in the low-to mid teens range.

### Rating Factors

#### American Electric Power Company, Inc.

Regulated Electric and Gas Utilities Industry [1][2]	Current LTM 6/30/2012		Moody's 12-18 month Forward View* As of June 2012	
	Measure	Score	Measure	Score
<b>Factor 1: Regulatory Framework (25%)</b>				
a) Regulatory Framework		Baa		Baa
<b>Factor 2: Ability To Recover Costs And Earn Returns (25%)</b>				
a) Ability To Recover Costs And Earn Returns		Baa		Baa
<b>Factor 3: Diversification (10%)</b>				
a) Market Position (5%)		A		A
b) Generation and Fuel Diversity (5%)		B		B
<b>Factor 4: Financial Strength, Liquidity And Key Financial Metrics (40%)</b>				
a) Liquidity (10%)		Baa		Baa
b) CFO pre-WC + Interest/ Interest (3 Year Avg) (7.5%)	4.3x	Baa	4.0 - 4.3x	Baa

c) CFO pre-WC / Debt (3 Year Avg) (7.5%)	18%	Baa	16 - 19%	Baa
d) CFO pre-WC - Dividends / Debt (3 Year Avg) (7.5%)	14%	Baa	12 - 14%	Baa
e) Debt/Capitalization (3 Year Avg) (7.5%)	50%	Baa	45 - 49%	Baa
<b>Rating:</b>				
a) Indicated Rating from Grid		Baa2		Baa2
b) Actual Rating Assigned		Baa2		Baa2

\* THIS REPRESENTS MOODY'S FORWARD VIEW; NOT THE VIEW OF THE ISSUER; AND UNLESS NOTED IN THE TEXT DOES NOT INCORPORATE SIGNIFICANT ACQUISITIONS OR DVESTITURES

[1] All ratios are calculated using Moody's Standard Adjustments. [2] As of LTM 6/30/12; Source: Moody's Financial Metrics

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## American Electric Power Co. Inc.

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Business Risk Profile: Excellent; Largely Regulated Operations With Growing Unregulated Operations

Financial Risk Profile: Aggressive; Mostly Steady Cash Flow And Substantial Debt Leverage

Related Criteria And Research

# American Electric Power Co. Inc.

## Major Rating Factors

### Strengths:

- Mostly steady operating cash flow from regulated utilities;
- Large and diverse customer base;
- Geographic diversity; and
- Low-cost generation fleet.

### Corporate Credit Rating

BBB/Stable/A-2

### Weaknesses:

- Exposure to environmental regulations could pressure financial measures;
- Marketing operations weaken creditworthiness; and
- Increased unregulated generation may pressure business profile.

## Rationale

Standard & Poor's Ratings Services bases its rating on American Electric Power Co. Inc. (AEP) on the consolidated credit profile, which includes an "excellent" business risk profile and an "aggressive" financial risk profile under our criteria. The outlook is stable.

The excellent business risk profile primarily reflects AEP's status as a large public utility holding company that owns regulated electric utility subsidiaries operating in 11 states in the Midwest and Southwest. These subsidiaries consist of low-risk transmission and distribution wires-only businesses in Texas; fully integrated regulated utilities in states such as Indiana and West Virginia; and higher-risk hybrid operations in Ohio. Although a portion of generation assets are outside rate base, most of the consolidated generating capacity is under stabilizing regulatory oversight. The company's generating and transmission facilities are interconnected, and its operations are coordinated as an integrated electric utility system.

We consider the financial risk profile for AEP aggressive, reflecting adjusted financial measures that are in line with the rating. In addition, even though it is committed to credit quality, we consider the company's financial policies to be aggressive. The company has a generally transparent business model and pursues activities and projects that mostly add to the regulated rate base and regulated cash flows. We believe the company will perform relatively well compared with its peers even though financial measures may erode due to less operating cash flow.

Our base forecast of between 15% and 16% adjusted funds from operations (FFO) to total debt, 4.4x adjusted debt to EBITDA, and about 58% adjusted total debt to total capital continues to reflect steady operating cash flows and execution on the transition in Ohio. Our rating on AEP reflects our view of a mostly regulated utility strategy that will include continuous capital spending and timely cost recovery through various regulatory mechanisms. We expect this to lead to steady cash flow measures and manageable debt leverage.

## Liquidity

The short-term rating on AEP is 'A-2'. We consider AEP's liquidity position "adequate" under Standard & Poor's liquidity methodology. We base our liquidity assessment on the following factors and assumptions:

- We expect AEP's liquidity sources over the next 12 months, including FFO (\$3.1 billion), credit facility availability (\$2.1 billion), and working capital (\$500 million), to exceed uses by 1.2x, which is the minimum threshold for an adequate designation. Uses include necessary capital spending (\$1.9 billion), maturing debt (\$1.8 billion), and shareholder distributions (\$900 million).
- Debt maturities are manageable over the next 12 months. Also, debt maturities are manageable through 2016. Including amortizing AEP Texas Central Co. securitization bonds, \$1.8 billion is due in 2013, \$1 billion in 2014, \$1.3 billion in 2015, \$940 million in 2016, and \$1.2 billion in 2017. We expect that the company will refinance most of the maturing debt.
- We believe liquidity sources would exceed uses even if EBITDA decreased 15%.
- In our assessment, AEP has good relationships with its banks and has a good standing in the credit markets, having successfully issued debt during the recent credit crisis.

AEP's credit agreements include a financial covenant requiring that debt to total capitalization, excluding securitization debt, junior subordinated notes, and debt of AEP Credit, to be no greater than 67.5%. As of Sept. 30, 2012, the company was in compliance with the covenant at 49.5%.

## Outlook

The stable outlook on the ratings on AEP and its subsidiaries assumes timely recovery of rate base investments for environmental compliance, system reliability, and continued strategic emphasis on regulated operations. Our base forecast includes adjusted FFO to total debt of at least 15%, debt to EBITDA of less than 5x, and debt leverage to total capital of no more than 60%, all of which are consistent with our expectations for the 'BBB' rating. We could lower the ratings if financial measures fall short of our base forecast on a sustained basis to adjusted FFO to total debt of less than 12%, debt to EBITDA of more than 5.2x, and debt leverage of more than 62%. We could raise the ratings if there is greater certainty regarding business risks and if financial measures exceed our baseline forecast, including FFO to total debt in excess of 20%, debt to EBITDA of less than 4x, and debt to total capital of less than 55%.

## Business Description

AEP is a large energy and utility holding company that owns numerous utilities that operate in 11 states in the U.S. Midwest and Southwest and provide electric service to 5.3 million customers.

AEP owns five fully regulated vertically integrated electric utilities: Appalachian Power Co.; Indiana Michigan Power Co.; Kentucky Power Co.; Public Service Co. of Oklahoma; and Southwestern Electric Power Co.

Ohio Power Co. is a vertically integrated, quasiregulated electric utility that provides service in Ohio, from the northwestern part down to the southeastern part of the state. Once the utility transfers its generation assets to affiliates, including an unregulated generation entity, Ohio Power will be a fully regulated electric transmission and distribution utility in Ohio.

AEP Texas Central Co. and AEP Texas North Co. are "wires-only" electric transmission and distribution utilities that have no supply obligations and operate in southern and central Texas and western and north-central Texas, respectively.

## **Rating Methodology**

The ratings reflect the consolidated credit profiles of AEP's operating subsidiaries and other operations, incorporating their respective business and financial risk profiles. In addition, the ratings incorporate the lack of any meaningful restrictions in the flow of funds throughout the enterprise, which leads to the conclusion that the corporate credit rating (CCR) should be uniformly applied to all entities.

We rate the operating utilities' senior unsecured debt the same as the corporate credit ratings. We rate the senior unsecured holding company debt one notch below the CCR because of structural subordination where priority obligations exceed 20% of total assets absent goodwill.

## **Business Risk Profile: Excellent; Largely Regulated Operations With Growing Unregulated Operations**

Electric utility operations are slightly above average, characterized by competitive rates; good reliability; a strong collection of low-cost, coal-fired generation in the eastern part of the system; and supportive regulatory relationships in numerous jurisdictions. Service territories vary widely, ranging from manufacturing and rural areas with lower-growth economies to higher-growth, service-oriented economies, like in the Columbus, Ohio, metropolitan area, that are more stable. The diversity in markets and in regulation somewhat elevates credit quality, but managing the complex variety of regulatory environments can be challenging and requires constant vigilance.

Ohio Power continues to transition to a competitive generation market with shopping for generation service available to all retail customers and Ohio commission approval to transfer all its generation assets out of the utility, including to an unregulated generation affiliate. By June 1, 2015, Ohio Power is expected to have fully transitioned to a transmission and distribution utility that will hold auctions to serve standard service offer customers. During the transition, AEP will be recovering transition costs through a non-bypassable retail stability rider (RSR) and partly recovering from customers the difference between PJM reliability pricing model (RPM) capacity prices and a Public Utilities Commission of Ohio-determined capacity price of \$188.88 per MW day for the company. Any unrecovered capacity deferral is to be accrued and recovered in rates through 2018. Cash flow is further boosted through rate recovery of a deferred fuel balance that exceeds \$500 million and a deferred regulatory asset balance of approximately \$300 million.

Over the longer term, with roughly 25,000 megawatts (MW) of coal-fired generation, including those owned by Ohio Power, material compliance costs related to numerous environmental rules could pressure credit quality without adequate cost recovery. In addition to these coal assets, AEP has 9,700 MW of gas generation and a 2,200 MW nuclear plant.

The company's unregulated operations will grow to include about 8,900 MW of former Ohio Power generation assets following Ohio Power's 2,400 MW transfer to affiliate utilities and its coal plant closures. Ohio Power's remaining 5,740 MW of coal units should have all the required pollution controls except Conesville 5 and 6, on which the company may install selective catalytic reduction equipment for nitrogen oxide controls. Gas-fired combined-cycle units will be 2,026 MW and gas-fired peaking assets will be 1,100 MW. We expect AEP's track record of good operating performance in its unregulated business operations to continue. Stricter environmental regulation will erode the fleet's competitiveness, but we do not expect these pressures to completely eliminate the advantages of AEP's coal plants. AEP has indicated that it will retire roughly 5,500 MW of additional coal-fired assets, including Ohio Power's closures, and retrofit other coal assets with pollution-control equipment. Although AEP's Ohio-based generation accounts for only a portion of the company's credit profile, absent more robust financial measures, a shift to a greater reliance on market prices to generate cash would increase business risk and could ultimately weaken credit quality.

### **Management and strategy**

Our assessment of the company's management and governance is "satisfactory". AEP's management has done an adequate job of managing regulatory risk, implementing risk-management strategies, lowering expenses, and providing high-quality service. Other than transferring Ohio generation out of Ohio Power, including to an unregulated generation entity, management has not pursued risky unregulated diversified activities. The company has demonstrated it can access the debt and equity markets. The corporate strategy of transforming Ohio Power from a mostly regulated utility to a transmission and distribution utility following the proposed transfer of generation assets appears to be moving forward on an established time schedule. We believe that the company has so far been able to execute this strategy, and management has been able to achieve most goals and convert strategy into constructive action. Management has significant expertise and experience in its line of business and appears to have good depth and breadth. Unusual items have occasionally affected performance. Financial risk management has generally been good. Standards for operational performance appear to be similar to those of the industry.

### **Standard & Poor's base case operating expectations**

Standard & Poor's base case scenario for AEP indicates:

- The company remains a holding company that owns mostly regulated electric utilities and unregulated power plants and will generate more than 75% of its operating cash flow through regulated operations.
- The economic conditions in the company's service territories are either holding steady or improving, which will likely increase customer usage.
- The customer base is largely residential and commercial, which is beneficial because such customers generally maintain their electricity usage, providing at least a base level of usage.
- Utility subsidiaries operate under regulatory terms that largely support credit quality and are generally constructive, which includes good fuel-clause mechanisms and other cost-pass-through mechanisms.
- There is effective management of regulatory relationships.
- AEP continues spending on new transmission projects and pollution-control equipment while seeking higher operating cash flow through various rate riders and base rate proceedings.
- AEP's unregulated generating assets are operated efficiently so as to produce competitively priced power, achieve high levels of plant utilization, a low level of unforced outages, and high reliability.
- We expect that management will have a conservative merchant generation and retail marketing strategy that maintains a business risk profile assessment that we consider excellent.

Table 1

<b>American Electric Power Co. Inc. -- Peer Comparison</b>					
<b>Industry sector: energy</b>					
	<b>American Electric Power Co. Inc.</b>	<b>Duke Energy Corp.</b>	<b>Southern Co.</b>	<b>MidAmerican Energy Co.</b>	<b>Xcel Energy Inc.</b>
Rating as of Dec. 13, 2012	BBB/Stable/A-2	BBB+/Negative/A-2	A/Stable/A-1	A-/Stable/A-2	A-/Stable/A-2
<b>--Average of past three fiscal years--</b>					
<b>(Mil. \$)</b>					
Revenues	14,093.5	13,844.0	15,848.1	3,668.0	10,202.8
EBITDA	4,421.1	4,760.6	5,199.3	805.0	2,689.8
Net income from continuing operations	1,383.0	1,361.7	1,834.3	342.0	759.6
Funds from operations (FFO)	3,518.1	3,969.0	4,569.2	964.5	2,226.2
Capital expenditures	2,797.7	4,468.4	4,281.4	496.0	2,085.3
Free operating cash flow	576.7	(207.0)	68.8	368.5	168.7
Discretionary cash flow	(265.1)	(1,509.7)	(1,461.3)	243.0	(285.1)
Cash and short-term investments	692.7	1,837.3	805.2	97.0	124.1
Debt	20,671.1	20,272.4	22,382.9	3,327.6	11,330.0
Equity	13,986.7	22,468.0	16,932.0	3,074.2	8,184.6
<b>Adjusted ratios</b>					
EBITDA margin (%)	31.4	34.4	32.8	21.9	26.4
EBITDA interest coverage (x)	3.8	4.6	5.0	4.5	4.2
EBIT interest coverage (x)	2.8	3.3	3.6	2.7	2.9
Return on capital (%)	7.8	7.1	8.3	6.3	8.1
FFO/debt (%)	17.0	19.6	20.4	29.0	19.6
Free operating cash flow/debt (%)	2.8	(1.0)	0.3	11.1	1.5
Debt/EBITDA (x)	4.7	4.3	4.3	4.1	4.2
Total debt/debt plus equity (%)	59.6	47.4	56.9	52.0	58.1

## Financial Risk Profile: Aggressive; Mostly Steady Cash Flow And Substantial Debt Leverage

We consider AEP's financial risk profile aggressive, reflecting adjusted financial measures that are in line with the rating. This assessment reflects large capital expenditures, mostly for environmental-compliance programs and for new generation and transmission. We forecast that the elevated spending and recurring dividend payments could result in negative discretionary cash flow for several years and will require vigilant cost recovery to maintain cash flow measures. We expect consolidated financial measures, including ratios of debt to EBITDA, funds from operations (FFO) to total debt, and debt to capital, to remain in line with the rating. For the 12 months ended Sept. 30, 2012, FFO to total debt was about 18.3%, total debt to total capital was about 57%, and debt to EBITDA was 4.5x. After reducing

cash flow from operations by capital expenditures and dividends, discretionary cash flow was negative \$470 million and net cash flow (FFO after dividends) to capital expenditures was 91%. Both indicate a need for external financing to fund both capital expenditures and dividends. FFO interest coverage was robust at 4.2x and the dividend payout ratio was manageable at 62%.

Table 2

Annual Cash Flow Measures							
EBITDA	3,689.0	3,895.0	3,903.3	4,373.0	4,293.6	4,596.5	4,607.8
Funds from operations (FFO)	2,820.1	2,707.7	2,779.0	3,668.7	3,322.9	3,562.8	3,813.3
Working capital	61.0	(163.0)	(207.0)	(1,212.0)	(367.0)	498.0	(483.0)
Cash flow from operations (CFO)	2,861.1	2,573.7	2,429.0	2,475.7	3,586.9	4,060.8	3,627.3
Capital expenditures	3,545.3	3,665.5	4,173.6	2,989.3	2,383.0	3,021.0	3,168.5
Free operating cash flow (FOCF)	(684.1)	(1,091.8)	(1,744.5)	(513.6)	1,203.9	1,039.8	458.8
Dividends	591.0	628.5	675.3	773.3	839.3	912.8	929.8
Discretionary cash flow (DCF)	(1,275.1)	(1,720.3)	(2,419.8)	(1,286.9)	364.6	127.0	(471.0)
Debt	14,375.2	16,611.4	20,811.3	20,787.1	20,631.2	20,594.9	20,873.9
Equity	9,473.0	10,109.5	10,881.0	13,328.0	13,809.5	14,822.5	15,463.5
EBITDA interest coverage (x)	4.0	3.7	3.4	3.7	3.7	4.1	4.2
FFO interest coverage (x)	3.7	3.2	3.1	3.8	3.6	3.9	4.2
FFO/debt (%)	19.6	16.3	13.4	17.6	16.1	17.3	18.3
FOCF/debt (%)	(4.8)	(6.6)	(8.4)	(2.5)	5.8	5.0	2.2
DCF/debt (%)	(8.9)	(10.4)	(11.6)	(6.2)	1.8	0.6	(2.3)
Net cash flow/capex (%)	62.9	56.7	50.4	96.9	104.2	87.7	91.0
Debt/EBITDA (x)	3.9	4.3	5.3	4.8	4.8	4.5	4.5
Debt/debt and equity (%)	60.3	62.2	65.7	60.9	59.9	58.1	57.4
Dividend payout ratio (%)	59.6	55.1	48.4	55.4	68.0	57.2	62.0

### Standard & Poor's base case cash flow and capital structure expectations

Our base forecast suggests mostly steady key credit measures over the next several years. We expect cash flow measures will slightly weaken from current levels, due to decreasing deferred taxes. However, debt leverage measures are expected to modestly improve with adjusted debt to total capital trending slightly less than 58% and adjusted debt to EBITDA projected to hover at about 4.4x. We expect net cash flow to capital spending to decrease to about 60% and begin improving after environmental spending begins to taper off. Discretionary cash flow is forecasted to become significantly negative over the next few years, both due to growing capital expenditures and ongoing dividends. We project that FFO interest coverage will decrease to about 3.3x in part from lower FFO caused by the decrease in deferred taxes. We derive the base case forecast financial measures from our assumptions, including:

- Over the next several years, capital spending remains high for environmental compliance and transmission operations and for routine repairs and maintenance.
- Capital spending results in weakening internal funding and a greater reliance on capital markets for financing.
- EBITDA growth consisting of revenue increases and customer growth is likely to be about the same as in recent years, but increase as capacity prices return to higher levels as demonstrated by the recent PJM RPM capacity auction.
- Retail stability rider recovery of approximately \$500 million through the Ohio transition period ending May 31,

2015.

- Refinancing of many upcoming debt maturities.
- Dividend payout ratio similar to current levels and assumed dividend growth in line with historical levels.
- Maintaining a liquidity assessment we believe to be adequate.
- Maintaining financial policies we consider aggressive.
- Continuing commitment to credit quality and the maintenance of a balanced capital structure.

### Standard & Poor's adjustments

Standard & Poor's adjusted consolidated financial ratios for AEP include adjustments for capital and operating leases, pension-related items, intermediate equity treatment of the junior subordinated notes, the reduction of debt due to the overfunded nuclear fund, securitized debt, and the addition of Ohio Valley Electric Corp. debt equal to AEP's ownership.

Table 3

### Reconciliation Of American Electric Power Co. Inc. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. \$)

--Fiscal year ended Dec. 31, 2011--

#### American Electric Power Co. Inc. reported amounts

	Debt	Shareholders' equity	Revenues	EBITDA	Operating income	Interest expense	Cash flow from operations	Cash flow from c
Reported	18,166.0	14,665.0	15,116.0	4,576.0	2,782.0	933.0	3,788.0	
<b>Standard &amp; Poor's adjustments</b>								
Operating leases	1,860.3	--	--	112.4	112.4	112.4	198.6	
Intermediate hybrids reported as debt	(157.5)	157.5	--	--	--	(13.8)	13.8	
Intermediate hybrids reported as equity	--	--	--	--	--	1.0	(1.0)	
Postretirement benefit obligations	978.3	--	--	18.0	18.0	--	324.4	
Capitalized interest	--	--	--	--	--	63.0	(63.0)	
Share-based compensation expense	--	--	--	61.8	--	--	--	
Securitized utility cost recovery	(1,688.0)	--	(253.7)	(253.7)	(94.7)	(94.7)	(159.0)	
Asset retirement obligations	321.8	--	--	82.0	82.0	82.0	(41.0)	
Nonoperating income (expense)	--	--	--	--	545.0	--	--	
Reverse changes in working-capital	--	--	--	--	--	--	--	
Debt--accrued interest not included in reported debt	279.0	--	--	--	--	--	--	
Debt-other	835.1	--	--	--	--	--	--	
D&A--impairment charges/(reversals)	--	--	--	--	139.0	--	--	
Interest expense-other	--	--	--	--	--	31.7	--	



Table 3

Reconciliation Of American Electric Power Co. Inc. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. \$)								
Total adjustments	2,428.9	157.5	(253.7)	20.5	801.7	181.6	272.8	
<b>Standard &amp; Poor's adjusted amounts</b>								
	<b>Debt</b>	<b>Equity</b>	<b>Revenues</b>	<b>EBITDA</b>	<b>EBIT</b>	<b>Interest expense</b>	<b>Cash flow from operations</b>	<b>Funds from op</b>
Adjusted	20,594.9	14,822.5	14,862.3	4,596.5	3,583.7	1,114.6	4,060.8	

## Related Criteria And Research

- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008
- Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Business Risk/Financial Risk Matrix Expanded, Sept. 18, 2012
- 2008 Corporate Ratings Criteria: Ratios And Adjustments, April 15, 2008
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012

Temporary contact numbers: Gerrit Jepsen 917-584-2786; Dimitri Nikas 646-584-8438

### Ratings Detail (As Of December 17, 2012)

#### American Electric Power Co. Inc.

Corporate Credit Rating	BBB/Stable/A-2
Junior Subordinated	BB+
Senior Unsecured	BBB
Senior Unsecured	BBB-

#### Corporate Credit Ratings History

07-Mar-2003	BBB/Stable/A-2
24-Jan-2003	BBB+/Watch Neg/A-2
23-May-2002	BBB+/Stable/A-2

#### Related Entities

##### AEP Texas Central Co.

Issuer Credit Rating	BBB/Stable/--
Senior Unsecured	BBB
Senior Unsecured	BBB/Developing

##### AEP Texas North Co.

Issuer Credit Rating	BBB/Stable/--
Senior Unsecured	BBB
Senior Unsecured	BBB/Developing

##### Appalachian Power Co.

Issuer Credit Rating	BBB/Stable/--
Senior Unsecured	BBB

##### Indiana Michigan Power Co.

Issuer Credit Rating	BBB/Stable/--
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##### Kentucky Power Co.

Issuer Credit Rating	BBB/Stable/--
Senior Unsecured	BBB

**Ratings Detail (As Of December 17, 2012) (cont.)**

**Ohio Power Co.**

Issuer Credit Rating	BBB/Stable/--
Senior Unsecured	BBB
Senior Unsecured	BBB/Negative

**Public Service Co. of Oklahoma**

Issuer Credit Rating	BBB/Stable/--
Senior Unsecured	BBB
Senior Unsecured	BBB/Developing

**RGS (AEGCO) Funding Corp.**

Issuer Credit Rating	BBB/Stable/--
Senior Unsecured	BBB-

**RGS (I&M) Funding Corp.**

Issuer Credit Rating	BBB/Stable/--
Senior Unsecured	BBB-

**Southwestern Electric Power Co.**

Issuer Credit Rating	BBB/Stable/--
Senior Unsecured	BBB
Senior Unsecured	BBB/Developing

\*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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**McGRAW-HILL**

December 14, 2011

## American Electric Power Co. Inc.

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# American Electric Power Co. Inc.

## Major Rating Factors

### Strengths:

- Mostly steady operating cash flow from regulated utilities;
- Large and diverse customer base;
- Geographic diversity; and
- Low-cost generation fleet.

### Weaknesses:

- Exposure to environmental regulations could pressure financial measures;
- Marketing operations weaken creditworthiness; and
- Increased unregulated generation may pressure business profile.

**Corporate Credit Rating**

BBB/Stable/A-2

## Rationale

Standard & Poor's Ratings Services' ratings on American Electric Power Co. Inc. (AEP) reflect its consolidated credit profile, which includes regulated and unregulated operations. We consider the company's business risk profile excellent and its financial risk profile aggressive. (For more on business risk and financial risk, see "Business Risk/Financial Risk Matrix Expanded," published on May 27, 2009, on RatingsDirect.)

The excellent business profile primarily reflects AEP's status as a large public utility holding company that owns regulated electric utility subsidiaries operating in 11 states in the Midwest and Southwest. The company operates low-risk transmission and distribution wires-only businesses in Texas; fully integrated regulated utilities in states such as Indiana and West Virginia; and higher-risk hybrid utilities in Ohio. Although a portion of generation assets are outside the rate base, most of the consolidated generating capacity is under stabilizing regulatory oversight. The company's generating and transmission facilities are interconnected, and its operations are coordinated as an integrated electric utility system.

Electric utility operations are slightly above average, characterized by competitive rates, good reliability, a strong collection of low-cost, coal-fired generation in the eastern part of the system, and mostly supportive regulatory relationships. Service territories vary widely, ranging from manufacturing and rural areas with lower-growth economies to higher-growth, service-oriented economies, like in the Columbus, Ohio, metropolitan area, that are more stable. The diversity in markets and in regulation somewhat elevates credit quality, but managing the complex variety of regulatory environments can be challenging and requires constant vigilance. This is evident in Arkansas, where the company is continuing to build the Turk coal unit while multiple legal challenges are pending, including litigation in connection with the unit's water intake. Over the longer term, with roughly 25,000 megawatts (MW) of coal-fired generation, including those in Ohio, material compliance costs related to numerous environmental rules could pressure credit quality. In addition to these coal assets, there are 9,000 MW of gas generation and 2,200 MW of nuclear.

The company's unregulated operations consist mostly of a large portfolio of quasi-regulated electric generating plants, mainly in Ohio, that have been primarily serving AEP's retail utility customers. We expect AEP's long track

record of solid operating performance in its unregulated business operations to continue. Stricter environmental regulation will place financial stress on the company and erode the fleet's competitiveness, but we don't expect these pressures to completely eliminate the advantages of AEP's coal fleet. AEP has indicated that it will retire 5,109 MW of coal-fired assets and retrofit part of the fleet with pollution control equipment. Although AEP's Ohio-based generation accounts for only a portion of the company's credit profile, absent more robust financial measures, a strategic shift to a greater reliance on wholesale market prices to generate cash would increase business risk and could ultimately weaken credit quality.

We consider AEP's financial risk profile to be aggressive. This assessment reflects financial measures that are in line with the rating, along with large capital expenditures. The company's considerable capital spending is mostly for environmental compliance programs and for new generation and transmission. The elevated spending levels and dividend payments could result in negative discretionary cash flow for several years, and will require vigilant cost recovery to maintain cash flow measures. For the 12 months ended Sept. 30, 2011, funds from operations (FFO) to total debt was 21%, total debt to total capital was around 58%, and debt to EBITDA was 4.3x. The ratios are in line with the rating. Discretionary cash flow is positive and net cash flow (FFO after dividends) to capital expenditures exceeded 130%. FFO interest coverage was 4.5x and the dividend payout ratio was a manageable 58%. Adjustments include capital and operating leases, pension-related items, intermediate equity treatment of the junior subordinated notes, and securitized debt.

### **Liquidity**

The short-term rating on AEP is 'A-2'. We consider AEP's liquidity adequate under Standard & Poor's liquidity methodology. (We categorize liquidity in five standard descriptors. See "Liquidity Descriptors For Global Corporate Issuers," published on Sept. 28, 2011.) We base our liquidity assessment on the following factors and assumptions:

- We expect AEP's liquidity sources over the next 12 months, including cash, FFO, and credit facility availability, to exceed uses by 1.2x. Uses include necessary capital spending, working capital, debt maturities, and shareholder distributions.
- Debt maturities are manageable over the next 12 months.
- We believe liquidity sources would exceed uses even if EBITDA declined 15%.
- In our assessment, AEP has good relationships with its banks, and has a good standing in the credit markets, having successfully issued debt during the recent credit crisis.

In our analysis of liquidity over the next 12 months, we assume \$7.2 billion of liquidity sources, consisting of FFO and credit facility availability. We estimate liquidity uses of \$4.9 billion for capital spending, maturing debt, working capital, and shareholder distributions.

AEP's credit agreements include a financial covenant requiring that debt to total capitalization be no greater than 67.5%. As of Sept. 30, 2011, the company was in compliance with the covenant at 50.3%.

Debt maturities are manageable through 2016. Excluding amortizing AEP Texas Central securitization bonds, \$690 million is due in 2012, \$1.4 billion in 2013, \$1 billion in 2014, \$1.3 billion in 2015, and \$500 million in 2016. We expect that the company will refinance a majority of the maturing debt.

## Outlook

The stable outlook for the ratings on AEP and its subsidiaries assumes timely recovery of rate base investments for environmental compliance, system reliability, and continued strategic emphasis on regulated operations. Our base forecast includes adjusted FFO to total debt of at least 15%, debt to EBITDA under 5x, and debt leverage to total capital of no more than 60%, all of which are consistent with our expectations for the 'BBB' rating. We could lower the ratings if financial measures fall short of our base forecast on a sustained basis to adjusted FFO to total debt below 12%, debt to EBITDA over 5.2x, and debt leverage over 62%. We could raise the ratings if there is greater certainty regarding business risks and if financial measures exceed our baseline forecast, including FFO to total debt in excess of 20%, debt to EBITDA below 4x, and debt to total capital under 55%.

## Related Criteria And Research

- Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- Ratios And Adjustments, April 15, 2008
- Analytical Methodology, April 15, 2008

Table 1

American Electric Power Co. Inc. -- Peer Comparison					
Industry Sector: Energy					
	American Electric Power Co. Inc.	Duke Energy Corp.	Southern Co.	Progress Energy Inc.	Xcel Energy Inc.
Rating as of Dec. 14, 2011	888/Stable/A-2	A-/Stable/A-2	A/Stable/A-1	88B+/Watch Pos/A-2	A-/Stable/A-2
--Average of past three fiscal years--					
<b>(Mil. \$)</b>					
Revenues	13,871.7	13,403.3	15,645.6	9,747.3	10,385.6
EBITDA	4,190.0	4,474.4	4,921.6	3,089.4	2,524.8
Net income from cont. oper.	1,314.7	1,219.7	1,664.9	823.0	694.4
Funds from operations (FFO)	3,256.9	3,985.8	3,955.5	2,218.9	2,004.8
Capital expenditures	3,182.0	4,530.2	4,191.1	2,547.3	2,052.6
Free operating cash flow	(568.1)	(549.7)	(596.1)	(459.7)	(67.7)
Dividends paid	762.6	1,232.7	1,402.8	724.3	422.9
Discretionary cash flow	(1,330.7)	(1,782.4)	(1,998.8)	(1,184.0)	(490.5)
Cash and short-term investments	767.0	1,416.3	498.9	505.3	155.1
Debt	20,743.2	18,503.2	21,358.2	14,718.8	10,963.4
Preferred stock	187.8	0.0	747.0	182.5	252.5
Equity	12,672.8	21,896.7	15,532.3	9,574.2	7,696.0
Debt and equity	33,416.0	40,399.9	36,890.6	24,293.0	18,659.4
<b>Adjusted ratios</b>					
EBITDA margin (%)	30.2	33.4	31.5	31.7	24.3
EBIT interest coverage (x)	2.5	3.2	3.3	2.5	2.7
Return on capital (%)	7.7	6.8	8.3	8.8	8.0

Table 1

American Electric Power Co. Inc. -- Peer Comparison (cont.)					
FFO int. cov. (X)	3.5	5.1	4.5	3.4	4.1
FFO/debt (%)	15.7	21.5	18.5	15.1	18.3
Free operating cash flow/debt (%)	(2.7)	(3.0)	(2.8)	(3.1)	(0.6)
Discretionary cash flow/debt (%)	(6.4)	(9.6)	(9.4)	(8.0)	(4.5)
Net cash flow/capex (%)	78.4	60.8	60.9	58.7	77.1
Debt/EBITDA (x)	5.0	4.1	4.3	4.8	4.3
Total debt/debt plus equity (%)	62.1	45.8	57.9	60.6	58.8
Return on capital (%)	7.7	6.8	8.3	8.8	8.0
Return on common equity (%)	9.9	4.3	10.4	7.4	8.2
Common dividend payout ratio (un-adj.) (%)	56.8	99.7	86.4	84.1	64.2

Table 2

### American Electric Power Co. Inc. -- Financial Summary

#### Industry Sector: Energy

	--Fiscal year ended Dec. 31--				
	2010	2009	2008	2007	2006
Rating history	BBB/Stable/A-2	BBB/Stable/A-2	BBB/Stable/A-2	BBB/Stable/A-2	BBB/Stable/A-2
<b>(Mil. \$)</b>					
Revenues	14,176.4	13,241.8	14,197.0	13,259.7	12,502.9
EBITDA	4,293.6	4,373.0	3,903.3	3,895.0	3,689.0
Net income from continuing operations	1,214.0	1,362.0	1,368.0	1,144.0	992.0
Funds from operations (FFO)	3,322.9	3,668.7	2,779.0	2,707.7	2,820.1
Capital expenditures	2,383.0	2,989.3	4,173.6	3,665.5	3,545.3
Dividends paid	839.3	773.3	675.3	628.5	591.0
Debt	20,631.2	20,787.1	20,811.3	16,611.4	14,375.2
Preferred stock	187.5	188.0	188.0	30.5	61.0
Equity	13,809.5	13,328.0	10,881.0	10,109.5	9,473.0
Debt and equity	34,440.7	34,115.1	31,692.3	26,720.9	23,848.2
<b>Adjusted ratios</b>					
EBITDA margin (%)	30.3	33.0	27.5	29.4	29.5
EBIT interest coverage (x)	2.5	2.6	2.4	2.3	2.5
FFO int. cov. (x)	3.6	3.8	3.1	3.2	3.7
FFO/debt (%)	16.1	17.6	13.4	16.3	19.6
Discretionary cash flow/debt (%)	(1.3)	(6.3)	(11.6)	(10.5)	(8.9)
Net cash flow/capex (%)	104.2	96.9	50.4	56.7	62.9
Debt/debt and equity (%)	59.9	60.9	65.7	62.2	60.3
Return on capital (%)	7.2	7.8	8.0	8.0	8.2
Return on common equity (%)	8.1	10.2	12.0	10.6	9.5
Common dividend payout ratio (un-adj.) (%)	68.0	55.4	48.4	55.1	59.6



Table 3

**Reconciliation Of American Electric Power Co. Inc. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. \$)**

--Fiscal year ended Dec. 31, 2010--

**American Electric Power Co. Inc. reported amounts**

	Debt	Shareholders' equity	Revenues	EBITDA	Operating income	Interest expense	Cash flow from operations	Cash flow from operations	Dividends paid	Capital expenditures
Reported	18,157.0	13,682.0	14,427.0	4,304.0	2,663.0	999.0	2,662.0	2,662.0	827.0	2,436.0
<b>Standard &amp; Poor's adjustments</b>										
Trade receivables sold or securitized	--	--	--	--	--	0.0	--	--	--	--
Operating leases	1,963.9	--	--	122.1	122.1	122.1	197.9	197.9	--	--
Intermediate hybrids reported as debt	(157.5)	157.5	--	--	--	(13.8)	13.8	13.8	13.8	--
Intermediate hybrids reported as equity	30.0	(30.0)	--	--	--	1.5	(1.5)	(1.5)	(1.5)	--
Postretirement benefit obligations	1,048.5	--	--	15.0	15.0	--	341.3	341.3	--	--
Capitalized interest	--	--	--	--	--	53.0	(53.0)	(53.0)	--	(53.0)
Share-based compensation expense	--	--	--	28.1	--	--	--	--	--	--
Securitized utility cost recovery	(1,847.0)	--	(250.6)	(250.6)	(102.6)	(102.6)	(148.0)	(148.0)	--	--
Asset retirement obligations	304.2	--	--	75.0	75.0	75.0	(56.6)	(56.6)	--	--
Reclassification of nonoperating income (expenses)	--	--	--	--	197.0	--	--	--	--	--
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	--	367.0	--	--
Debt - Accrued interest not included in reported debt	281.0	--	--	--	--	--	--	--	--	--
Debt - Other	851.1	--	--	--	--	--	--	--	--	--
Interest expense - Other	--	--	--	--	--	31.7	--	--	--	--
Total adjustments	2,474.2	127.5	(250.6)	(10.4)	306.5	166.9	293.9	660.9	12.3	(53.0)

Table 3

**Reconciliation Of American Electric Power Co. Inc. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. S) (cont.)****Standard & Poor's adjusted amounts**

	Debt	Equity	Revenues	EBITDA	EBIT	Interest expense	Cash flow from operations	Funds from operations	Dividends paid	Capital expenditures
Adjusted	20,631.2	13,809.5	14,176.4	4,293.6	2,969.5	1,165.9	2,955.9	3,322.9	839.3	2,383.0

**Ratings Detail (As Of December 14, 2011)****American Electric Power Co. Inc.**

Corporate Credit Rating	BBB/Stable/A-2
Commercial Paper	
Local Currency	A-2
Junior Subordinated (1 Issue)	BB+
Senior Unsecured (1 Issue)	BBB

**Corporate Credit Ratings History**

07-Mar-2003	BBB/Stable/A-2
24-Jan-2003	BBB+/Watch Neg/A-2
23-May-2002	BBB+/Stable/A-2

**Business Risk Profile**

Excellent

**Financial Risk Profile**

Aggressive

**Related Entities****AEP Texas Central Co.**

Issuer Credit Rating	BBB/Stable/--
Preferred Stock (2 Issues)	BB+
Senior Secured (1 Issue)	BBB/Developing
Senior Unsecured (6 Issues)	BBB
Senior Unsecured (1 Issue)	BBB/Developing

**AEP Texas North Co.**

Issuer Credit Rating	BBB/Stable/--
Senior Unsecured (1 Issue)	BBB
Senior Unsecured (1 Issue)	BBB/Developing

**Appalachian Power Co.**

Issuer Credit Rating	BBB/Stable/--
Senior Unsecured (18 Issues)	BBB
Senior Unsecured (1 Issue)	BBB/Developing

**Columbus Southern Power Co.**

Issuer Credit Rating	BBB/Stable/--
Senior Unsecured (8 Issues)	BBB
Senior Unsecured (2 Issues)	BBB/Negative

**Indiana Michigan Power Co.**

Issuer Credit Rating	BBB/Stable/--
Senior Unsecured (11 Issues)	BBB

**Ratings Detail (As Of December 14, 2011) (cont.)****Kentucky Power Co.**

Issuer Credit Rating	BBB/Stable/--
Senior Unsecured (2 Issues)	BBB

**Ohio Power Co.**

Issuer Credit Rating	BBB/Stable/--
Senior Unsecured (13 Issues)	BBB

**Public Service Co. of Oklahoma**

Issuer Credit Rating	BBB/Stable/--
Preferred Stock (2 Issues)	BB+
Senior Unsecured (5 Issues)	BBB
Senior Unsecured (1 Issue)	BBB/Developing

**RGS (AEGCO) Funding Corp.**

Issuer Credit Rating	BBB/Stable/--
Senior Unsecured (2 Issues)	BBB-

**RGS (I&M) Funding Corp.**

Issuer Credit Rating	BBB/Stable/--
Senior Unsecured (2 Issues)	BBB-

\*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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December 29, 2009

## American Electric Power Co. Inc.

**Primary Credit Analyst:**

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# American Electric Power Co. Inc.

## Major Rating Factors

### Strengths:

- Steady utility operating cash flows;
- Large and diverse customer base;
- Geographic diversity; and
- Low-cost generation.

### Weaknesses:

- Marketing operations detract from credit profile;
- Capital spending levels;
- Exposure to laws or rules regarding carbon dioxide emissions; and
- Aggressive consolidated debt leverage.

**Corporate Credit Rating**

BBB/Stable/A-2

## Rationale

The ratings on American Electric Power Co. Inc. (AEP) reflect its consolidated credit profile that includes regulated and non-regulated operations. The company's business risk profile is considered excellent and its financial risk profile is considered aggressive. Columbus, Ohio-based AEP has \$17.6 billion of outstanding debt.

The excellent business profile primarily reflects AEP's status as a large public utility holding company that owns regulated electric utility subsidiaries operating in 11 states in the Midwest and Southwest of the United States. The company operates as low-risk transmission and distribution wires-only businesses in regions of Texas; fully integrated regulated utilities in places such as Indiana and West Virginia; or higher-risk hybrid utilities in states developing deregulation models like Ohio. Electric generation is housed in and out of utility rate bases, but most of the generating capacity is under stabilizing regulatory oversight. The company's generating and transmission facilities are interconnected, and their operations are coordinated as an integrated electric utility system.

Electric utility operations are slightly above average, characterized by competitive rates, good reliability, a strong collection of low-cost, coal-fired generation in the eastern part of the system, and mostly supportive regulatory relationships. Service territories vary widely, ranging from manufacturing and rural areas with lower growth economies, to higher-growth, service-oriented economies like Columbus, Ohio, that are more stable. The diversity in markets and in regulation somewhat elevates credit quality, but managing the complex variety of regulatory environments can challenge AEP management and requires constant vigilance. Over the longer term, as an overwhelmingly coal-based electric utility, credit quality could be affected if legislation is enacted regarding carbon dioxide emissions that would result in material compliance costs.

The company's unregulated operations primarily consist of a large portfolio of domestic unregulated electric generating plants, mainly in Ohio, that primarily serve AEP's retail utility customers and continue to reside somewhere between a regulated rate base and full merchant status. AEP's long track record of solid operating performance is expected to continue and improve under the unregulated business operations. Stricter environmental laws and regulation will place financial stress and erode the fleet's competitiveness, but are not expected to

completely eliminate the advantages of AEP's coal-fired plants. AEP has indicated that ultimately about 25% of its coal-fired generation may be retired. Although AEP's Ohio-based generation accounts for only a modest portion of the company's credit profile, any strategic move that quickly leads to a greater reliance on wholesale market prices to generate cash and earnings from that fleet would suggest a tolerance for increased business risk that could weaken credit quality.

We consider AEP's financial risk profile as aggressive, which reflects the company's large capital spending program and financial measures inline for its rating. The company's considerable capital expenditures are needed to fund its environmental-compliance programs for stricter air-quality standards and for new generation to meet load growth. AEP also intends to spend substantial amounts of capital on its transmission and distribution system to improve reliability. The elevated spending levels could result in negative free cash flow for several years, and will likely require ongoing rate changes in many of its jurisdictions to maintain operating cash flow at the utilities. Although adjusted financial measures have declined year over year, they remain in line for the rating. For 12 months ended Sept. 30, 2009, funds from operations (FFO) interest coverage was about 3.29x, FFO to total debt was about 15.5%, and total debt to total capital was about 60%. Net cash flow (FFO post dividends) to capital expenditures was 63% and the dividend payout ratio was 58%. All these ratios improved from those as of 12 months ended March 31, 2009, before the company's common equity issuance and incremental rate relief. Debt to EBITDA also showed improvement to 5.0x from 5.8x as of March. Adjustments reflect capital and operating leases, and pension-related items, intermediate equity treatment of the junior subordinated notes, and securitized debt. Given AEP's business risks, sustainable financial expectations are for debt leverage to be under 60%, FFO interest coverage to approximate 3.5x, and FFO to debt ratio approaching 20% in order to comfortably maintain the current ratings.

#### **Short-term credit factors**

AEP's short-term rating is 'A-2'. AEP's liquidity reflects high cash balances of \$877 million and substantial availability of roughly 80% under the company's \$3.6 billion of credit facilities, all as of Sept. 30, 2009. AEP's commercial paper program is backed by its credit facilities that mature in 2011 (\$1.5 billion) and 2012 (\$1.5 billion). The company has a third \$627 million credit agreement that matures in April 2011 against which letters of credit can be issued. As of Sept. 30, 2009, there was \$347 million of outstanding CP and \$372 million of issued LCs. Liquidity for the domestic electric subsidiaries is largely from AEP's money pool and the sale of accounts receivables. The strength of the liquidity also incorporates the stability of the regulated businesses that reliably produce operating cash flow. Except for 2010 when \$1.8 billion matures, and will require a prudent financing, debt maturities are manageable through 2012.

## **Outlook**

The stable outlook for AEP assumes timely recovery of rate base investments for environmental compliance, system reliability, and continued strategic emphasis on regulated operations. Maintaining the company's balance sheet and other key credit measures will be necessary for continued ratings stability. Higher ratings would be possible over time if AEP demonstrates consistency in its regulated utility strategy and more commitment to improve its financial profile. Rising capital spending or a series of harmful regulatory decisions that thwart the company's recovery of those and other costs could lead to a negative outlook or lower ratings.

Table 1.

<b>American Electric Power Co. Inc. -- Peer Comparison*</b>				
<b>Industry Sector: Energy</b>				
	<b>American Electric Power Co. Inc.</b>	<b>Duke Energy Corp.</b>	<b>Southern Co.</b>	<b>MidAmerican Energy Holdings Co.</b>
Rating as of Dec. 22, 2009	BBB/Stable/A-2	A-/Positive/A-2	A/Stable/A-1	BBB+/Stable/--
<b>--Average of past three fiscal years--</b>				
<b>(Mil. \$)</b>				
Revenues	13,319.9	14,217.3	14,591.1	11,781.6
Net income from cont. oper.	1,168.0	1,630.0	1,549.8	1,318.4
Funds from operations (FFO)	2,769.0	4,149.1	3,352.8	2,540.0
Capital expenditures	3,794.8	3,878.1	3,233.1	3,355.3
Debt	17,266.0	17,312.7	17,438.6	19,652.0
Equity	10,154.5	23,111.8	13,225.8	10,565.1
<b>Adjusted ratios</b>				
Oper. income (bef. D&A)/revenues (%)	29.9	32.5	31.1	32.5
EBIT interest coverage (x)	2.4	3.1	3.4	2.4
EBITDA interest coverage (x)	3.7	4.4	4.9	3.1
Return on capital (%)	8.1	7.1	8.8	9.4
FFO/debt (%)	16.0	24.0	19.2	12.9
Debt/EBITDA (x)	4.5	3.8	3.9	5.2

\*Fully adjusted (including postretirement obligations).

Table 2.

<b>American Electric Power Co. Inc. -- Financial Summary*</b>					
<b>Industry Sector: Energy</b>					
<b>--Fiscal year ended Dec. 31--</b>					
	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
Rating history	BBB/Stable/A-2	BBB/Stable/A-2	BBB/Stable/A-2	BBB/Stable/A-2	BBB/Stable/A-2
<b>(Mil. \$)</b>					
Revenues	14,197.0	13,259.7	12,502.9	12,111.0	14,057.0
Net income from continuing operations	1,368.0	1,144.0	992.0	1,029.0	1,127.0
Funds from operations (FFO)	2,779.0	2,707.7	2,820.1	1,928.7	2,544.3
Capital expenditures	4,173.6	3,665.5	3,545.3	2,560.1	1,764.5
Cash and short-term investments	738.0	543.0	726.0	528.0	595.0
Debt	20,811.3	16,611.4	14,375.2	15,036.0	15,400.8
Preferred stock	188.0	30.5	61.0	61.0	61.0
Equity	10,881.0	10,109.5	9,473.0	7,942.6	7,614.0
Debt and equity	31,692.3	26,720.9	23,848.2	22,978.6	23,014.8
<b>Adjusted ratios</b>					
EBIT interest coverage (x)	2.3	2.3	2.5	2.3	2.2
FFO int. cov. (x)	3.1	3.2	3.7	2.7	3.2
FFO/debt (%)	13.4	16.3	19.6	12.8	16.5



Table 2.

American Electric Power Co. Inc. -- Financial Summary* (cont.)					
Discretionary cash flow/debt (%)	(10.9)	(10.5)	(8.7)	(4.9)	4.5
Net Cash Flow / Capex (%)	50.4	56.7	62.9	53.7	112.7
Debt/debt and equity (%)	65.7	62.2	60.3	65.4	66.9
Return on common equity (%)	12.0	10.6	9.5	11.0	13.3
Common dividend payout ratio (un-adj.) (%)	48.4	55.1	59.6	53.7	49.2

\*Fully adjusted (including postretirement obligations).

Table 3.

Reconciliation Of American Electric Power Co. Inc. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. \$)*											
--Fiscal year ended Dec. 31, 2008--											
American Electric Power Co. Inc. reported amounts											
	Debt	Shareholders' equity	Revenues	Operating income (before D&A)	Operating income (before D&A)	Operating income (after D&A)	Interest expense	Cash flow from operations	Cash flow from operations	Dividends paid	Capital expenditures
Reported	17,959.0	10,754.0	14,440.0	3,999.0	3,999.0	2,516.0	958.0	2,576.0	2,576.0	663.0	3,992.0
Standard & Poor's adjustments											
Trade receivables sold or securitized	650.0	--	--	--	--	--	32.5	--	--	--	--
Operating leases	2,296.7	--	--	336.5	139.3	139.3	139.3	197.2	197.2	--	256.6
Intermediate hybrids reported as debt	(157.5)	157.5	--	--	--	--	(13.8)	13.8	13.8	13.8	--
Intermediate hybrids reported as equity	30.5	(30.5)	--	--	--	--	1.5	(1.5)	(1.5)	(1.5)	--
Postretirement benefit obligations	1,277.3	--	--	(52.0)	(52.0)	(52.0)	--	20.8	20.8	--	--
Accrued interest not included in reported debt	270.0	--	--	--	--	--	--	--	--	--	--
Capitalized interest	--	--	--	--	--	--	75.0	(75.0)	(75.0)	--	(75.0)
Securitized utility cost recovery	(2,132.0)	--	(243.0)	(243.0)	(243.0)	(115.0)	(115.0)	(128.0)	(128.0)	--	--
Asset retirement obligations	102.7	--	--	60.0	60.0	60.0	60.0	(31.2)	(31.2)	--	--
Reclassification of nonoperating income (expenses)	--	--	--	--	--	185.0	--	--	--	--	--

Table 3.

Reconciliation Of American Electric Power Co. Inc. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. S)* (cont.)											
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	--	--	207.0	--	--
Other	514.6	--	--	--	--	--	27.6	--	--	--	--
Total adjustments	2,852.3	127.0	(243.0)	101.5	(95.7)	217.3	207.1	(4.0)	203.0	12.3	181.6

**Standard & Poor's adjusted amounts**

	Debt	Equity	Revenues	Operating income (before D&A)	EBITDA	EBIT	Interest expense	Cash flow from operations	Funds from operations	Dividends paid	Capital expenditures
Adjusted	20,811.3	10,881.0	14,197.0	4,100.5	3,903.3	2,733.3	1,165.1	2,572.0	2,779.0	675.3	4,173.6

\*American Electric Power Co. Inc. reported amounts shown are taken from the company's financial statements but might include adjustments made by data providers or reclassifications made by Standard & Poor's analysts. Please note that two reported amounts (operating income before D&A and cash flow from operations) are used to derive more than one Standard & Poor's-adjusted amount (operating income before D&A and EBITDA, and cash flow from operations and funds from operations, respectively). Consequently, the first section in some tables may feature duplicate descriptions and amounts.

**Ratings Detail (As Of December 29, 2009)**

**American Electric Power Co. Inc.**

Corporate Credit Rating	888/Stable/A-2
Commercial Paper	
Local Currency	A-2
Junior Subordinated (1 Issue)	BB+
Senior Unsecured (2 Issues)	BBB

**Corporate Credit Ratings History**

07-Mar-2003	BBB/Stable/A-2
24-Jan-2003	BBB+/Watch Neg/A-2
23-May-2002	BBB+/Stable/A-2

**Business Risk Profile**

Excellent

**Financial Risk Profile**

Aggressive

**Related Entities**

**AEP Texas North Co**

Issuer Credit Rating	BBB/Stable/--
Preferred Stock (2 Issues)	BB+
Senior Unsecured (1 Issue)	A/Developing
Senior Unsecured (2 Issues)	BBB

**Appalachian Power Co.**

Issuer Credit Rating	BBB/Stable/--
Senior Secured (4 Issues)	BBB
Senior Secured (1 Issue)	BBB/Negative
Senior Unsecured (1 Issue)	A/Developing
Senior Unsecured (1 Issue)	AAA/Stable
Senior Unsecured (17 Issues)	BBB

**Ratings Detail (As Of December 29, 2009) (cont.)****Columbus & Southern Ohio Electric Co.**

Issuer Credit Rating	BBB/Stable/--
Senior Secured (1 Issue)	AAA/Negative
Senior Unsecured (1 Issue)	BBB

**Columbus Southern Power Co.**

Issuer Credit Rating	BBB/Stable/--
Preferred Stock (1 Issue)	BB+
Senior Unsecured (8 Issues)	BBB
Senior Unsecured (2 Issues)	BBB/Negative

**Indiana Michigan Power Co.**

Issuer Credit Rating	BBB/Stable/--
Senior Unsecured (12 Issues)	BBB
Subordinated (1 Issue)	BBB-

**Kentucky Power Co.**

Issuer Credit Rating	BBB/Stable/--
Senior Unsecured (4 Issues)	BBB

**Ohio Power Co.**

Issuer Credit Rating	BBB/Stable/--
Senior Secured (1 Issue)	BBB
Senior Unsecured (18 Issues)	BBB
Subordinated (1 Issue)	BBB-

**Public Service Co. of Oklahoma**

Issuer Credit Rating	BBB/Stable/--
Preferred Stock (4 Issues)	BB+
Senior Unsecured (1 Issue)	A/Developing
Senior Unsecured (8 Issues)	BBB

**RGS (AEGCO) Funding Corp.**

Issuer Credit Rating	BBB/Stable/--
Senior Unsecured (2 Issues)	BBB-

**RGS (I&M) Funding Corp.**

Issuer Credit Rating	BBB/Stable/--
Senior Unsecured (2 Issues)	BBB-

**Southwestern Electric Power Co.**

Issuer Credit Rating	BBB/Stable/--
Preferred Stock (1 Issue)	BB+
Senior Secured (1 Issue)	A-
Senior Unsecured (1 Issue)	A/Developing
Senior Unsecured (9 Issues)	BBB

\*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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The McGraw-Hill Companies

December 16, 2010

**Summary:**

## American Electric Power Co. Inc.

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## Summary:

# American Electric Power Co. Inc.

**Credit Rating:** BBB/Stable/A-2

## Rationale

The ratings on American Electric Power Co. Inc. (AEP) reflect its consolidated credit profile that includes regulated and non-regulated operations. The company's business risk profile is considered excellent and its financial risk profile is considered aggressive. Columbus, Ohio-based AEP has \$18.7 billion of outstanding debt including junior subordinated notes and securitized debt.

The excellent business profile primarily reflects AEP's status as a large public utility holding company that owns regulated electric utility subsidiaries operating in 11 states in the Midwest and Southwest. The company operates as low-risk transmission and distribution wires-only businesses in regions of Texas; fully integrated regulated utilities in places such as Indiana and West Virginia; and, higher-risk hybrid utilities in Ohio. Although a portion of generation assets reside outside rate base, most of the consolidated generating capacity is under stabilizing regulatory oversight. The company's generating and transmission facilities are interconnected, and their operations are coordinated as an integrated electric utility system.

Electric utility operations are slightly above average, characterized by competitive rates, good reliability, a strong collection of low-cost, coal-fired generation in the eastern part of the system, and mostly supportive regulatory relationships. Service territories vary widely, ranging from manufacturing and rural areas with lower growth economies, to higher-growth, service-oriented economies like Columbus, Ohio, that are more stable. The diversity in markets and in regulation somewhat elevates credit quality, but managing the complex variety of regulatory environments can be challenging and requires constant vigilance. This is evident in Arkansas where the company is building the Turk coal unit and continues to have multiple legal challenges around the construction of the unit. Over the longer term, with roughly 25,000 MW of coal-fired generation, material compliance costs related to multiple forthcoming and pending emissions rules could pressure credit quality. Although the majority of the generation portfolio is coal based, there are 9,000 MW of natural gas and 2,200 MW of nuclear generation too.

The company's unregulated operations consist mostly of a large portfolio of domestic unregulated electric generating plants, mainly in Ohio, that primarily serve AEP's retail utility customers and continue to remain quasi-regulated. AEP's long track record of solid operating performance is expected to continue and improve under the unregulated business operations. Stricter environmental laws and regulation will place financial stress and erode the fleet's competitiveness, but are not expected to completely eliminate the advantages of AEP's coal-fired plants. AEP has indicated that it may ultimately retire a significant amount of coal-fired assets and 1,925 MW of coal-fired units in the eastern system were placed in an extended startup mode. Although AEP's Ohio-based generation accounts for only a modest portion of the company's credit profile, any strategic move that quickly leads to a greater reliance on wholesale market prices to generate cash and earnings from that fleet would increase business risk that could ultimately weaken credit quality without stronger financial measures.

We consider AEP's financial risk profile as 'aggressive'. This reflects a large capital spending program and financial measures inline for the rating. The company's considerable capital expenditures are needed to fund its

environmental-compliance programs for stricter air-quality standards and for new generation and transmission. The elevated spending levels could result in negative free cash flow for several years, and will likely require vigilant cost recovery to maintain operating cash flow. For 12 months ended Sept. 30, 2010, funds from operations (FFO) to total debt was about 15%, total debt to total capital was around 61%, and debt to EBITDA was 5x. The ratios are in line for the rating. FFO interest coverage was 3.5x, net cash flow (FFO post dividends) to capital expenditures exceeded 1x and the dividend payout ratio was 62%. Adjustments reflect capital and operating leases, and pension-related items, intermediate equity treatment of the junior subordinated notes, and securitized debt. Given AEP's business risks, sustainable financial expectations are for debt leverage to be under 60% and FFO to debt to approach 20% in order to comfortably maintain the current ratings.

### **Short-term credit factors**

AEP's short-term rating is 'A-2'. Liquidity is 'adequate' under Standard & Poor's liquidity methodology, which categorizes liquidity in five standard descriptors, and this supports AEP's 'BBB' issuer credit rating. Projected sources of liquidity, mainly operating cash flow and available bank lines, exceed projected uses largely for necessary capital expenditures, debt maturities, and common dividends, by more than 1.2x. Furthermore, AEP has the ability to absorb high-impact, low-probability events with limited need for refinancing; flexibility to lower capital spending; sound bank relationships; solid standing in credit markets, and generally prudent risk management. As of Sept. 30, 2010, the company had cash of \$1.4 billion and 62% availability under its \$3.4 billion of credit facilities after excluding outstanding commercial paper and letters of credit. These facilities consist of a \$1.45 billion expiring April 2012, \$1.5 billion expiring June 2013, and \$478 million expiring April 2011. The company currently maintains liquidity that more than adequately addresses potential collateral calls under a stressed scenario comprised of a negative credit event and an adverse movement in commodity prices. Long-term debt maturities are manageable in 2011 (\$616 million) and 2012 (\$565 million) but, in 2013, there may be refinancing risk with \$1.64 billion maturing.

## **Outlook**

The stable outlook for AEP and its subsidiaries assumes timely recovery of rate base investments for environmental compliance, system reliability, and continued strategic emphasis on regulated operations. Maintaining the company's balance sheet and other key credit measures will be necessary for continued ratings stability. Our base forecast includes adjusted FFO to total debt of at least 15%, debt to EBITDA under 5x, and debt leverage to total capital of no more than 60%, all consistent with our expectations for the 'BBB' rating. We could revise the outlook to negative and subsequently lower ratings if financial measures do not remain at our expected levels on a sustained basis because construction projects are not completed on time and budget, a series of harmful regulatory decisions impede the company's recovery of capital expenditures and other costs, or the company funds itself in a less creditworthy manner. We could revise the outlook to positive and ratings could subsequently be raised with greater certainty regarding business risks and financial measures exceed our base line forecast, including FFO to total debt in excess of 20%, debt to EBITDA below 4x, and debt to total capital under 55%.

## **Related Criteria And Research**

- 2008 Corporate Criteria: Analytical Methodology
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded

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December 19, 2008

**Summary:**

**American Electric Power Co. Inc.**

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## Summary:

# American Electric Power Co. Inc.

**Credit Rating:** BBB/Stable/A-2

## Rationale

The ratings on American Electric Power Co. Inc. (AEP) reflect its consolidated credit profile that includes both regulated and non-regulated subsidiaries. The company's business risk profile is excellent, and its financial risk profile is aggressive. (The business profile is ranked as excellent, strong, satisfactory, weak, or vulnerable, and the financial profile is ranked as minimal, modest, intermediate, aggressive, or highly leveraged.)

The excellent business profile primarily rests on the stability of the regulated utility operations and is marginally affected by the more risky unregulated business and ongoing uncertainty of the regulatory paradigm in Ohio.

AEP is a large public utility holding company that owns directly or indirectly all of the common stock of electric utility subsidiaries operating in 11 states in the U.S. Midwest and Southwest. The company operates as either low-risk "wires" businesses; moderate-risk, fully integrated regulated utilities; or higher-risk hybrid utilities in states with unsettled deregulation models. Electric generation is housed in and out of utility rate bases, but most capacity is directly or virtually subject to stabilizing regulatory oversight. The company's generating and transmission facilities are interconnected, and their operations are coordinated as an integrated electric utility system.

Electric utility operations are slightly above average, characterized by competitive rates, good reliability, a strong collection of low-cost, coal-fired generation in the eastern part of the system, and mostly supportive regulatory relationships. Service territories vary widely, ranging from "Rust Belt" and rural areas that exhibit less-than-favorable economic profiles, to higher-growth, service economy-oriented regions like Columbus, Ohio, which are much more resistant to economic cycles. The diversity in markets and regulation somewhat elevates credit quality, but managing the complex variety of regulatory environments is a challenge for AEP management and requires constant vigilance. Over the longer term, its status as an overwhelmingly coal-based electric utility company could imperil credit quality if the global warming issue becomes a permanent part of the political landscape.

The company's unregulated operations primarily consists of a large portfolio of domestic merchant electric generating plants, mainly in Ohio, which are primarily used to serve AEP's retail utility customers and continue to reside somewhere between a regulated rate base and full merchant status. AEP's long track record of solid operating performance is expected to continue and improve under the unregulated business operations. Stricter environmental laws and regulation will place financial stress and erode the fleet's competitiveness, but are not expected to completely eliminate the advantages of AEP's coal-fired plants.

Although AEP's Ohio-based generation accounts for only a modest portion of the company's credit profile, any strategic move that quickly leads to a greater reliance on wholesale market prices to generate cash and earnings from that fleet would suggest a tolerance for increased business risk that could lead to lower ratings. The new legislation in Ohio, and the Public Utility Commission of Ohio's management of the transition process stemming from it, do not appear to support a hasty shift to market-based prices for AEP's Ohio generation.

AEP's aggressive financial profile reflects its large capital programs and marginal financial measures for its rating.

The company's considerable capital expenditure program is needed to fund its environmental-compliance programs, strategic investment in transmission, and for new generation to meet load growth. The company projects an environmental capital-expenditure program totaling almost \$4 billion through 2010 to meet stricter air-quality standards and approximately \$4.5 billion to develop new power plants. AEP also intends to spend substantial amounts of capital on its transmission and distribution system to improve reliability. The elevated spending levels indicate that the company will experience negative free cash flow for several years, and can expect lower utility returns such that AEP will need to continually pursue higher rates in many of its jurisdictions. Given AEP's business risks, sustainable financial expectations are for debt leverage to be under 60%, funds from operations (FFO) interest coverage to approximate 3.5x, and FFO to debt ratio approaching 20% in order to comfortably maintain the current ratings.

### **Short-term credit factors**

AEP's short-term rating is 'A-2'. The adequate liquidity of AEP reflects cash and investments of \$1.37 billion and \$1.33 billion of availability under the company's \$3.919 billion of credit facilities, all as of Oct. 28, 2008. Adequate liquidity also incorporates the stability of the regulated businesses that reliably produce operating cash flow. Long-term maturities in the next two years are significant, particularly the \$1.7 billion due in 2010, and will require a prudent financing strategy. Liquidity for the domestic electric subsidiaries is largely from AEP's money pool and the sale of accounts receivables. AEP's commercial paper program is backed by its credit facilities that mature in 2011 (\$1.5 billion) and 2012 (\$1.454 billion). Additionally, the company has a \$627 million credit agreement that matures in April 2011 and a \$338 million credit agreement that matures in April 2009.

## **Outlook**

The stable outlook for AEP assumes timely recovery of rate base investments for environmental compliance, system reliability, and continued strategic emphasis on regulated operations. Maintaining the company's balance sheet and other key credit measures will be necessary for continued ratings stability. Higher ratings would be possible over time if AEP demonstrates consistency in its regulated utility strategy and more commitment to improve its financial profile. Spiraling capital spending or a series of harmful regulatory decisions that thwart the company's recovery of those and other costs could lead to a negative outlook or lower ratings.

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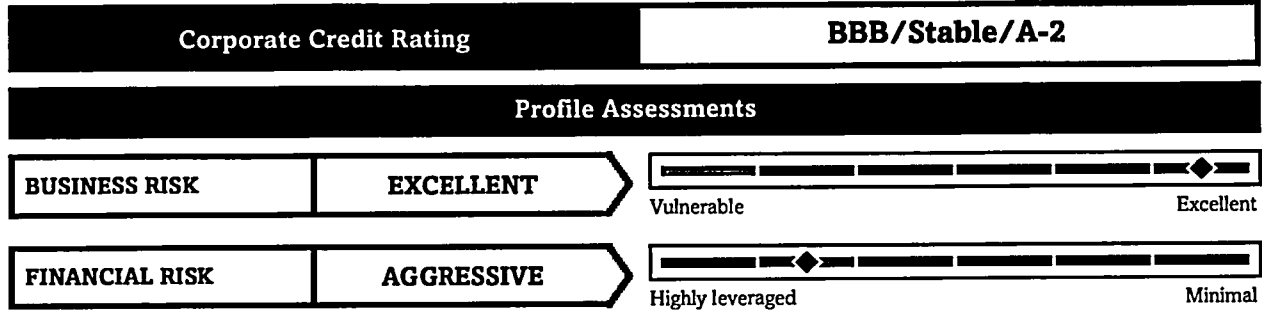
Financial Risk

Liquidity

Related Criteria And Research

**Summary:**

# American Electric Power Co. Inc.



## Rationale

<b>Business Risk: Excellent</b>	<b>Financial Risk: Aggressive</b>
<ul style="list-style-type: none"> <li>• Sole provider (or distributor only) in its service territories of essential electricity service</li> <li>• Large and diverse customer base</li> <li>• Geographic diversity</li> <li>• Steady operating cash flow from regulated utilities</li> <li>• Low-cost coal and nuclear generation</li> <li>• Large coal fleet exposed to environmental standards</li> <li>• Growing unregulated operations that are materially riskier than regulated businesses</li> </ul>	<ul style="list-style-type: none"> <li>• Cash flow erosion from transition in Ohio</li> <li>• Large capital expenditures</li> <li>• Discretionary cash flow to remain negative</li> <li>• Exposure to environmental regulations could pressure financial measures</li> <li>• Net cash flow to capital spending to remain less than 100%</li> <li>• Marketing operations weaken creditworthiness</li> </ul>

## Outlook: Stable

The stable rating outlook on American Electric Power Co. Inc. (AEP) assumes timely recovery of rate base investments for environmental compliance, system reliability, and continued strategic emphasis on regulated operations. Our base forecast includes adjusted funds from operations (FFO) to total debt of at least 15%, debt to EBITDA of less than 5x, and debt leverage to total capital of no more than 60%, all of which are consistent with our expectations for the 'BBB' rating.

### Downside scenario

We could lower the ratings if financial measures fell short of our base forecast on a sustained basis to adjusted FFO to total debt of less than 12%, debt to EBITDA of more than 5.2x, and debt leverage of more than 62%.

### Upside scenario

We could raise the ratings if there were greater certainty regarding business risks and if financial measures exceeded our baseline forecast, including FFO to total debt in excess of 20%, debt to EBITDA of less than 4x, and debt to total capital of less than 55%.

## Standard & Poor's Base-Case Scenario

Our AEP base case scenario, on a consolidated basis, results in EBITDA growth, capital spending growth, and mostly steady debt leverage.

Assumptions	Key Metrics*			
<ul style="list-style-type: none"> <li>Economic conditions in the company's service territories are improving, which will likely increase customer usage</li> <li>EBITDA growth consisting of revenue increases and customer growth is likely to be about the same as in recent years, but increase as capacity prices return to higher levels as demonstrated by the recent PJM reliability pricing model (RPM) capacity auction.</li> <li>Retail stability rider recovery of about \$500 million through the Ohio transition period ending May 31, 2015.</li> <li>Capital spending and dividend payouts lead to negative discretionary cash flow, indicating external funding needs</li> </ul>		<b>2013§</b>	<b>2013E</b>	<b>2014E</b>
	FFO/Total debt	17.4%	15%-17.5%	14.5%-16.5%
	Total debt/EBITDA	4.8x	4x-5x	3.8x-4.7x
	Total debt/Total cap.	58.2%	56.5%-59%	56.5%-58.5%

A—Actual. E—Estimate. §Last 12 months ended March 31, 2013. \*Standard & Poor's adjusted consolidated financial measures for AEP include adjustments to debt for operating leases (\$2.9 bil.), securitized stranded cost (negative \$2.18 bil.), pension-related items (\$514 mil.), asset-retirement obligations (\$322 mil.), accrued interest not in reported debt (\$241 mil.), and other debt (\$816 mil.). EBITDA adjustments include securitized stranded costs (negative \$608 mil.), operating leases (\$140 mil.), asset-retirement obligations (\$85 mil.), pension-related items (\$30 mil.), and share-based compensation expense (\$49 mil.). FFO adjustments include securitized stranded costs (negative \$420 mil.), operating leases (\$243 mil.), pension-related items (\$184 mil.), capitalized interest (negative \$71 mil.), and asset-retirement obligations (negative \$51 mil.). We do not expect these adjustments to change materially in 2013 and 2014.

## Business Risk: Excellent

Our assessment of AEP's business risk profile as "excellent" primarily reflects its status as a large public utility holding company that owns regulated electric utility subsidiaries operating in 11 states in the Midwest and Southwest. These subsidiaries consist of low-risk transmission and distribution wires-only businesses in Texas; fully integrated regulated utilities in states such as Indiana and West Virginia; and higher-risk hybrid operations in Ohio. Although a portion of generation assets is outside rate base, most of the consolidated generating capacity is in regulated rate base. The company's generating and transmission facilities are interconnected, and its operations are coordinated as an integrated electric utility system.

Electric utility operations are slightly above average, characterized by competitive rates; good reliability; low-cost coal-fired generation in the eastern part of the system; and supportive regulatory relationships in numerous jurisdictions. Service territories vary widely, including both manufacturing and rural areas with lower-growth



economies and higher-growth, service-oriented economies, like in the Columbus, Ohio, metropolitan area, that are more stable. The diversity in markets and in regulation somewhat elevates credit quality, but managing the complex variety of regulatory environments can be challenging and requires constant engagement.

Ohio Power continues to transition to a competitive generation market with shopping for generation service available to all retail customers and Ohio commission approval to transfer all its generation assets out of the utility, including to an unregulated generation affiliate. By June 1, 2015, Ohio Power is expected to have fully transitioned to a transmission and distribution utility that will hold auctions to provide power to standard service offer customers. During the transition, AEP will be recovering transition costs through a nonbypassable retail stability rider (RSR) and partly recovering from customers the difference between PJM RPM capacity prices and a Public Utilities Commission of Ohio-determined capacity price of \$188.88 per megawatt (MW) day for the company. Any unrecovered capacity deferral is to be accrued and recovered in rates through 2018. Cash flow is further boosted through rate recovery of a deferred fuel balance that exceeds \$500 million and a deferred regulatory asset balance of about \$300 million.

Over the longer term, with roughly 25,000 MW of coal-fired generation, including those owned by Ohio Power, material compliance costs related to numerous environmental rules could pressure credit quality without adequate cost recovery. In addition to these coal assets, AEP has 9,700 MW of gas generation and a 2,200 MW nuclear plant.

The company's unregulated operations will grow to include about 8,900 MW of Ohio Power generation assets following Ohio Power's 2,400 MW transfer to affiliate utilities and its coal plant closures. Most of Ohio Power's remaining 5,740 MW of coal units should have all the required pollution controls. Gas-fired combined-cycle units will be 2,026 MW and gas-fired peaking assets will be 1,100 MW. We expect AEP's track record of good operating performance in its unregulated business operations to continue. Stricter environmental regulation will erode the fleet's competitiveness, but we do not expect these pressures to completely eliminate the advantages of AEP's coal plants. AEP has indicated that it will retire roughly 5,500 MW of additional coal-fired assets, including Ohio Power's closures, and retrofit other coal assets with pollution-control equipment. Although AEP's Ohio-based generation accounts for only a portion of the company's credit profile, absent more robust financial measures, a shift to a greater reliance on market prices to generate cash would increase business risk and could ultimately weaken credit quality.

## **Financial Risk: Aggressive**

We consider AEP's financial risk profile "aggressive" based on its adjusted consolidated financial measures for the 12 months ended March 31, 2013, including FFO to total debt of 17.4%, debt to EBITDA of 4.8x, and debt to total capital of 58.2%, all in line with the rating. In addition, even though it is committed to credit quality, we consider the company's financial policies to be aggressive. The company has a generally transparent business model and pursues activities and projects that mostly add to the regulated rate base and regulated cash flows. Capital spending and dividend payments translate to negative discretionary cash flow over the forecast period, requiring management to maintain robust cost recovery and tight cost controls to maintain cash flow measures. This negative discretionary cash flow also indicates external funding needs. Our base forecast suggests mostly steady key credit measures over the next several years and continues to reflect steady operating cash flows and execution of the transition in Ohio. We expect cash flow measures will slightly weaken from current levels, due to decreasing deferred taxes, with between 15% and

16% adjusted FFO to total debt. However, debt leverage measures are expected to modestly improve, with adjusted debt to total capital trending slightly less than 58% and adjusted debt to EBITDA projected to hover at about 4.4x. We expect net cash flow to capital spending to decrease to about 60% and begin improving after environmental spending begins to taper off. Our rating on AEP reflects our view of a mostly regulated utility strategy that will include continuous capital spending and timely cost recovery through various regulatory mechanisms. We expect this to lead to steady cash flow measures and manageable debt leverage.

## Liquidity: Adequate

We consider the consolidated liquidity position "adequate" under Standard & Poor's corporate liquidity methodology. We expect that AEP's liquidity sources will exceed its uses by 1.2x over the next 12 months. We do expect that AEP will need to externally fund a portion of its liquidity needs for debt maturities over the next few years.

Principal Liquidity Sources	Principal Liquidity Uses
<ul style="list-style-type: none"> <li>• FFO of roughly \$3.1 billion in 2013</li> <li>• Assumed credit facility availability of about \$2.1 billion in 2013</li> <li>• Working capital of about \$500 million in 2013</li> </ul>	<ul style="list-style-type: none"> <li>• Debt maturities of \$1.8 billion in 2013</li> <li>• Necessary capital spending of about \$1.9 billion in 2013</li> <li>• Shareholder distributions of about \$900 million</li> </ul>

## Covenants

AEP's credit agreements include a financial covenant requiring that debt to total capitalization, excluding securitization debt, junior subordinated notes, and debt of AEP Credit, be no greater than 67.5%. As of March 31, 2013, the company was in compliance with the covenant at 51.4%. Headroom could erode somewhat if debt rises rapidly without adequate growth in equity during the capital spending phase.

## Related Criteria And Research

- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008
- Business Risk/Financial Risk Matrix Expanded, Sept. 18, 2012
- 2008 Corporate Ratings Criteria: Ratios And Adjustments, April 15, 2008
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008
- 2008 Corporate Criteria: Commercial Paper, April 15, 2008
- Corporate Criteria: Assessing U.S. Utility Regulatory Environments, Nov. 7, 2007
- Corporate Criteria: Standard & Poor's Methodology For Imputing Debt For U.S. Utilities' Power Purchase Agreements, May 7, 2007
- Parent/Subsidiary Links; General Principles; Subsidiaries/Joint Ventures/Nonrecourse Projects; Finance Subsidiaries; Rating Link to Parent, Oct. 28, 2004

**Business And Financial Risk Matrix**

Business Risk	Financial Risk					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly Leveraged
Excellent	AAA/AA+	AA	A	A-	BBB	--
Strong	AA	A	A-	BBB	BB	BB-
Satisfactory	A-	BBB+	BBB	BB+	BB-	B+
Fair	--	BBB-	BB+	BB	BB-	B
Weak	--	--	BB	BB-	B+	B-
Vulnerable	--	--	--	B+	B	B- or below

**Note:** These rating outcomes are shown for guidance purposes only. The ratings indicated in each cell of the matrix are the midpoints of the likely rating possibilities. There can be small positives and negatives that would lead to an outcome of one notch higher or lower than the typical matrix outcome. Moreover, there will be exceptions that go beyond a one-notch divergence. For example, the matrix does not address the lowest rungs of the credit spectrum (i.e., the 'CCC' category and lower). Other rating outcomes that are more than one notch off the matrix may occur for companies that have liquidity that we judge as "less than adequate" or "weak" under our criteria, or companies with "satisfactory" or better business risk profiles that have extreme debt burdens due to leveraged buyouts or other reasons. For government-related entities (GREs), the indicated rating would apply to the standalone credit profile, before giving any credit for potential government support.

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June 9, 2011

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## Summary:

# American Electric Power Co. Inc.

**Credit Rating:** BBB/Stable/A-2

## Rationale

Standard & Poor's Ratings Services' ratings on American Electric Power Co. Inc. (AEP) reflect its consolidated credit profile, which includes regulated and unregulated operations. We consider the company's business risk profile excellent and its financial risk profile aggressive. (For more on business risk and financial risk, see "Business Risk/Financial Risk Matrix Expanded," published May 27, 2009, on RatingsDirect on the Global Credit Portal.) Columbus, Ohio-based AEP has \$18.5 billion of outstanding debt, including junior subordinated notes and securitized debt.

The excellent business profile primarily reflects AEP's status as a large public utility holding company that owns regulated electric utility subsidiaries operating in 11 states in the Midwest and Southwest. The company operates low-risk transmission and distribution wires-only businesses in Texas; fully integrated regulated utilities in places such as Indiana and West Virginia; and higher-risk hybrid utilities in Ohio. Although a portion of generation assets are outside rate base, most of the consolidated generating capacity is under stabilizing regulatory oversight. The company's generating and transmission facilities are interconnected, and its operations are coordinated as an integrated electric utility system.

Electric utility operations are slightly above average, characterized by competitive rates, good reliability, a strong collection of low-cost, coal-fired generation in the eastern part of the system, and mostly supportive regulatory relationships. Service territories vary widely, ranging from manufacturing and rural areas with lower-growth economies to higher-growth, service-oriented economies, like Columbus, Ohio's, that are more stable. The diversity in markets and in regulation somewhat elevates credit quality, but managing the complex variety of regulatory environments can be challenging and requires constant vigilance. This is evident in Arkansas, where the company is continuing to build the Turk coal unit while multiple legal challenges are pending, including litigation in connection with the unit's water intake. Over the longer term, with roughly 25,000 megawatts (MW) of coal-fired generation, including those in Ohio, material compliance costs related to numerous environmental rules could pressure credit quality. In addition to these coal assets, there are 9,000 MW of gas generation and 2,200 MW of nuclear.

The company's unregulated operations consist mostly of a large portfolio of quasi-regulated electric generating plants, mainly in Ohio, that have been primarily serving AEP's retail utility customers. We expect AEP's long track record of solid operating performance in its unregulated business operations to continue. Stricter environmental regulation will place financial stress on the company and erode the fleet's competitiveness, but we don't expect these pressures to completely eliminate the advantages of AEP's coal fleet. AEP has indicated that it may ultimately retire a significant number of coal-fired assets in addition to 1,925 MW of coal-fired units in the eastern system that are already in extended startup mode. Although AEP's Ohio-based generation accounts for only a portion of the company's credit profile, absent more robust financial measures, any strategic move that quickly leads to a greater reliance on wholesale market prices to generate cash would increase business risk and could ultimately weaken credit quality.

We consider AEP's financial risk profile aggressive. This reflects financial measures that are in line with the rating, along with large capital expenditures. The company's considerable capital spending is mostly for environmental compliance programs and for new generation and transmission. The elevated spending levels and dividend payments could result in negative discretionary cash flow for several years, and will require vigilant cost recovery to maintain cash flow measures. For the 12 months ended March 31, 2011, funds from operations (FFO) to total debt was 15.5%, total debt to total capital was around 60%, and debt to EBITDA was 4.8x. The ratios are in line with the rating. FFO interest coverage was 3.5x, net cash flow (FFO after dividends) to capital expenditures exceeded 1x, and the dividend payout ratio was 70%. Adjustments reflect capital and operating leases, pension-related items, intermediate equity treatment of the junior subordinated notes, and securitized debt. To comfortably maintain the current ratings given AEP's business risks, we would expect debt leverage to be under 60% and FFO to debt to approach 20%.

### **Liquidity**

The short-term rating on AEP is 'A-2'. Liquidity is adequate under Standard & Poor's liquidity methodology, which categorizes liquidity in five standard descriptors. (For more on our liquidity assessments, see "Standard & Poor's Standardizes Liquidity Descriptors For Global Corporate Issuers," published July 2, 2010.) AEP's adequate liquidity supports the 'BBB' issuer credit rating. Projected sources of liquidity, mainly operating cash flow and available bank lines, cover projected uses, mainly necessary capital expenditures, debt maturities, and common dividends, by about 1.2x. AEP has the ability to absorb high-impact, low-probability events with limited need for refinancing, the flexibility to lower capital spending, sound bank relationships, solid standing in credit markets, and generally prudent risk management. As of March 31, 2011, the company had cash of \$625 million and 68% availability under its \$2.954 billion of credit facilities, excluding outstanding commercial paper and letters of credit. These facilities consist of a \$1.45 billion facility expiring in 2012 and a \$1.5 billion facility expiring in 2013. Long-term debt maturities are manageable in 2011 (\$616 million) and 2012 (\$630 million), but there may be refinancing risk in 2013, with \$1.73 billion maturing.

### **Outlook**

The stable outlook for the ratings on AEP and its subsidiaries assumes timely recovery of rate base investments for environmental compliance, system reliability, and continued strategic emphasis on regulated operations. Maintaining the company's balance sheet and other key credit measures will be necessary for continued ratings stability. Our base forecast includes adjusted FFO to total debt of at least 15%, debt to EBITDA under 5x, and debt leverage to total capital of no more than 60%, all of which are consistent with our expectations for the 'BBB' rating. We could lower the ratings if financial measures fall short of our base forecast on a sustained basis, which could occur if construction projects are not completed on time and budget, a series of harmful regulatory decisions impede the company's recovery of capital expenditures and other costs, or the company raises funds in a less creditworthy manner. We could raise the ratings if there is greater certainty regarding business risks and if financial measures exceed our baseline forecast, including FFO to total debt in excess of 20%, debt to EBITDA below 4x, and debt to total capital under 55%.

## **Related Criteria And Research**

- Standard & Poor's Standardizes Liquidity Descriptors For Global Corporate Issuers, July 2, 2010
- Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- Ratios And Adjustments, April 15, 2008
- Analytical Methodology, April 15, 2008



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June 19, 2012

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## Summary:

# American Electric Power Co. Inc.

**Credit Rating:** BBB/Stable/A-2

## Rationale

Standard & Poor's Ratings Services' ratings on American Electric Power Co. Inc. (AEP) reflect its consolidated credit profile, which includes what we consider to be an "excellent" business risk profile and "aggressive" financial risk profile. The excellent business risk profile primarily reflects AEP's status as a large public utility holding company that owns regulated electric utility subsidiaries operating in 11 states in the Midwest and Southwest. These subsidiaries consist of low-risk transmission and distribution wires-only businesses in Texas; fully integrated regulated utilities in states such as Indiana and West Virginia; and higher-risk hybrid operations in Ohio. Although a portion of generation assets are outside rate base, most of the consolidated generating capacity is under stabilizing regulatory oversight. The company's generating and transmission facilities are interconnected, and its operations are coordinated as an integrated electric utility system.

Electric utility operations are slightly above average, characterized by competitive rates, good reliability, a strong collection of low-cost, coal-fired generation in the eastern part of the system, and supportive regulatory relationships in numerous jurisdictions. Service territories vary widely, ranging from manufacturing and rural areas with lower-growth economies to higher-growth, service-oriented economies, like in the Columbus, Ohio, metropolitan area, that are more stable. The diversity in markets and in regulation somewhat elevates credit quality, but managing the complex variety of regulatory environments can be challenging and requires constant vigilance. This is evident in Ohio, where the regulatory commission approved a stipulated resolution to transition utility customers to competitive generation. Ohio Power Co. was also to transfer its generation assets to an unregulated affiliate. The Ohio commission subsequently retracted its approval of this stipulated resolution and initially opened up shopping to all the utility's retail customers, but subsequently limited shopping to a certain percentage of customers. This has provided greater cash flow certainty to Ohio Power. More clarity around the level of retail shopping that can take place should follow the commission's ruling in the utility's electricity security plan by mid-summer 2012. Over the longer term, with roughly 25,000 megawatts (MW) of coal-fired generation, including those owned by Ohio Power, material compliance costs related to numerous environmental rules could pressure credit quality. In addition to these coal assets, AEP has 9,000 MW of gas generation and a 2,200 MW nuclear plant.

The company's unregulated operations consist mostly of a large portfolio of quasi-regulated electric generating plants, mainly in Ohio, that to date have been primarily serving AEP's retail utility customers at a commission approved generation rate. We expect AEP's track record of good operating performance in its unregulated business operations to continue. Stricter environmental regulation will place financial stress on the company and erode the fleet's competitiveness, but we don't expect these pressures to completely eliminate the advantages of AEP's coal plants. AEP has indicated that it will retire roughly 5,500 MW of additional coal-fired assets and retrofit other coal assets with pollution-control equipment. Although AEP's Ohio-based generation accounts for only a portion of the company's credit profile, absent more robust financial measures, a shift to a greater reliance on market prices to generate cash would increase business risk and could ultimately weaken credit quality.

We consider the financial risk profile for AEP aggressive, reflecting adjusted financial measures that are in line with the rating. This assessment reflects large capital expenditures, mostly for environmental-compliance programs and for new generation and transmission. The elevated spending and dividend payments could result in negative discretionary cash flow for several years, and will require vigilant cost recovery to maintain cash flow measures. We expect consolidated financial measures, including ratios of debt to EBITDA, funds from operations (FFO) to total debt, and debt to capital, to remain in line with the rating. For the 12 months ended March 31, 2012, FFO to total debt was about 17.5%, total debt to total capital was about 57%, and debt to EBITDA was 4.7x. After reducing cash flow from operations by capital expenditures and dividends, discretionary cash flow was a negative \$250 million and net cash flow (FFO after dividends) to capital expenditures dropped to 81%. Both indicate a need for external financing to fund both capital expenditures and dividends. FFO interest coverage continued to be around 3.9x and the dividend payout ratio was manageable at 56%. Adjustments include capital and operating leases, pension-related items, intermediate equity treatment of the junior subordinated notes, and securitized debt.

### Liquidity

The short-term rating on AEP is 'A-2'. We consider AEP's liquidity position "adequate" under Standard & Poor's liquidity methodology. We base our liquidity assessment on the following factors and assumptions:

- We expect AEP's liquidity sources over the next 12 months, including cash, FFO, and credit facility availability, to exceed uses by 1.2x. Uses include necessary capital spending, working capital, debt maturities, and shareholder distributions.
- Debt maturities are manageable over the next 12 months.
- We believe liquidity sources would exceed uses even if EBITDA declined 15%.
- In our assessment, AEP has good relationships with its banks, and has a good standing in the credit markets, having successfully issued debt during the recent credit crisis.

In our analysis of liquidity over the next 12 months, we assume \$7.3 billion of liquidity sources, consisting of FFO and credit facility availability. We estimate liquidity uses of \$4.8 billion for capital spending, maturing debt, working capital, and shareholder distributions.

AEP's credit agreements include a financial covenant requiring that debt to total capitalization be no greater than 67.5%. As of year-end 2011, the company was in compliance with the covenant at 51%.

Debt maturities are manageable through 2016. Including amortizing AEP Texas Central Co. securitization bonds, \$1.4 billion is due in 2012, \$1.4 billion in 2013, \$1.1 billion in 2014, \$1.5 billion in 2015, and \$700 million in 2016. We expect that the company will refinance most of the maturing debt.

### Outlook

The stable outlook for the ratings on AEP and its subsidiaries assumes timely recovery of rate base investments for environmental compliance, system reliability, and continued strategic emphasis on regulated operations. Our base forecast includes adjusted FFO to total debt of at least 15%, debt to EBITDA under 5x, and debt leverage to total capital of no more than 60%, all of which are consistent with our expectations for the 'BBB' rating. We could lower the ratings if financial measures fall short of our base forecast on a sustained basis to adjusted FFO to total debt below 12%, debt to EBITDA over 5.2x, and debt leverage over 62%. We could raise the ratings if there is greater certainty regarding business risks and if financial measures exceed our baseline forecast, including FFO to total debt

in excess of 20%, debt to EBITDA below 4x, and debt to total capital under 55%.

## **Related Criteria And Research**

- Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- Ratios And Adjustments, April 15, 2008
- Analytical Methodology, April 15, 2008

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**McGRAW-HILL**

June 23, 2010

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## Summary:

# American Electric Power Co. Inc.

**Credit Rating:** BBB/Stable/A-2

## Rationale

The ratings on American Electric Power Co. Inc. (AEP) reflect its consolidated credit profile that includes regulated and non-regulated operations. The company's business risk profile is considered excellent and its financial risk profile is considered aggressive. Columbus, Ohio-based AEP has \$18.6 billion of outstanding debt, including junior subordinated notes and securitized debt.

The excellent business profile primarily reflects AEP's status as a large public utility holding company that owns regulated electric utility subsidiaries operating in 11 states in the Midwest and Southwest. The company operates as low-risk transmission and distribution wires-only businesses in regions of Texas; fully integrated regulated utilities in places such as Indiana and West Virginia; or higher-risk hybrid utilities in states developing deregulation models like Ohio. Electric generation is housed in and out of utility rate bases, but most of the generating capacity is under stabilizing regulatory oversight. The company's generating and transmission facilities are interconnected, and their operations are coordinated as an integrated electric utility system.

Electric utility operations are slightly above average, characterized by competitive rates, good reliability, a strong collection of low-cost, coal-fired generation in the eastern part of the system, and mostly supportive regulatory relationships. Service territories vary widely, ranging from manufacturing and rural areas with lower growth economies, to higher-growth, service-oriented economies like Columbus, Ohio, that are more stable. The diversity in markets and in regulation somewhat elevates credit quality, but managing the complex variety of regulatory environments can challenge AEP management and requires constant vigilance. This is evident in Arkansas where the company is building the Turk coal unit and continues to have multiple legal challenges around the construction of the unit. Over the longer term, as an overwhelmingly coal-based electric utility, material compliance costs with legislation or regulation of carbon dioxide emissions could affect credit quality.

The company's unregulated operations consist mostly of a large portfolio of domestic unregulated electric generating plants, mainly in Ohio, that primarily serve AEP's retail utility customers and continue to reside somewhere between a regulated rate base and full merchant status. AEP's long track record of solid operating performance is expected to continue and improve under the unregulated business operations. Stricter environmental laws and regulation will place financial stress and erode the fleet's competitiveness, but are not expected to completely eliminate the advantages of AEP's coal-fired plants. AEP has indicated that ultimately about 25% of its coal-fired generation may be retired, and the company has concluded to place 1925 MW of coal-fired units in the eastern system in an extended startup mode. Although AEP's Ohio-based generation accounts for only a modest portion of the company's credit profile, any strategic move that quickly leads to a greater reliance on wholesale market prices to generate cash and earnings from that fleet would suggest a tolerance for increased business risk that could weaken credit quality.

We consider AEP's financial risk profile as aggressive. This reflects a large capital spending program and financial measures inline for the rating. The company's considerable capital expenditures are needed to fund its



environmental-compliance programs for stricter air-quality standards and for new generation to meet load growth. AEP also intends to spend substantial amounts of capital on its transmission and distribution system. The elevated spending levels could result in negative free cash flow for several years, and will likely require ongoing rate relief to maintain operating cash flow at the utilities. For 12 months ended March 31, 2010, funds from operations (FFO) to total debt was about 16%, total debt to total capital was around 61%, and debt to EBITDA was 5x. The ratios are in line for the rating and reflect a large common equity issuance in the spring of 2009 and ongoing rate relief and capital spending reduction. FFO interest coverage was 3.5x, net cash flow (FFO post dividends) to capital expenditures was approximately 95% and the dividend payout ratio was 55%. Adjustments reflect capital and operating leases, and pension-related items, intermediate equity treatment of the junior subordinated notes, and securitized debt. Given AEP's business risks, sustainable financial expectations are for debt leverage to be under 60% and FFO to debt to approach 20% in order to comfortably maintain the current ratings.

#### **Short-term credit factors**

AEP's short-term rating is 'A-2'. AEP's liquidity reflects high cash balances of roughly \$1 billion and substantial availability of roughly 70% under the company's \$3.6 billion of credit facilities, all as of March 31, 2010. AEP's commercial paper program is backed by its credit facilities that mature in 2011 (\$1.5 billion) and 2012 (\$1.5 billion). The company has a third \$627 million credit agreement that matures in April 2011 against which letters of credit can be issued. As of March 31, 2010, there was \$399 million of outstanding CP and \$652 million of issued LCs. Liquidity for the domestic electric subsidiaries is largely from AEP's money pool and the sale of accounts receivables. The strength of the liquidity also incorporates the stability of the regulated businesses that reliably produce operating cash flow. The company has consistently either been refinancing, including through prefunding, or retiring debt maturities in 2010 of \$1.8 billion. Debt maturities are manageable in 2011 and 2012.

## **Outlook**

The stable outlook for AEP assumes timely recovery of rate base investments for environmental compliance, system reliability, and continued strategic emphasis on regulated operations. Maintaining the company's balance sheet and other key credit measures will be necessary for continued ratings stability. Higher ratings would be possible over time if AEP demonstrates consistency in its regulated utility strategy and more commitment to improve its financial profile. Rising capital spending or a series of harmful regulatory decisions that impede the company's recovery of those and other costs could lead to a negative outlook or lower ratings.

## **Related Criteria And Research**

- 2008 Corporate Criteria: Analytical Methodology
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded
- 2008 Corporate Criteria: Ratios And Adjustments

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January 25, 2008

**Summary:**

**American Electric Power Co. Inc.**

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Rationale

Outlook

## Summary:

# American Electric Power Co. Inc.

**Credit Rating:** BBB/Stable/A-2

## Rationale

The ratings on American Electric Power Co. Inc. (AEP) reflect its consolidated credit profile including its regulated and non-regulated subsidiaries. The company's business risk profile is excellent, and its financial risk profile is aggressive. (The business profile is ranked as excellent, strong, satisfactory, weak, or vulnerable, and the financial profile is ranked as modest, intermediate, aggressive, or highly leveraged.)

The excellent business profile primarily reflects the stability of the regulated utility operations marginally affected by the more risky unregulated business and management's recent strategic initiative in Ohio.

AEP is a large public utility holding company that owns directly or indirectly all of the common stock of electric utility subsidiaries operating in 11 states in the U.S. Midwest and Southwest. The company operates as either low-risk "wires" businesses; moderate-risk, fully integrated regulated utilities; or higher-risk hybrid utilities in states with unsettled deregulation models. Electric generation is housed in and out of utility rate bases, but most capacity is directly or virtually subject to stabilizing regulatory oversight. The company's generating and transmission facilities are interconnected, and their operations are coordinated as an integrated electric utility system.

Electric utility operations are slightly above average, characterized by competitive rates, good reliability, a strong collection of low-cost, coal-fired generation in the eastern part of the system, and mostly supportive regulatory relationships. Service territories vary widely, ranging from "Rust Belt" and rural areas that exhibit less-than-favorable economic profiles, to higher-growth, service economy-oriented regions like Columbus, Ohio, which are much more resistant to economic cycles. The diversity in markets and regulation somewhat elevates credit quality, but managing the complex variety of regulatory environments is a challenge for AEP management and requires constant vigilance. Over the longer term, its status as an overwhelmingly coal-based electric utility company could imperil credit quality if the global warming issue becomes a permanent part of the political landscape.

The company's unregulated operations primarily consists of a large portfolio of domestic merchant electric generating plants, mainly in Ohio, which are primarily used to serve AEP's retail utility customers and continue to reside somewhere between a regulated rate base and full merchant status. AEP's long track record of solid operating performance is expected to continue and improve under the unregulated business operations. Stricter environmental laws and regulation will place financial stress and erode the fleet's competitiveness, but are not expected to completely eliminate the advantages of AEP's coal-fired plants.

Also influencing the business profile is management's support for market prices in Ohio. A sudden move to market would have a harsh effect on AEP Ohio's customers' bills. Although AEP's Ohio-based generation accounts for only a portion of the company's credit profile, management's strategy could lead to a greater reliance on wholesale market prices to generate cash and earnings from a large fleet of electric plants and may suggest a tolerance for increased future business risk.

AEP's aggressive financial profile reflects its large capital programs and marginal financial measures for its rating.

The company's considerable capital expenditures are needed to fund its environmental-compliance programs, strategic investment in transmission, and for new generation to meet load growth. The company projects an environmental capital-expenditure program totaling almost \$4 billion through 2010 to meet stricter air-quality standards and approximately \$4.5 billion to develop new power plants. AEP also intends to spend substantial amounts of capital on its transmission and distribution system to improve reliability. The elevated spending levels indicate that the company will experience negative free cash flow for several years, and can expect lower utility returns such that AEP will need to continually pursue higher rates in many of its jurisdictions.

Given AEP's business risks, sustainable financial expectations are for debt leverage to be around 55% to 60%, funds from operations (FFO) interest coverage to approximate 3.5x, and FFO to debt ratio greater than 20%.

For the 12 months ended Sept. 30, 2007, adjusted debt to total capital rose to 61.8% from 60.3% at the end of 2006. Cash flow measures were also weak for the rating. For the 12 months ended Sept. 30, 2007, after adjustments, consolidated FFO interest coverage was 3.2x, down from 3.7x at the end of 2006 and FFO to total debt was at 15.7%, lower than the 19.8% at the end of 2006.

#### **Short-term credit factors**

AEP's short-term rating is 'A-2'. AEP has adequate liquidity, with \$196 million of cash on hand as of Sept. 30, 2007, stable regulated businesses that can reliably produce operating cash flow, and sufficient capacity under its bank facilities to meet working-capital needs. Long-term maturities due are approximately \$590 million in 2008, \$480 million in 2009, \$1.7 billion in 2010, and \$590 million in 2011. The company operates a money pool and sells accounts receivables to provide liquidity for the domestic electric subsidiaries.

Liquidity is primarily provided through a commercial paper program at the parent that lends to subsidiaries through intercompany notes. The commercial paper program is backed by \$3 billion in bank facilities that mature in 2011 (\$1.5 billion) and 2012 (\$1.5 billion).

## **Outlook**

The stable outlook for AEP assumes timely recovery of rate base investments for environmental compliance, system reliability, and continued strategic emphasis on regulated operations. Maintaining the improving trend in the company's balance sheet and other key credit measures will be necessary for continued ratings stability. Higher ratings would be possible over time if AEP demonstrates consistency in its regulated utility strategy and gradual improvement in its financial profile. Spiraling capital spending or a series of harmful regulatory decisions that thwart the company's recovery of those and other costs could lead to a negative stance or lower ratings.

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Moody's Investors Service

## Credit Opinion: Kentucky Power Company

Global Credit Research - 28 Jan 2010

Ashland, Kentucky, United States

### Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Baa2
Senior Unsecured	Baa2
<b>Parent: American Electric Power Company, Inc.</b>	
Outlook	Negative
Sr Unsec Bank Credit Facility	Baa2
Senior Unsecured	Baa2
Jr Subordinate	Baa3
Commercial Paper	P-2

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### Key Indicators

#### [1] Kentucky Power Company

	LTM 3Q 09	2008	2007	2006
(CFO Pre-W/C + Interest) / Interest Expense	2.6x	2.5x	3.6x	3.8x
(CFO Pre-W/C) / Debt	12.4%	9.6%	15.8%	15.6%
(CFO Pre-W/C - Dividends) / Debt	9.1%	7.5%	13.6%	12.9%
Debt / Book Capitalization	46.1%	50.3%	46.0%	47.0%

[1] All ratios calculated in accordance with the Regulated Electric and Gas Utilities Rating Methodology using Moody's standard adjustments

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

### Opinion

#### Rating Drivers

Constructive regulatory environment viewed positively

Key financial metrics are weak

Sizeable capital expenditures could pressure rating

100% coal generation modestly constrains rating and requires prudent management of increasingly stringent environmental mandates

Acute economic recessionary pressures only somewhat mitigated with business plan

### **Corporate Profile**

Kentucky Power Company (KYPCo, Baa2 senior unsecured) is a vertically integrated electric utility company and is a wholly owned subsidiary of American Electric Power Company (AEP, Baa2 senior unsecured). KYPCo's approximately \$1 billion rate base is under the jurisdiction of the Kentucky Public Service Commission (KY PSC). KYPCo owns approximately 1GW of 100% coal fired generating capacity.

### **Recent Developments**

On Dec. 29, 2009, KYPCo filed with the KYPSC for a \$123.6 million (24.3%) electric rate increase premised upon an 11.75% ROE on a year-end rate base valued at \$1.012 billion for a test year ended Sept. 30, 2009. A final PSC decision is expected in October 2010.

In August 2009, KYPCo filed with KYPSC seeking authorization to defer approximately \$10 million of incremental storm restoration expenses for review and recovery in the next base rate proceeding. The requested deferral of the \$10 million is in addition to the annual \$2 million of storm-related operation and maintenance expense included in current base rates.

### **SUMMARY RATING RATIONALE**

KYPCo's Baa2 issuer rating primarily reflects the reasonably constructive relationship with the KPSC, and the potential rating constraints as a result of its current capital spending plan, single fuel source and the economic stress within the region it operates.

### **DETAILED RATING CONSIDERATIONS**

#### **CONSTRUCTIVE REGULATORY ENVIRONMENT A CREDIT POSITIVE**

Moody's views the regulatory environment in Kentucky as reasonably supportive to long-term credit stability, a material credit positive. KYPCo is primarily regulated by the Kentucky Public Service Commission (KYPSC) which we consider a constructive jurisdiction. KYPCo has a rate base of approximately \$1 billion and an authorized return on equity of 10.5%, which was established in March 2006. KYPCo currently has a monthly fuel clause tracker (a credit positive), and environmental surcharge rider, among other recovery mechanisms (i.e., demand side management and system sales riders). Prospectively, we expect the on-going rate case will likely to be resolved in a way that is positive to its credit quality.

#### **MAINTAINING STABLE FINANCIAL CREDIT METRICS KEY TO RATING**

KYPCo's key financial credit metrics are weak for its Baa2 senior unsecured rating category. For the last 5 year, 3 year and twelve month period ended September 2009, KYPCo's ratio of cash from operations pre working capital adjustments (CFO pre-w/c) to debt averaged about 14.2%, 13.7% and 12.4%, respectively. The ratio of CFO pre-w/c interest coverage averaged 3.4x, 3.3x and 2.6x, respectively for the same periods. We observe that several winter storms occurred in 2009 increasing operation and maintenance expenses.

#### **CAPITAL EXPENDITURE PROGRAM COULD PRESSURE RATINGS OVER THE LONG TERM**

KYPCo's cumulative long-term capital investment program is large given its size. Although the company has temporarily delayed some of the investment programs in 2009 and likely in 2010, we expect the program to resume to its full force in the next few years. KYPCo received approximately \$30 million in equity contributions from its parent AEP in April 2009. However, we expect increasing up-stream dividends in the next few years and free cash flow will return to negative over the intermediate and long term horizon. While we generally view investments in rate base positively, we would be concerned if KYPCo's spending plans result in a persistent negative free cash flow position that will be primarily funded with internal or external debt. Should this situation materialize, KYPCo's financial profile could become stressed given its Baa2-rating category.

#### **ACUTE ECONOMIC RECESSIONARY PRESSURES REPRESENT A RISK GIVEN LARGE INDUSTRIAL LOADS**

The State of Kentucky is considered to be in a deep protracted recession, in part due to its heavy exposure to the automotive manufacturing industry. Approximately 50% of KYPCo's volume sales in 2008 were industrial. Among the top 10 industrial customers, KYPCo's second largest customer has a primary presence in automotive industry. The



other 9 are mostly involved in coal refining and mining which is less cyclical, but also facing pressures.

#### **100% COAL GENERATING ASSETS VULNERABLE TO SIGNIFICANT ENVIRONMENTAL LEGISLATION**

We observe the potential for significant environmental legislation, especially related to carbon dioxide emissions, as a material risk affecting KYPCo's 100% coal-fired generating assets. Moody's incorporates a view that the timing of compliance requirements within any potential new legislation may be many years in the future and that the costs associated with any new legislation regarding emissions will generally be recovered through rates (either through existing fuel clause pass-through mechanisms or other incremental rate riders).

#### **Liquidity**

KYPCo participates in the AEP Utility Money Pool, which provides access to the parent company's liquidity up to \$250 million. As of September 30, 2009, there were no borrowings under the money pool by KYPCo.

As of September 30, 2009, AEP had three separate credit facilities totaling \$3.6 billion; two of which are \$1.5 billion five year credit facilities - expiring in March 2011 and April 2012. These facilities contain a debt to capitalization limit of 67.5%. AEP asserts that it remains in compliance. There is a \$750 million letter of credit capacity (prior to final Bank of America litigation judgment, \$600 million after) on each facility (\$1.5 billion in total, \$1.2 billion after Bank of America resolution), a \$500 million accordion feature for each facility (for a total accordion of \$1.0 billion) and a one-year extension option.

There are no material adverse change restrictions on drawings, no litigation representation provision at the time of borrowing and a definition adjustment to exclude one of AEP's subsidiaries, AEP Texas Central, as a "significant subsidiary" to prevent cross-acceleration in the event of a default. AEP also has a \$627 million credit facility, expiring April 2011, that can be utilized for letter of credit or draws and has covenant restrictions similar to the primary 5-year facilities.

AEP has approximately \$1.7 billion of long term debt that will mature in 2010. We estimate that AEP will spend approximately \$2.5 billion in capital expenditures and approximately \$800 million in dividends over the next twelve months. As of September 30, 2009, AEP's credit facilities had approximately \$347 million utilized in support of commercial paper outstanding and roughly \$470 million of LC's posted, leaving approximately \$2.8 billion of capacity available. Combined with \$877 million of cash, total liquidity amounted to \$3.6 billion.

Over the twelve months ended September 2009, KYPCo generated approximately \$36 million of cash from operations, invested approximately \$90 million in capital expenditures, made a \$20 million upstream dividend payment and received \$30 equity contribution from its parent, AEP, resulting in approximately \$44 million of negative free cash flow. KYPCo has no significant debt maturities until September 2017.

#### **Rating Outlook**

The stable rating outlook for KYPCo is primarily based on our expectation that the company will continue to maintain a reasonably constructive relationship with the KYPSC, be prudent in meeting its infrastructure spending plans, attain reasonably good recovery on a timely basis and improve its key financial credit metrics that justify the rating.

#### **What Could Change the Rating - Up**

Rating upgrades appear unlikely over the near to intermediate term horizon, primarily due to our expectation that KYCo's financial profile will not be in a position to exhibit the improvements necessary to justify a Baa1-rating category. This is partly due to our understanding of KYCo's longer term capital investment and financing plans. However, KYCo could be considered for a ratings upgrade if it were to achieve key financial credit metrics, including a ratio of CFO pre w/c plus interest divided by interest of approximately 5x and CFO pre w/c to debt of approximately 20% on a sustainable basis.

#### **What Could Change the Rating - Down**

Ratings could be downgraded if the regulatory environment took a more adversarial tone, its capital expenditure program requires substantial amount of debt financing or if the key financial credit metrics exhibit a prolonged deterioration. These metrics would include a ratio of CFO pre w/c plus interest divided by interest of below 3.0x or CFO pre w/c to debt closer to the low-teens.

#### **Rating Factors**

**Kentucky Power Company**

<b>Regulated Electric and Gas Utilities</b>	<b>Aaa</b>	<b>Aa</b>	<b>A</b>	<b>Baa</b>	<b>Ba</b>	<b>B</b>
<b>Factor 1: Regulatory Framework (25%)</b>				X		
<b>Factor 2: Ability to Recover Costs and Earn Returns (25%)</b>				X		
<b>Factor 3: Diversification (10%)</b>						
a) Market Position (5%)				X		
b) Generation and Fuel Diversity (5%)						X
<b>Factor 4: Financial Strength, Liquidity &amp; Financial Metrics (40%)</b>						
a) Liquidity (10%)				X		
b) CFO pre-WC + Interest / Interest (7.5%) (3yr Avg)				X		
c) CFO pre-WC / Debt (7.5%) (3yr Avg)				X		
d) CFO pre-WC - Dividends / Debt (7.5%) (3yr Avg)				X		
e) Debt / Capitalization or Debt / RAV (7.5%) (3yr Avg)				X		
<b>Rating:</b>						
a) Methodology Implied Senior Unsecured Rating				Baa2		
b) Actual Senior Unsecured Rating				Baa2		



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## Global Power U.S. and Canada Update

## Kentucky Power Co.

A Subsidiary of American Electric Power Co.

### Ratings

Security Class	Current Rating
Issuer Default Rating (IDR)	BBB-
Senior Unsecured Debt	BBB
Commercial Paper/Short-Term IDR	F2

### Rating Outlook

Stable

### Financial Data

Kentucky Power Co. (\$ Mil.)	LTM	
	6/30/10	12/31/09
Revenues	610	633
Gross Margin	212	221
Cash Flow from Operations	65	54
Operating EBITDA	104	120
Total Debt	553	549
Total Capitalization	977	981
Capex/Depreciation (%)	94.2	123.1

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### Related Research

#### Applicable Criteria

- *Corporate Rating Methodology Aug. 16, 2010*
- *Parent and Subsidiary Rating Linkage (Fitch's Approach to Rating Entities within the Corporate Group Structure), July 14, 2010*
- *Utilities Sector Notching and Recovery Ratings, March 16, 2010*
- *U.S. Power and Gas Comparative Operating Risk (COR) Evaluation and Financial Guidelines, Aug. 22, 2007*
- *Credit Rating Guidelines for Regulated Utility Companies, July 31, 2007*

#### Other Research

- *American Electric Power Co., Feb. 12, 2010*

### Rating Rationale

- Fitch affirmed the ratings of Kentucky Power Co. (KPC) on Sept. 9, 2010. The Rating Outlook for the company remains Stable. KPC's ratings are supported by the company's stable utility operations and relatively constructive regulatory environment and affiliation with parent American Electric Power Co. (AEP; Fitch issuer default rating of 'BBB', with a Stable Outlook). While the utility is able to participate in the AEP power pool and AEP money pool, given AEP's highly centralized treasury and electric operations, any deterioration in the credit quality of the parent company could impair the ratings of KPC. Recent financial performance was negatively affected by lower retail and wholesale revenues, resulting in credit metrics that are currently below average for the 'BBB-' category. Fitch Ratings expects financial performance to improve following KPC's recent \$64 million rate increase, resulting in projected ratios of EBITDA to interest of more than 4.0x and FFO to interest to remain approximately 3.5x over the next several years.
- The primary rating concerns facing KPC relate to its exposure to a struggling local economy, particularly the industrial sector, which comprises 28% of revenues as well as stricter environmental legislation. Fitch expects adequate recovery of additional environmental costs through the company's environmental cost compliance (ECC) surcharge. Recovery delays or disallowances of environmental costs could place downward pressure on ratings.

### Key Ratings Drivers

- Stable utility operations.
- Generally balanced regulatory environment in Kentucky.
- Affiliation with parent, AEP.
- Impact of recession on local economy, in particular the industrial customers.
- Exposure to stricter environmental legislation.

### Liquidity and Debt Structure

KPC's liquidity position is solid with more than \$245 million of available capacity under the AEP money pool. Total AEP available liquidity of approximately \$2.9 billion as of June 30, 2010, including \$838 million of cash on hand. AEP's credit facilities are comprised of a \$1.454 billion facility that matures in April 2012, a \$1.5 billion facility that matures in June 2013, and a \$478 million facility that matures in April 2011. The credit agreements contain a covenant that requires AEP to maintain debt to total capitalization at or below 67.5%. KPC's next scheduled maturity of \$20 million is due in 2015.

KPC's capital spending budget through 2011 is projected to average approximately \$60 million per year. However, in 2007, the U.S. District Court approved the AEP System's consent decree with the EPA, the U.S. Department of Justice, the states, and the special interest groups that KPC's Big Sandy coal plant will be scrubbed by 2015. As such, KPC's capital spending is expected to increase starting in 2013 for this project. Funding will be met through a combination of internal cash and external debt.

## Financial Summary — Kentucky Power Co.

(\$ Mil., Fiscal Years-End Dec. 31)

	6/30/10 LTM	2009	2008	2007	2006
<b>Fundamental Ratios</b>					
FFO/Interest Expense (x)	3.4	4.2	2.7	3.8	3.8
CFO/Interest Expense (x)	2.7	2.6	2.7	4.1	4.6
FFO/Debt (%)	16.6	19.9	11.3	18.0	17.4
Operating EBIT/Interest Expense (x)	1.4	2.0	1.8	2.5	2.7
Operating EBITDA/Interest Expense (x)	2.7	3.5	3.1	4.1	4.2
Debt/Operating EBITDA (x)	5.3	4.6	4.9	3.8	3.8
Common Dividend Payout (%)	145.5	79.2	56.0	37.5	42.9
Internal Cash/Capex (%)	100.0	54.7	36.9	119.1	117.9
Capex/Depreciation (%)	94.2	123.1	270.8	144.7	169.6
<b>Profitability</b>					
Adjusted Revenues	610	633	666	588	585
Net Revenues	212	221	234	237	232
Operating and Maintenance Expense	96	89	111	103	96
Operating EBITDA	104	120	113	122	127
Operating EBIT	52	68	65	75	81
Gross Interest Expense	38	34	37	30	30
Net Income for Common	11	24	25	32	35
Operating and Maintenance Expense % of Net Revenues	45.3	40.3	47.4	43.5	41.4
Operating EBIT % of Net Revenues	24.5	30.8	27.8	31.6	34.9
<b>Cash Flow</b>					
Cash Flow from Operations	65	54	62	93	107
Change in Working Capital	(27)	(55)	—	9	24
Funds from Operations	92	109	62	84	83
Dividends	(16)	(19)	(14)	(12)	(15)
Capital Expenditures	(49)	(64)	(130)	(68)	(78)
Free Cash Flow	—	(29)	(82)	13	14
Net Other Investment Cash Flow	—	—	—	—	—
Net Change in Debt	(2)	(2)	81	(14)	(17)
Net Equity Proceeds	—	30	—	—	—
<b>Capital Structure</b>					
Short-Term Debt	4	—	131	19	31
Long-Term Debt	549	549	419	448	447
Total Debt	553	549	550	467	478
Total Hybrid Equity and Minority Interest	—	—	—	—	—
Common Equity	424	432	398	387	370
Total Capital	977	981	948	854	848
Total Debt/Total Capital (%)	56.6	56.0	58.0	54.7	56.4
Total Hybrid Equity and Minority Interest/Total Capital (%)	—	—	—	—	—
Common Equity/Total Capital (%)	43.4	44.0	42.0	45.3	43.6

Operating EBIT – Operating income before total reported state and federal income tax expense. Operating EBITDA – Operating income before total reported state and federal income tax expense plus depreciation and amortization expense. Note: Numbers may not add due to rounding.

Source: Company reports, Fitch Ratings.

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**Global Power  
U.S. and Canada  
Credit Analysis**

**Kentucky Power Co.**

A Subsidiary of American Electric Power Co.

**Ratings**

Security Class	Current Rating
Issuer Default Rating	BBB-
Senior Unsecured Debt	BBB
Short-Term Rating	F2

**Outlook**

Stable

**Financial Data**

Kentucky Power Co.  
(\$ Mil.)

	LTM	
	6/30/09	12/31/08
Revenues	686	666
Gross Margin	228	234
Cash Flow from Operations	42	62
Operating EBITDA	109	113
Total Debt	555	550
Total Capitalization	985	948
Capex/Depreciation (%)	214.0	270.8

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**Related Research**

- *Southwestern Electric Power Co., June 15, 2009*
- *Appalachian Power Co., June 3, 2008*
- *Indiana Michigan Power Co., April 30, 2009*
- *AEP Texas North Co., Feb. 24, 2009*
- *AEP Texas Central Co., Feb. 24, 2009*
- *American Electric Power Co., Nov. 21, 2008*
- *Ohio Power Co., Oct. 12, 2008*
- *Columbus Southern Power Co., Oct. 12, 2008*

**Rating Rationale**

- Fitch affirmed the ratings for Kentucky Power Co. (KPC) on Aug. 20, 2009.
- The ratings for KPC take into consideration the company's stable utility operations, relatively constructive regulatory environment and affiliation with its parent, American Electric Power Co. (AEP; IDR 'BBB'/Stable Outlook). While the utility benefits from participation in the AEP power pool and AEP money pool, given AEP's highly centralized electric and treasury operations, any deterioration in the credit quality of the parent company could impair the ratings of KPC. Favorably, KPC has no debt maturities until 2015, a solid liquidity position, declining capital expenditures through 2011, as well as a cost control program in place.
- KPC's credit metrics are currently below average for its current rating category, with recent financial performance negatively impacted by higher levels of fuel and purchased power expense. Going forward, contributions to the pension plan are forecasted in 2010 and 2011, which will continue to place pressure on cash from operations. Fitch forecasts KPC to continue to have weakened credit projection measures until the company is able to receive rate relief.
- The primary rating concerns facing KPC relate to its exposure to a struggling local economy, particularly the industrial sector which comprises 36% of retail revenues, as well as stricter environmental legislation, in particular because the company's generation is a single 1,060-MW coal-fired unit. Fitch expects adequate recovery of additional environmental costs through the company's environmental cost compliance (ECC) surcharge, but there could be a recovery lag.
- The Stable Outlook for KPC takes into consideration Fitch's expectation that the company will improve credit metrics following rate relief and obtain reasonable outcomes to future rate cases and recovery environmental compliance costs through regulatory mechanisms in Kentucky. In addition, Fitch assumes ongoing parent company support.

**Key Rating Drivers**

- Stable utility operations.
- Relatively balanced regulatory environment.
- Affiliation with parent, AEP.
- Below-average credit metrics.
- Exposure to struggling local economy.
- Constructive outcomes in future rate cases.

**Recent Events**

Earlier this year, AEP announced it had reduced its 2009 capital budget to \$2.6 billion from \$3.3 billion and its 2010 capital budget to \$1.8 billion from \$3.4 billion to manage through the economic downturn. The reductions in capital spending for 2009 and 2010 are spread across AEP's utility operating companies in generation, transmission, and distribution. Discretionary projects are being deferred until the economic climate

warrants the additional investment. KPC's capital spending budget for 2009–2011 has been reduced to \$167 million from \$334 million from the prior forecast by deferring environmental emissions projects. Funding for the company's capex program is expected to come from internally generated cash flows.

Additionally, AEP executed a common equity offering to shore up the capital structure, which resulted in net proceeds of \$1.69 billion. The parent company used \$1.44 billion to repay outstanding balances on its credit facilities; the remainder of the equity proceeds will be used to repay parent and other affiliate operating company debt. With the pay down of the credit facilities, the operating companies, including KPC, have significant borrowing capacity.

KPC experienced severe storms in its service territory in January, February, and May of this year, which caused significant damage to the company's electrical facilities. KPC incurred approximately \$11 million in storm costs and expects to file for related recovery during the third quarter of 2009.

### Liquidity and Debt Structure

KPC has no debt maturities over the next five years, with the next scheduled maturity of \$20 million due in 2015.

KPC has access to short-term borrowings through a cash pool managed by AEP, whereby entities with excess short-term liquidity lend to affiliates with cash needs. External financing needs of this pool are sourced directly by the parent, AEP. AEP has \$3 billion in committed bank credit facilities in place; \$1.5 billion that expires in March 2011 and \$1.5 billion that expires in April 2012. The revolving credit agreements contain a covenant that requires AEP to maintain a debt to total capitalization at or below 67.5%.

#### Debt Structure

(\$ Mil., As of June 30, 2009)

	Amount	%
Long-Term Debt (Including Current Portion)	549	55.7
Short-Term Debt	6	0.8
<b>Total Debt</b>	<b>555</b>	<b>56.5</b>
Common Equity	430	43.7
<b>Total Capitalization</b>	<b>985</b>	<b>100.0</b>

Source: Company reports.

#### AEP Liquidity Position

(\$ Mil., As of June 30, 2009)

	Amount	Maturity
Revolving Credit Facility	1,500	March 2011
Revolving Credit Facility	1,454	April 2012
Revolving Credit Facility	627	April 2011
<b>Total</b>	<b>3,581</b>	
Plus: AEP Cash on Hand	358	
Less:		
Draw on Credit Facilities	(219) <sup>a</sup>	
Commercial Paper Outstanding	(316)	
Letters of Credit Issued	(485)	
<b>Total Available Liquidity</b>	<b>2,919</b>	

<sup>a</sup>Repaid in July 2009.

Source: Company reports.

#### Money Pool Activity for YTD 2009

(\$ Mil.)

Maximum Borrowings	Average Borrowings	Borrowings as of 6/30/09	Authorized Limit
174.1	143.7	6.05	250

Source: Company reports.



**Financial Summary — Kentucky Power Co.**

(\$ Mil., Fiscal Years Ended Dec. 31)

	LTM Ended 6/30/09	2008	2007	2006	2005
<b>Fundamental Ratios (x)</b>					
FFO/Interest Expense	2.7	2.7	3.8	3.8	3.0
CFO/Interest Expense	2.1	2.7	4.1	4.6	3.1
Debt/FFO	9.0	8.9	5.6	5.8	8.5
Operating EBIT/Interest Expense	1.6	1.8	2.5	2.7	2.1
Operating EBITDA/Interest Expense	2.9	3.1	4.1	4.2	3.6
Debt/Operating EBITDA	5.1	4.9	3.8	3.8	4.7
Common Dividend Payout (%)	122.2	56.0	37.5	42.9	10.0
Internal Cash/Capex (%)	18.7	36.9	119.1	117.9	101.8
Capex/Depreciation (%)	214.0	270.8	144.7	169.6	126.7
<b>Profitability</b>					
Adjusted Revenues	686	666	588	585	532
Net Revenues	228	234	237	232	205
Operating and Maintenance Expense	107	111	103	96	91
Operating EBITDA	109	113	122	127	105
Depreciation and Amortization Expense	50	48	47	46	45
Operating EBIT	59	65	75	81	60
Gross Interest Expense	37	37	30	30	29
Net Income for Common	18	25	32	35	20
Operating Maintenance Expense % of Net Revenues	46.9	47.4	43.5	41.4	44.4
Operating EBIT % of Net Revenues	25.9	27.8	31.6	34.9	29.3
<b>Cash Flow</b>					
Cash Flow from Operations	42	62	93	107	60
Change in Working Capital	(20)	—	9	24	2
Funds from Operations	62	62	84	83	58
Dividends	(22)	(14)	(12)	(15)	(2)
Capital Expenditures	(107)	(130)	(68)	(78)	(57)
Free Cash Flow	(87)	(82)	13	14	1
Net Other Investment Cash Flow	—	—	—	—	15
Net Change in Debt	56	81	(14)	(17)	(16)
Net Equity Proceeds	30	—	—	—	—
<b>Capital Structure</b>					
Short-Term Debt	6	131	19	31	6
Long-Term Debt	549	419	448	447	487
Total Debt	555	550	467	478	493
Total Hybrid Equity and Minority Interest	—	—	—	—	—
Common Equity	430	398	387	370	348
Total Capital	985	948	854	848	841
Total Debt/Total Capital (%)	56.3	58.0	54.7	56.4	58.6
Total Hybrid Equity and Minority Interest/Total Capital (%)	—	—	—	—	—
Common Equity/Total Capital (%)	43.7	42.0	45.3	43.6	41.4

LTM – Latest 12 months. Operating EBIT – Operating income before total reported state and federal income tax expense. Operating EBITDA – Operating income before total reported state and federal income tax expense plus depreciation and amortization expense. Note: Numbers may not add due to rounding.

Source: Company reports, Fitch Ratings.

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# Kentucky Power Company

A Subsidiary of American Electric Power Company, Inc.  
Full Rating Report

## Ratings

Long-Term IDR                    BBB-  
Senior Unsecured                BBB

IDR – Issuer Default Rating.

## Rating Outlook

Outlook Negative

## Financial Data

Kentucky Power Co.

(\$ Mil.)	12/31/12	12/31/11
Revenue	625	728
EBITDA	163	153
Free Cash Flow	(83)	6
Total Adjusted Debt	558	556
FFO	102	102
Capex	(102)	(66)
FFO/Debt (%)	18.28	18.35
EBITDA/Interest (x)	4.29	4.14

Source: Fitch.

## Related Research

Fitch Affirms AEP & Units; Outlook Negative for AEP, Kentucky Power & Ohio Power Company (February 2013)

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## Key Rating Drivers

**Negative Rating Outlook:** Expected changes to Kentucky Power Company's (KPCO) generation profile and power procurement practices will pressure KPCO's financial profile. KPCO currently participates in parent company, American Electric Power Company, Inc.'s (AEP, 'BBB', Negative) eastern power pool, which will terminate at year-end 2013. KPCO's coal-fired generation plant will be retired or repowered by 2016.

**Parent Linkage:** KPCO's ratings are supported by the operational, financial and functional ties to its parent, AEP. The utility participates in the AEP money pool and the AEP eastern power pool. Changes to KPCO's generation and power procurement profile will likely require financial support from AEP.

**Higher Business Risk Profile:** KPCO's credit profile over the rating horizon (2013–2015) will remain pressured with pronounced uncertainties and variables from required regulatory approvals of its new generating capacity plan, timing of the approval of the general rate case application and the additional environmental compliance costs if it invests in another coal-fired power plant.

**Weakening Credit Profile:** At the end of 2012, FFO-based credit metrics, FFO/debt and FFO/interest expenses, were 18% and 3.7x, respectively. These support the company's current Issuer Default Rating (IDR). However, these measures are likely to be pressured when KPCO retires or repowers its only coal plant, which will require substantial investment in new capacity. In addition, higher routine operating costs will pressure cash flow over the rating horizon.

**Supportive Regulatory Environment:** Fitch Ratings considers the regulatory environment in Kentucky as constructive. A supportive regulatory environment is one of the key rating drivers, given that timely and adequate recovery of invested capital will be required to maintain credit protection measures.

**New Generating Capacity:** Retirement of KPCO's coal-fired generating capacity by 2016 and the termination of the power pool agreement at the end of 2013 will require either repowering of its existing generating facility, the purchase of another existing power generation facility or the construction of a new power plant. These options will require regulatory approval and result in higher leverage.

## Rating Sensitivities

**Positive Rating Action:** A positive rating action is unlikely at this time given the uncertainty around the company's generating capacity and rising operating costs.

**Negative Rating Action:** An inability to earn an adequate and timely return on investment would pressure credit ratings. Fitch will take a negative rating action if FFO-based credit metrics, FFO to debt and FFO to interest expenses, remain below 13% and 3.2x respectively on a sustainable basis in a normal operating environment.

## Financial Overview

### Liquidity and Debt Structure

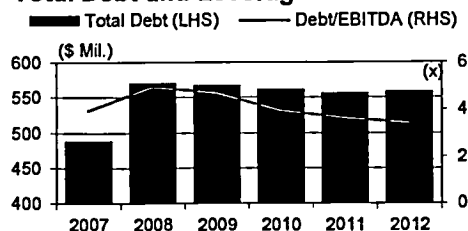
KPCO shares a liquidity facility maintained by its parent, AEP. AEP's money pool operates in accordance with the terms and conditions approved in a regulatory order. KPCO's borrowing limit is \$250 million and the outstanding borrowing at the end of March 2013 was about \$11 million.

### Debt Maturities and Liquidity at End-2012

Debt Maturities	(USD Mil.)
2013	—
2014	—
2015	—
2016	—
After 2017	549
Cash and Cash Equivalents	1

Source: Company reports, Fitch.

### Total Debt and Leverage



Source: Company reports, Fitch.

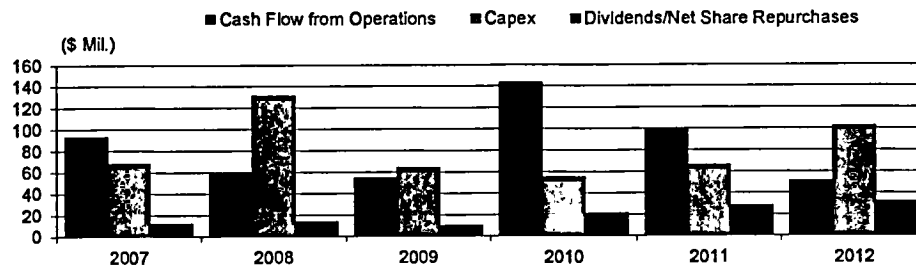
At the end of March 2013, AEP had \$3.7 billion in available liquidity, including \$179 million in cash and cash equivalents.

KPCO has no long-term debt maturities before 2017. Lower capital expenditure and a regulatory order approving an increase in general rates in 2010 helped the company to lower its leverage. However, leverage is expected to increase as a result of the additional investment needed for repowering of its existing plant or to acquire new generating capacity.

### Cash Flow Analysis

Cash flow from operations benefitted from additional revenues from an approved base rate increase in 2010 and lower capital and maintenance spending with the anticipated closure of its power plants by 2016. The company will need to repower its retiring generating assets or invest in additional generating capacity and these options will require regulatory approval. It also needs to file a request for a base rate increase with the Kentucky Public Service Commission (KPSC) to maintain its credit profile.

### CFO and Cash Use



Source: Company reports, Fitch.

### Related Criteria

Corporate Rating Methodology (August 2012)

Short-Term Ratings Criteria for Non-Financial Corporates (August 2012)

Rating North American Utilities, Power, Gas, and Water Companies (May 2011)

## Peer Group

Issuer	Country
<b>BBB</b> Westar Energy, Inc.	United States
<b>BBB-</b> Empire District Electric Company	United States
Indianapolis Power & Light Co.	United States

## Issuer Rating History

Date	LT IDR (FC)	Outlook/ Watch
Feb. 22, 2013	BBB-	Negative
Feb. 27, 2012	BBB-	Stable
Feb. 28, 2011	BBB-	Stable
Sep. 9, 2010	BBB-	Stable
Aug. 20, 2009	BBB-	Stable
Apr. 24, 2008	BBB-	Stable
Apr. 17, 2007	BBB-	Stable
Dec. 6, 2005	BBB-	Stable
Jun. 28, 2002	BBB	Stable
Jun. 1, 2000	BBB	N.A.

LT IDR (FC) – Long-term foreign-currency Issuer Default Rating. N.A. – Not applicable.  
Source: Fitch.

## Peer Group Analysis

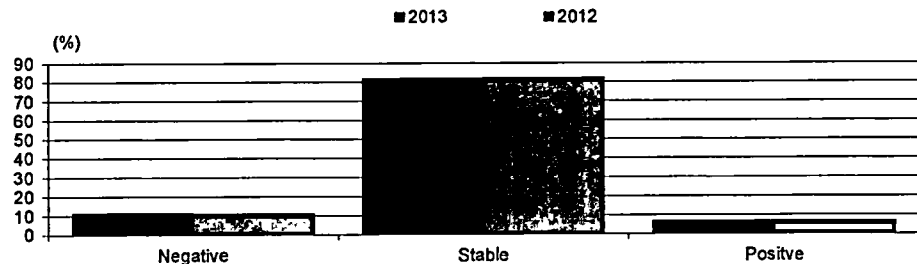
	Kentucky Power Co.	Westar Energy, Inc.	Empire District Electric Company	Indianapolis Power & Light Co.
LTM as of	12/31/12	12/31/12	12/31/12	12/31/12
Long-Term IDR	BBB-	BBB	BBB-	BBB-
Outlook	Rating Outlook Negative	Rating Outlook Stable	Rating Outlook Stable	Rating Outlook Stable
<b>Financial Statistics (\$ Mil.)</b>				
Revenue	625	2,261	558	1,230
EBITDA	163	849	192	407
Free Cash Flow	(83)	(366)	(20)	15
Total Adjusted Debt	558	3,544	717	1,044
Funds Flow from Operations	102	733	166	295
Capex	(102)	(807)	(137)	(130)
<b>Credit Metrics (x)</b>				
EBITDA/Gross				
Interest Coverage	4.29	4.38	4.57	6.90
Debt/FFO	5.47	4.84	4.32	3.54
Debt/EBITDA	3.42	4.17	3.73	2.56
FFO Interest Coverage	3.68	4.78	4.95	6.00
Capex/Depreciation (%)	185.46	289.25	228.33	73.45

Source: Company reports, Fitch.

## Peer and Sector Analysis

Uncertainty around the timing and the recovery of capital expenditure associated with the replacement of retiring generating capacity and the recovery of increased operating costs has led Fitch to assign a Negative Outlook as the credit metrics will be weak over the rating horizon (2013–2015). Westar Energy, Inc.'s credit profile will benefit from recovery of new capital spent through rate riders over the rating horizon, even though its credit profile is currently stressed by the environmental capital expenditure the company is undertaking. Empire District Electric Company's credit profile benefits from diversified cash flow, cost-tracking mechanisms in Missouri and rate increases implemented in 2010 that included recovery of costs related to the construction of a new coal-fired power plant. Indiana Power and Light Company's credit metrics benefit from a strong regulatory framework in Indiana, but its rating is constrained by the credit profile of its weak parent, IPALCO Enterprises Inc. Fitch expects credit protection measures to decline over the rating horizon due to a large capital spending program, but to remain within the range for the company's current IDR.

## Sector Outlook Distribution



Source: Fitch.

Fitch's 2013 Outlook for the sector is Stable. Vertically integrated utilities are inherently low risk, but operating conditions are becoming more challenging with slowing sales growth, diminishing returns and the end of federal tax incentives that temporarily boosted cash flow over the last two years. Utilities have reduced regulatory risk by shifting cost recovery from general rate

cases to standardized tariffs that provide greater certainty and timeliness of cost recovery. However, long-term risks to the Stable Outlook become more pronounced with technological changes improving efficiency and higher cost renewable and other energy resources. The low interest rate environment and low commodity prices are strong tailwinds in 2013.

## **Key Rating Issues**

### ***Future General Rate Case***

Increased operating costs, retirement of its only coal-fired generating plant and the termination of its parent-sponsored power pool by the end of 2013 will require a general rate filing to recover expenses and capital investments.

### ***Market Risk***

Ten large customers account for about 67% of industrial sales, mainly concentrated around the coal industry. Stricter environmental regulations will increase the risk of lower revenues and Kentucky regulations currently do not provide decoupling for the recovery of lost revenues due to lower sales volume.

### ***Environmental Expenditure***

The company plans to replace its existing plant with another coal-fired plant in an increasingly stringent regulatory environment, adversely affecting operating costs and efficiency.

## Definitions

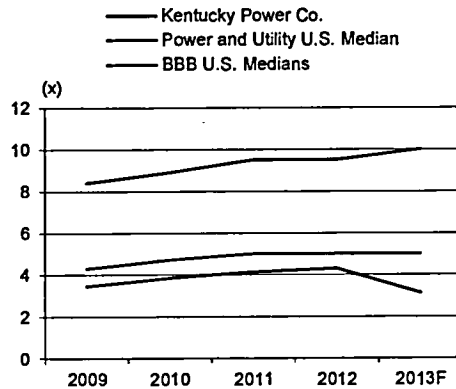
- **Leverage:** Gross debt plus lease adjustment minus equity credit for hybrid instruments plus preferred stock divided by FFO plus gross interest paid plus preferred dividends plus rental expense
- **Interest Cover:** FFO plus gross interest paid plus preferred dividends divided by gross interest paid plus preferred dividends
- **FFO/Debt:** FFO divided by gross debt plus lease adjustment minus equity credit for hybrid instruments plus preferred stock

Fitch's expectations are based on the agency's internally produced, conservative rating case forecasts. They do not represent the forecasts of rated issuers individually or in aggregate. Key Fitch forecast assumptions include:

- Reduced EBITDA contributions.
- Management's interest rate forecast was increases by 50 basis points.
- Fitch used debt financing of negative cash flow generated by its key assumptions to adjust management's forecast.

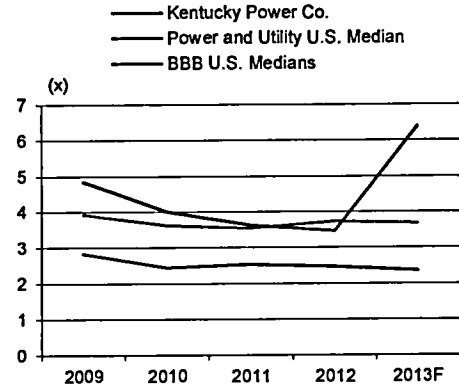
## Key Metrics

### Interest Coverage: Operating EBITDA/Gross Interest Expense



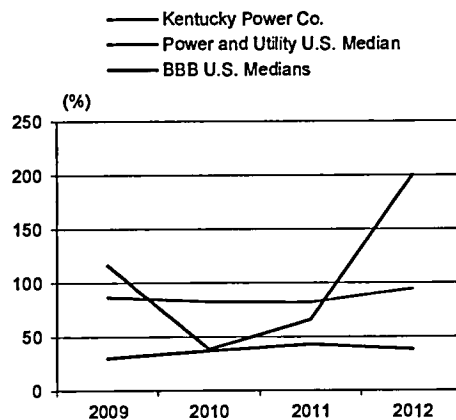
Source: Company data, Fitch.

### Leverage: Total Adjusted Debt/Operating EBITDAR



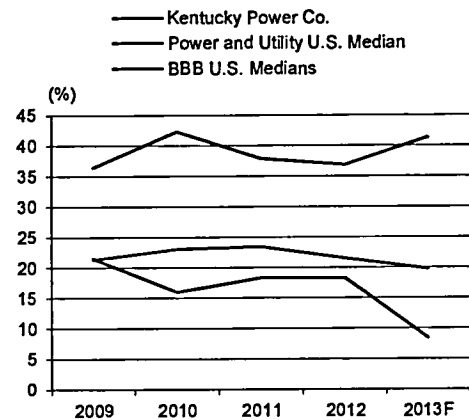
Source: Company data, Fitch.

### Capex/CFO



Source: Company data, Fitch.

### FFO/Debt



Source: Company data, Fitch.

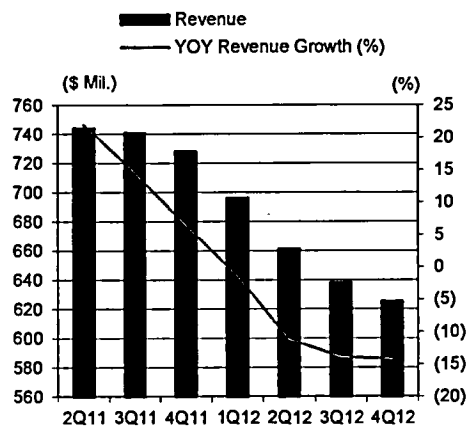
## Company Profile

KPCO is a vertically integrated utility serving about 173,000 retail customers in eastern Kentucky. KPCO is a member of Pennsylvania-Jersey-Maryland Interconnection LLC's operated wholesale electricity market. The management of KPCO is focused on its core utility business and will be working with the regulators to find a reasonable alternative to its plan to mothball all of its generating capacity by 2016.

## Business Trends

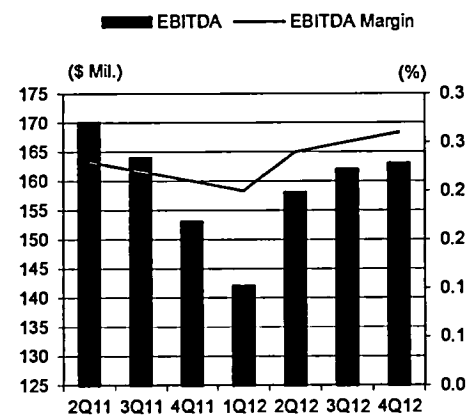
Declining revenues reflect expiry of various rate riders and related cost of goods sold. EBITDA remained stable in 2012 when compared to 2011. Fitch expects EBITDA to remain at the same level through 2015 or until the company receives regulatory approval to increase its electric rates.

### Revenue Dynamics



Source: Company data, Fitch.

### EBITDA Dynamics



Source: Company data, Fitch.

## Organizational Structure — American Electric Power Co., Inc. (\$ Mil., As of Dec. 31, 2012)

American Electric Power, Inc. IDR: BBB		
2.950% Sr. Unsecured Notes due 12/15/22	550	
1.650% Sr. Unsecured Notes due 12/15/17	300	
<b>Appalachian Power Co.</b> IDR: BBB-		
Floating Rate Sr. Unsecured Notes due 8/16/13	275	
4.950% Sr. Unsecured Notes due 2/1/15	200	
3.400% Sr. Unsecured Notes due 5/24/15	300	
5.000% Sr. Unsecured Notes due 6/1/17	250	
7.950% Sr. Unsecured Notes due 1/15/20	350	
4.600% Sr. Unsecured Notes due 3/30/21	350	
5.950% Sr. Unsecured Notes due 5/15/33	200	
5.800% Sr. Unsecured Notes due 10/1/35	250	
6.375% Sr. Unsecured Notes due 4/1/36	250	
6.700% Sr. Unsecured Notes due 8/15/37	250	
7.000% Sr. Unsecured Notes due 4/1/38	500	
4.850% Pollution Control Bonds due 5/1/19	30	
4.850% Pollution Control Bonds due 5/1/19	40	
4.625% Pollution Control Bonds due 11/1/21	18	
2.000% Pollution Control Bonds due 10/1/22	100	
Floating Rate Pollution Control Bonds due 2/1/35	50	
Floating Rate Pollution Control Bonds due 2/1/36	75	
5.375% Pollution Control Bonds due 12/1/38	50	
Adjustable Pollution Control Bonds due 1/1/41	65	
Floating Rate Pollution Control Bonds due 12/1/42	54	
Floating Rate Pollution Control Bonds due 12/1/42	50	
Other Long-term Debt due 2026	2	
<b>Ohio Power Co.</b> IDR: BBB		
5.600% Sr. Unsecured Notes due 2/15/13	250	
5.500% Sr. Unsecured Notes due 3/1/13	250	
5.750% Sr. Unsecured Notes due 9/1/13	250	
4.850% Sr. Unsecured Notes due 1/15/14	225	
6.000% Sr. Unsecured Notes due 6/1/16	350	
6.050% Sr. Unsecured Notes due 5/1/18	350	
5.375% Sr. Unsecured Notes due 10/1/21	500	
6.600% Sr. Unsecured Notes due 2/15/33	250	
6.600% Sr. Unsecured Notes due 3/1/33	250	
6.375% Sr. Unsecured Notes due 7/15/33	225	
5.850% Sr. Unsecured Notes due 10/1/35	250	
Floating Rate Pollution Control Bonds due 7/1/14	50	
5.150% Pollution Control Bonds due 5/1/26	50	
2.875% Pollution Control Bonds due 12/1/27	39	
4.900% Pollution Control Bonds due 6/1/37	65	
3.875% Pollution Control Bonds due 12/1/38	60	
5.800% Pollution Control Bonds due 12/1/38	32	
Floating Rate Pollution Control Bonds due 6/1/41	79	
5.100% Pollution Control Bonds due 11/1/42	56	
3.125% Pollution Control Bonds due 6/1/43	86	
<b>AEP Texas Central Co.</b> IDR: BBB+		
6.650% Sr. Unsecured Notes due 2/15/33	275	
5.625% Pollution Control Bonds due 10/1/17	41	
4.450% Pollution Control Bonds due 6/1/20	6	
6.300% Pollution Control Bonds due 11/1/29	101	
4.400% Pollution Control Bonds due 5/1/30	112	
5.200% Pollution Control Bonds due 5/1/30	60	
4.550% Pollution Control Bonds due 5/1/30	50	
6.250% Securitization Bond due 1/15/16	192	
4.980% Securitization Bond due 7/1/13	75	
5.980% Securitization Bond due 7/15/13	67	
5.090% Securitization Bond due 7/1/15	250	
5.170% Securitization Bond due 1/1/18	437	
5.306% Securitization Bond due 7/1/20	495	
2.845% Securitization Bond due 2024	312	
0.88 Securitization Bond due 2017	273	
1.976% Securitization Bond due 2020	180	
<b>Southwestern Electric Power Co.</b> IDR: BBB-		
5.375% Sr. Unsecured Notes due 4/15/15	100	
4.900% Sr. Unsecured Notes due 7/1/15	150	
5.550% Sr. Unsecured Notes due 1/15/17	250	
5.875% Sr. Unsecured Notes due 3/1/18	300	
6.450% Sr. Unsecured Notes due 1/15/19	400	
3.550% Sr. Unsecured Notes due 2022	275	
6.200% Sr. Unsecured Notes due 3/15/40	350	
4.950% Pollution Control Bonds due 3/1/18	82	
3.250% Pollution Control Bonds due 1/1/19	54	
4.580% Notes Payable due 2032	63	
6.370% Notes Payable due 10/31/24	25	
<b>AEP Texas North Co.</b> IDR: BBB+		
5.500% Sr. Unsecured Notes due 3/1/13	225	
5.890% Sr. Unsecured Notes due 4/1/18	30	
6.760% Sr. Unsecured Notes due 4/1/38	70	
4.500% Unsecured Debt due 2059	1	
4.450% Pollution Control Bonds due 6/1/20	44	
<b>Indiana Michigan Power Co.</b> IDR: BBB-		
5.050% Sr. Unsecured Notes due 11/15/14	175	
5.650% Sr. Unsecured Notes due 12/1/15	125	
7.000% Sr. Unsecured Notes due 3/15/19	475	
6.050% Sr. Unsecured Notes due 3/15/37	400	
Floating Rate Pollution Control Bonds due 10/1/19	25	
Floating Rate Pollution Control Bonds due 11/1/21	52	
5.250% Pollution Control Bonds due 4/1/25	40	
6.250% Pollution Control Bonds due 6/1/25	50	
6.250% Pollution Control Bonds due 6/1/25	50	
6.250% Pollution Control Bonds due 6/1/25	50	
1.913-5.440% Notes Payable due 2013-2016	224	
Other Long-Term Debt due 2015-2025	130	
<b>Public Service Co. of Oklahoma</b> IDR: BBB		
6.150% Sr. Unsecured Notes due 8/1/16	150	
5.150% Sr. Unsecured Notes due 12/1/19	250	
4.400% Sr. Unsecured Notes due 2/1/21	250	
6.625% Sr. Unsecured Notes due 11/15/37	250	
5.250% Pollution Control Bonds due 6/1/14	34	
4.450% Pollution Control Bonds due 6/1/20	13	
3.000% Notes Payable due 12/1/25	7	
<b>Kentucky Power Co.</b> IDR: BBB-		
6.000% Sr. Unsecured Notes due 9/15/17	325	
7.250% Sr. Unsecured Notes due 6/18/21	40	
8.030% Sr. Unsecured Notes due 6/18/29	30	
5.625% Sr. Unsecured Notes due 12/1/32	75	
8.130% Sr. Unsecured Notes due 6/18/39	60	
<b>Other Subsidiaries</b>		
AEP Generating Co	NR	
Trent Wind Farm LP	NR	
AEP River Operations LLC	NR	
Desert Sky Wind Farm	NR	
DCC Fuel	NR	
Sabine Mining Co	NR	

NR – Not rated. IDR – Issuer Default Rating. Note: Issuances in *italics* are securitization bonds not included in Fitch's analysis.  
Source: Company filings, Bloomberg, Fitch Ratings



## Financial Summary — Kentucky Power Co.

(\$ Mil. Fiscal Years Ended Dec. 31)	2008	2009	2010	2011	2012
<b>Fundamental Ratios (x)</b>					
FFO/Interest Expense	2.55	4.49	3.43	3.76	3.68
CFO/Interest Expense	2.55	2.57	4.86	3.70	2.34
FFO/Debt (%)	10.35	21.51	16.04	18.35	18.28
Operating EBIT/Interest Expense	1.74	1.94	2.38	2.68	2.84
Operating EBITDA/Interest Expense	3.03	3.46	3.84	4.14	4.29
Operating EBITDAR/(Interest Expense + Rent)	2.88	3.27	3.74	4.14	4.18
Debt/Operating EBITDA	4.96	4.69	3.95	3.63	3.42
Common Dividend Payout (%)	56.00	83.33	60.00	66.67	62.74
Internal Cash/Capital Expenditures (%)	35.16	54.69	230.19	109.09	18.63
Capital Expenditures/Depreciation (%)	267.35	120.76	101.85	122.22	185.46
<b>Profitability</b>					
Adjusted Revenues	666	633	684	728	625
Net Revenues	235	221	268	279	282
Operating and Maintenance Expense	112	90	116	114	108
Operating EBITDA	115	121	142	153	163
Depreciation and Amortization Expense	49	53	54	54	55
Operating EBIT	66	68	88	99	108
Gross Interest Expense	38	35	37	37	38
Net Income for Common	25	24	35	42	51
Operating and Maintenance Expense, % of Net Revenues	47.66	40.72	43.28	40.86	38.30
Operating EBIT, % of Net Revenues	28.08	30.77	32.84	35.48	38.30
<b>Cash Flow</b>					
Cash Flow from Operations	59	55	143	100	51
Change in Working Capital	—	(67)	53	(2)	(51)
Funds From Operations	59	122	90	102	102
Dividends	(14)	(20)	(21)	(28)	(32)
Capital Expenditures	(131)	(64)	(55)	(66)	(102)
Free Cash Flow	(86)	(29)	67	6	(83)
Net Other Investment Cash Flow	3	—	(66)	(3)	70
Net Change in Debt	81	(2)	(2)	(2)	(1)
Net Equity Proceeds	—	30	—	—	—
<b>Capital Structure</b>					
Short-Term Debt	131	—	—	—	—
Long-Term Debt	439	567	561	556	558
Total Debt	570	567	561	556	558
Total Hybrid Equity and Minority Interest	—	—	—	—	—
Common Equity	398	432	446	460	480
Total Capital	968	999	1,007	1,016	1,038
Total Debt/Total Capital (%)	58.88	56.76	55.71	54.72	53.76
Total Hybrid Equity and Minority Interest/Total Capital (%)	—	—	—	—	—
Common Equity/Total Capital (%)	41.12	43.24	44.29	45.28	46.24

Source: Company reports, Fitch.

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

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Global Power  
U.S. and Canada  
Credit Update

**Kentucky Power Co.**  
A Subsidiary of American Electric Power Co., Inc.

**Ratings**

Security Class	Current Rating
Issuer Default Rating	BBB-
Senior Unsecured Debt	BBB
Short-Term IDR	F2

**Outlook**

Stable

**Financial Data**

Kentucky Power Co. (\$ Mil.)	12/31/07	12/31/06
Revenues	588	586
Gross Margin	237	233
Cash Flow from Operations	94	107
Operating EBITDA	122	128
Total Debt	470	480
Total Capitalization	857	850
ROE (%)	8.1	6.5
Capex/ Depreciation (%)	144.4	167.8

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**Related Research**

- *Press Release, "Fitch Affirms Ratings for Kentucky Power Co.," dated April 24, 2008.*
- *Credit Analysis, American Electric Power Co., Inc., dated May 15, 2007.*

**Rating Rationale**

- Fitch affirmed the ratings and Stable Outlook for Kentucky Power Co. (KPC) on April 24, 2008.
- KPC's ratings take into consideration the company's stable utility operations, relatively constructive regulatory environment and affiliation with parent, American Electric Power Co., Inc. (AEP, rated 'BBB' with a Stable Outlook). The primary rating concern facing the company relates to its increasing debt levels to fund capital expenditures related to installing scrubbers at the Big Sandy coal plant for environmental compliance. Fitch expects adequate recovery of these environmental costs through the utility's environmental cost compliance (ECC) surcharge, although there will be regulatory lag.
- The Stable Outlook for KPC reflect Fitch's expectation that the company will continue to post credit metrics consistent with 'BBB-' guidelines, which includes recovering its significant environmental compliance costs and receiving reasonable outcomes to future rate cases in Kentucky.

**Key Rating Drivers**

- Credit strengths include:
  - Stable utility operations.
  - Relatively constructive regulatory environment.
  - Affiliation with parent AEP.
- Credit concerns include:
  - Increasing capital expenditures for environmental compliance.

**Recent Events**

In December 2007, the U.S. District Court approved AEP's consent decree with the Environmental Protection Agency (EPA), the Department of Justice (DOJ), various states and special interest groups, which resolved all issues related to claims in the New Source Review (NSR) cases. The EPA had alleged that KPC's affiliates modified certain coal-fired generating plants in violation of the NSR requirements of the Clean Air Act (CAA). The alleged modifications occurred over a 20-year period. KPC agreed to complete previously announced scrubbers on Unit 2 of its Big Sandy Plant by 2015. KPC recorded its share of the costs (\$5.2 million) during the third quarter of 2007.

**Liquidity and Debt Structure**

KPC has access to short-term borrowings through a cash pool managed by AEP. External financing needs of this pool are sourced directly by the parent. AEP has \$3 billion in committed bank credit facilities in place; \$1.5 billion that expires in March 2011 and \$1.5 billion that expires in April 2012. The revolving credit agreements contain a covenant that requires AEP to maintain a debt-to-total capitalization at or below 67.5%. As of Dec. 31, 2007, KPC had \$19.2 million of borrowings under the Corporate Borrowing Program, supported by the credit facilities.

**Financial Summary — Kentucky Power Co.**  
(\$ Mil., Years Ended Dec. 31)

	2007	2006	2005	2004	2003	2002
<b>Fundamental Ratios (x)</b>						
Funds from Operations (FFO)/Interest Expense	3.9	3.8	3.0	3.9	4.2	1.9
Cash Flow from Operations (CFO)/Interest Expense	4.3	4.6	3.0	4.0	3.6	3.7
Debt/FFO	5.6	5.8	8.6	6.0	5.7	20.1
Operating EBIT/Interest Expense	2.6	2.8	2.1	2.1	2.4	1.9
Operating EBITDA/Interest Expense	4.3	4.3	3.6	3.6	3.8	3.1
Debt/Operating EBITDA	3.8	3.8	4.7	4.8	4.8	5.9
Common Dividend Payout (%)	37.0	42.8	12.0	75.3	50.9	102.7
Internal Cash/Capital Expenditures (%)	119.9	117.7	99.0	190.7	63.7	28.6
Capital Expenditures/Depreciation (%)	144.4	167.8	126.3	84.3	241.3	537.7
<b>Profitability</b>						
Revenues	588	586	531	449	413	379
Net Revenues	237	233	205	201	191	181
Operating and Maintenance Expense	103	96	90	85	72	88
Operating EBITDA	122	128	106	107	110	84
Depreciation and Amortization Expense	47	46	45	44	39	33
Operating EBIT	75	82	61	63	71	51
Gross Interest Expense	29	29	29	30	29	27
Net Income for Common	32	35	21	26	32	21
Operating Maintenance Expense % of Net Revenues	43.5	41.3	43.7	42.1	37.8	48.7
Operating EBIT % of Net Revenues	31.6	35.1	29.7	31.5	37.0	28.3
<b>Cash Flow</b>						
Cash Flow from Operations	94	107	59	90	77	72
Change in Working Capital	9	24	1	5	(17)	48
Funds from Operations	84	82	58	85	94	25
Dividends	(12)	(15)	(3)	(20)	(16)	(21)
Capital Expenditures	(68)	(78)	(57)	(37)	(95)	(179)
Free Cash Flow	14	14	(1)	34	(34)	(128)
Net Other Investment Cash Flow	0	0	16	(16)	0	0
Net Change in Debt	(14)	(17)	(15)	(20)	32	78
Net Change in Equity	0	0	0	0	0	50
<b>Capital Structure</b>						
Short-Term Debt	19	31	6	0	38	23
Long-Term Debt	451	450	490	513	493	474
Total Debt	470	480	496	513	531	497
Preferred and Minority Equity	0	0	0	0	0	0
Common Equity	387	370	348	321	317	298
Total Capital	857	850	844	834	848	795
Total Debt/Total Capital (%)	54.8	56.5	58.8	61.5	62.6	62.5
Preferred and Minority Equity/Total Capital (%)	0.0	0.0	0.0	0.0	0.0	0.0
Common Equity/Total Capital (%)	45.2	43.5	41.2	38.5	37.4	37.5

LTM – Latest 12 months. Operating EBIT – Operating income plus total reported state and federal income tax expense. Operating EBITDA – Operating income plus total reported state and federal income tax expense plus depreciation and amortization expense.

Source: Financial data obtained from SNL Energy Information System, provided under license by SNL Financial, LC of Charlottesville, Va.

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Utilities, Power, and Gas  
U.S. and Canada  
Full Rating Report

## Kentucky Power Co.

Subsidiary of American Electric Power Co., Inc.

### Ratings

Security Class	Current Rating
IDR	BBB-
Senior Unsecured Debt	BBB
Short-Term IDR	F2

IDR – Issuer default rating.

### Rating Outlook

Stable

### Financial Data

Kentucky Power Company (\$ Mil.)	12/31/10	12/31/09
Revenues	684	633
Gross Margin	268	221
Funds from Operations	89	109
Operating EBITDA	141	120
Total Debt	549	549
Total Capitalization	995	981
Capex/Depreciation (%)	101.9	123.1

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### Related Research

#### Applicable Criteria

- *Corporate Rating Methodology, Aug. 16, 2010*
- *Parent and Subsidiary Rating Linkage, July 14, 2010*
- *Utilities Sector Notching and Recovery Ratings, March 16, 2010*
- *Credit Rating Guidelines for Regulated Utility Companies, July 31, 2007*
- *U.S. Power and Gas Comparative Operating Risk (COR) Evaluation and Financial Guidelines, Aug. 22, 2007*

### Rating Rationale

- **Rating Affirmation:** Fitch affirmed the ratings of Kentucky Power Co. (KPC) on Feb. 28, 2011. The Rating Outlook for the company remains Stable.
- **Consistent but Pressured Credit Metrics:** KPC's credit metrics are currently consistent with Fitch's 'BBB-' issuer default rating (IDR) guidelines. However, they will be pressured by debt-funded capital spending. The company posted ratios of EBITDA to interest and funds from operations interest coverage at 3.8x and 3.4x, respectively, for the year ended Dec. 31, 2010. Fitch expects future earnings to benefit from the \$64 million rate increase received in June 2010, resulting in projected EBITDA to interest coverage of approximately 4.0x.
- **Environmental Compliance:** KPC plans to add a scrubber to the Big Sandy unit 2 coal plant by 2015 per parent American Electric Power Co., Inc.'s (AEP, IDR 'BBB'/Stable) agreement with the Environmental Protection Agency (EPA). Currently, the estimated cost of the project is approximately \$650 million, the financing of which will be met through a combination of internal cash and external debt. Fitch's ratings assume adequate recovery of this and additional environmental compliance costs through the environmental cost compliance (ECC) surcharge. The ECC is not an automatic passthrough. However, it allows the company to request annual recovery of environmental costs outside of a full rate case. Recovery delays or disallowances of environmental costs could place downward pressure on ratings.
- **Higher Capital Expenditures:** Fitch projects KPC's capital-spending plan to approximate \$90 million for 2011, a level higher than previous years. The higher than typical capital expenditures will result in higher debt levels. Consequently, Fitch anticipates the utility to post funds from operations (FFO) to interest coverage and debt to EBITDA of less than 3.0x and approximately 4.0x, respectively, over the next several years.
- **Credit Concerns:** Fitch is also concerned about KPC's exposure to a still struggling local economy, wherein the unemployment rate remains above the national average. Additionally, the industrial sector composes 36% of the utility's revenues. There is also potential the company may use capital expenditures to comply with stricter environmental regulations or change the generation mix to reduce emissions, particularly since KPC's generation is exclusively coal-fired.
- **AEP East Power Pool:** The recent decision to terminate the AEP East power pool within the next three years is a source of uncertainty for KPC, particularly since the company is currently short capacity and dependent on the power pool. At this time, Fitch believes it is unlikely the new arrangements to replace the current pool will have a material credit impact. Fitch will continue to monitor developments.

### Key Ratings Drivers

- Stable utility operations.
- Generally balanced regulatory environment in Kentucky.
- Affiliation with parent AEP.

- Exposure to struggling local economy.
- High capital spending will increase leverage.
- Exposure to emissions regulation.

## Recent Developments

### Proposed AEP East Power Pool Termination

On Jan. 4, 2011, KPC affiliate, Appalachian Power Co. (APCo, IDR 'BBB-'/Stable) made a filing with the Virginia State Commerce Commission (VSCC) that detailed AEP East pool members' (Indiana Michigan Power Co., KPC, Columbus Southern Power Co., and Ohio Power Co.) intent to terminate the interconnection agreement. The pool members now have a three-year time frame in which to work out a settlement. The decision to evaluate the pool was initially raised by regulatory concerns, particularly from Virginia, that the current pool arrangement resulted in a lack of transparency.

### Base Rate Case

In June 2010, the Kentucky Public Service Commission (KPUC) authorized a \$63.66 million base rate increase for KPC. The increase was premised upon a 10.5% ROE and the recovery of \$23 million of deferred storm restoration expenses over five years. KPC initially filed for a \$124 million base rate increase, based on an 11.75% ROE.

## Liquidity and Debt Structure

KPC has access to short-term liquidity through credit facilities at AEP. As of Dec. 31, 2011, AEP had approximately \$2.5 billion of net available liquidity, including \$294 million of cash on hand. AEP has credit facilities totaling \$3.4 billion, of which two

### KPC Debt Structure

(\$ Mil., as of Dec. 31, 2010)

	Amount	% of Total
Short-Term Debt	0	0.0
Long-Term Debt	549	55.2
<b>Total Debt</b>	<b>549</b>	<b>55.2</b>
Preferred Stock	0	0.0
Common Equity	446	44.8
<b>Total Capitalization</b>	<b>995</b>	<b>100.0</b>

Source: Company reports.

\$1.5 billion credit facilities support the company's commercial paper program. The revolving credit agreements contain a covenant that requires AEP to maintain a debt-to-total capitalization ratio at or below 67.5%. The facility matures in April 2012 and June 2013. In March 2011, AEP extinguished its \$478 million credit facility supporting its variable-rate demand notes.

AEP's commercial paper program is used to meet to the short-term borrowings of its subsidiaries. The utility subsidiaries participate in a cash pool managed by AEP, whereby entities with excess short-term liquidity lend to affiliates with cash needs. External financing needs of this pool are sourced directly by the parent. As of April 1, 2011, KPC had no outstanding loans from the utility money pool. The company has a short-term borrowing limit of \$250 million. KPC's next scheduled debt maturity is in 2015 when \$20 million comes due. Fitch expects the company to pay down the 2015 maturity with internal cash.

## Financial Summary — Kentucky Power Co.

(\$ Mil., Fiscal Years Ended Dec. 31)

	2010	2009	2008	2007	2006
<b>Fundamental Ratios (x)</b>					
FFO/Interest Expense	3.4	4.2	2.7	3.8	3.8
CFO/Interest Expense	4.9	2.6	2.7	4.1	4.6
FFO/Debt (%)	16.2	19.9	11.3	18.0	17.4
Operating EBIT/Interest Expense	2.4	2.0	1.8	2.5	2.7
Operating EBITDA/Interest Expense	3.8	3.5	3.1	4.1	4.2
Operating EBITDAR/ (Interest Expense + Rent)	3.8	3.5	3.1	4.1	4.2
Debt/Operating EBITDA	3.9	4.6	4.9	3.8	3.8
Common Dividend Payout (%)	60.0	79.2	56.0	37.5	42.9
Internal Cash/Capital Expenditures (%)	225.9	54.7	36.9	119.1	117.9
Capital Expenditures/Depreciation (%)	101.9	123.1	270.8	144.7	169.6
<b>Profitability</b>					
Adjusted Revenues	684	633	666	588	585
Net Revenues	268	221	234	237	232
Operating and Maintenance Expense	116	89	111	103	96
Operating EBITDA	141	120	113	122	127
Depreciation and Amortization Expense	53	52	48	47	46
Operating EBIT	88	68	65	75	81
Gross Interest Expense	37	34	37	30	30
Net Income for Common	35	24	25	32	35
Operating and Maintenance Expense % of Net Revenues	43.3	40.3	47.4	43.5	41.4
Operating EBIT % of Net Revenues	32.8	30.8	27.8	31.6	34.9
<b>Cash Flow</b>					
Cash Flow from Operations	143	54	62	93	107
Change in Working Capital	54	(55)	—	9	24
Funds from Operations	89	109	62	84	83
Dividends	(21)	(19)	(14)	(12)	(15)
Capital Expenditures	(54)	(64)	(130)	(68)	(78)
Free Cash Flow	68	(29)	(82)	13	14
Net Other Investment Cash Flow	(67)	—	—	—	—
Net Change in Debt	(2)	(2)	81	(14)	(17)
Net Equity Proceeds	—	30	—	—	—
<b>Capital Structure</b>					
Short-Term Debt	—	—	131	19	31
Long-Term Debt	549	549	419	448	447
Total Debt	549	549	550	467	478
Total Hybrid Equity and Minority Interest	—	—	—	—	—
Common Equity	446	432	398	387	370
Total Capital	995	981	948	854	848
Total Debt/Total Capital (%)	55.2	56.0	58.0	54.7	56.4
Total Hybrid Equity and Minority Interest/Total Capital (%)	—	—	—	—	—
Common Equity/Total Capital (%)	44.8	44.0	42.0	45.3	43.6

Operating EBIT – Operating income before total reported state and federal income tax expense. Operating EBITDA – Operating income before total reported state and federal income tax expense plus depreciation and amortization expense. Note: Numbers may not add due to rounding.  
Source: Company reports and Fitch Ratings.

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# MOODY'S

## INVESTORS SERVICE

### Credit Opinion: Kentucky Power Company

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Global Credit Research - 07 Feb 2013

Ashland, Kentucky, United States

#### Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Baa2
Senior Unsecured	Baa2
Parent: American Electric Power Company, Inc.	
Outlook	Stable
Senior Unsecured	Baa2
Jr Subordinate Shelf	(P)Baa3
Commercial Paper	P-2

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#### Key Indicators

##### [1] Kentucky Power Company

	LTM 9/30/2012	2011	2010	2009
(CFO Pre-W/C + Interest) / Interest Expense	3.7x	3.8x	3.4x	3.9x
(CFO Pre-W/C) / Debt	17%	18%	15%	18%
(CFO Pre-W/C - Dividends) / Debt	12%	13%	11%	15%
Debt / Book Capitalization	42%	44%	46%	46%

[1] All ratios calculated in accordance with the Global Regulated Electric Utilities Rating Methodology using Moody's standard adjustments.

Note: For definitions of Moody's most common ratio terms please see the accompanying [User's Guide](#).

#### Opinion

##### Rating Drivers

Retiring Big Sandy will create need for substantial capacity additions

Constructive regulatory environment, but significant rate relief needed

Recently stabilized key financial metrics will be materially pressured by plant acquisitions

Maintenance of current ratings will depend on capital injections from the parent

Historically strong industrial sales showed some stress in 2012

## Corporate Profile

Kentucky Power Company (KPCo, Baa2 senior unsecured, stable outlook) is a vertically integrated electric utility company headquartered in Frankfort, Kentucky and is a wholly owned subsidiary of American Electric Power Company (AEP, Baa2 senior unsecured, stable outlook). KPCo is one of AEP's smaller subsidiaries, with about \$1 billion in rate base (6% of AEP's state jurisdictional total) and \$1.6 billion assets (3% of AEP consolidated). KPCo's primary regulator is the Kentucky Public Service Commission (KPSC). KPCo's total owned generation capacity is 1,078 MW, entirely at the Big Sandy plant, and it purchases approximately 390 MW from its affiliate AEP Generating Company's (Baa2 stable) share of the Rockport plant under a long-term unit power agreement. KPCo's total capacity of approximately 1,468 MW is 100% coal. KPCo's 2011 peak demand was reported as 1,522 MW, one percent below 2010, leaving a negative reserve margin of approximately 4%, which KPCo has primarily met with purchases from its affiliates in the AEP Power Pool.

## SUMMARY RATING RATIONAL

KPCo's Baa2 senior unsecured rating primarily reflect its reasonably constructive relationship with the Kentucky Public Service Commission, historical financial metrics that have improved to a level that is consistent with the rating, and the company's position as one of the smaller members the AEP family, balanced against a reserve deficit that will need to be addressed in serial rate filings, rates that are already high relative to in-state peers, and financial metrics that will likely be materially stressed as a result of planned asset acquisitions and other capacity purchases/construction that will be required to replace Big Sandy.

## DETAILED RATING CONSIDERATIONS

### REPLACING BIG SANDY CAPACITY AND ADDRESSING NEGATIVE RESERVE MARGINS

Big Sandy is expected to cease operation as a coal-fired plant in mid-2015. In May 2012, KPCo withdrew its application for a proposed \$940 million environmental retrofit project at Big Sandy Unit 2 (800 MW), opting instead to retire that unit in 2015 and acquire a 50%, 780 MW ownership share in the Mitchell Plant from its affiliate Ohio Power Company (OPCo, Baa1, stable) for an estimated cost of \$536 million, half of the asset's projected net book value at the time of closing. The Mitchell Plant consists of two environmentally-controlled coal-fired units with a total capacity of 1,560 MW. The other 50% interest is slated to be transferred to KPCo's affiliate Appalachian Power Company (APCo, Baa2 stable), who will also operate the plant. Both asset transfers remain subject to regulatory approvals (Kentucky filings were made in December 2012) and are expected to occur in late 2013 or early 2014.

By our calculation, even after the Mitchell transfer, KPCo will need approximately 580 MW of additional capacity to replace the remainder of Big Sandy capacity and to build its reserve margin. The company is exploring a re-powering to gas of Big Sandy Unit 1 (278 MW) and will issue an RFP for capacity replacements. One potential seller of capacity contracts is KPCo's unregulated Ohio generation affiliate, which will be acquiring most of OPCo's generation facilities. In addition, KPCo will also be responsible for a portion of the Rockport upgrades, but the company will pay these costs over time through higher capacity costs. In addition to regulatory approvals to increase rates commensurate with its higher rate base and capacity expenses, KPCo will require additional equity injections from AEP (the last received was in 2009) to maintain an appropriate capital structure. Overall, however, we view the decision to move forward with the Mitchell acquisition in lieu of the more expensive and operationally riskier Big Sandy retrofit as a credit positive.

A separate concern regarding the asset acquisition and environmental expenditures is the impact on rates. KPCo's average residential rate of 9.66 cents/KWh in 2011 was the highest among investor-owned utilities in the state, and 14% higher than the state average of 8.50 cents/KWh. KPCo estimates that the Mitchell Plant acquisition will raise rates by about 8%; however, rates for all utilities in the state will increase due to expenditures that are proportionally as large or even larger, in the case of large scrubber installation programs. Higher rates could engender demand response changes among all customer classes. Rate design will be an important consideration, as materially higher rates could discourage industrial activity and/or encourage self generation by large industrial customers, especially if shale gas keeps natural gas prices depressed.

### CONSTRUCTIVE REGULATORY ENVIRONMENT A CREDIT POSITIVE

Moody's views the regulatory environment in Kentucky as reasonably supportive to long-term credit stability, a material credit positive. In June 2010, the KPSC approved a not overly-generous rate settlement agreement for KPCo authorizing a \$64 million rate increase, based on a 10.5% authorized ROE with 43% equity, and recovery of \$23 million of storm costs over five years. However, electric utilities have generally been allowed to earn a return

on essentially all construction work in progress. Utilities can start to collect interim rates approximately six months after filing a rate case if the KPSC has not acted on it. There are also various riders and cost recovery mechanisms that help to avoid regulatory lag, including a fuel adjustment clause, an energy efficiency rider and, most significantly, an environmental cost recovery rider. Proceedings from the latter are conducted every two years. The KPSC has authorized significant amounts of environmental spending for some of the state's other investor-owned utilities, and Moody's expects that KPCo would be granted similar treatment for reasonable costs incurred to replace capacity that could not economically meet federally mandated environmental standards.

KPCo will require material rate relief over the next 12-24 months, with respect to the Mitchell plant, additional capacity and the potential abandonment costs at Big Sandy. It has also filed for recovery of certain cost deferrals, including approximately \$30 million of costs incurred from 2004-2012 in connection with the company's mitigation studies and efforts to meet Federal Clean Air Act and other environmental requirements at its Big Sandy Unit 2.

#### RECENTLY STABILIZED CREDIT METRICS WILL BE MATERIALLY PRESSED BY PLANT ACQUISITION AND OTHER NEW CAPACITY NEEDS

On balance, KPCo's financial credit metrics have mostly been appropriate for its Baa2 rating category over the past four years, after rebounding from a low point in 2008. On a three year average basis through 9/30/12, KPCo's ratio of cash from operations before working capital adjustments (CFO Pre-WC) to debt (16.1%), its ratio of CFO Pre-WC minus dividends to debt (RCF ratio, 11.8%) and its ratio of CFO Pre-WC + Interest/Interest (3.4x) were barely in line with mid-Baa scoring, whereas the Debt/Capitalization ratio (44%) was more in line with a low-A scoring. On a one year basis LTM 9/30/12 ratios were all stronger than the three year average ratios, with the exception of the RCF ratio, due to somewhat higher dividends. Going forward, we expect material deterioration in metrics following the acquisition of the Mitchell plant, since a relatively large amount of additional debt will be assumed. In addition, if KPCo decides to re-power Big Sandy Unit 1, it may have additional construction expenditures during this period. Thus, our expectation that AEP will provide sufficient equity capital to maintain an appropriate capital structure is crucial to the continuance of the current ratings.

#### HISTORICALLY STRONG INDUSTRIAL SALES SHOWED SOME STRESS IN 2012

Although KPCo's service territory is in the easternmost part of the state, with few urban areas other than Ashland, industrial sales represent a high percentage of total production - about 47% of retail KWh sales and 35% of retail revenues. Of the 10 largest industrial customers, which represent 67% of industrial sales, there are six coal mining companies, two steel manufacturers, one refinery, and one chemical company. Industrial sales were remarkably stable from 2006-2011, even during the recession, in part because coal prices have been generally sufficient to keep the mines active; however, industrial sales for LTM 9/30/12 declined 4% relative to calendar 2011. Recent Central Appalachian coal price declines could continue to negatively affect overall KWh demand. KPCo's territory is on the western edge of the Utica shale formation, which may spur further energy development in the longer term.

#### DISSOLUTION OF THE AEP POWER POOL ADDS A MODICUM OF UNCERTAINTY

In December 2010, all the members of the AEP Power Pool gave notice to terminate the FERC-regulated Interconnection Agreement (IA) under which they purchase, sell, and share the costs of capacity, effective January 2014 or as determined by FERC. The primary initial reason for termination was the dissatisfaction of Virginia regulators with the impact of the IA, including the cost sharing provisions, on affiliate Appalachian Power Company (APCo, Baa2, stable). Subsequently, Ohio regulators decided to cause the generation of affiliate Ohio Power Company (OPCo, Baa2, stable) to transition to competition, fundamentally changing the underpinning logic for the Power Pool.

In October 2012, AEP submitted a Power Coordination Agreement to FERC, under which it proposes that KPCo, APCo and their affiliate Indiana Michigan Power Company (I&M, Baa2 stable) will coordinate capacity planning starting in January 2014, with American Electric Power Service Corporation (AEPSC, not rated) acting as agent (including review of procedures for cost and benefit allocations). Under the new arrangement, generation will no longer be planned on a single-system basis. Rather, each operating company, assisted by AEPSC, will be required to own or contract for sufficient generation to meet its respective load and reserve obligations. While sales and purchases of capacity, energy and hedges will generally be coordinated, when possible they will be entered into by or specifically assigned to one utility, though joint ownership of facilities is also contemplated. The agreement will be administered by an Operating Committee consisting of representatives of each operating company and AEPSC, with decisions on a simple majority vote. There is no obligation for the utilities to first sell their energy or capacity to each other before selling to third parties, from which we infer that sales to affiliates will mostly occur at

a market price. Any company can exit the agreement with only 12 months notice.

For its part, KPCo will need to address its current capacity shortfall through asset acquisitions and/or capacity purchases at market prices.

### **Liquidity**

KPCo's liquidity is adequate. This scoring is based on our projection, assuming no access to the public debt or equity markets, of KPCo's ability to fund its maturing obligations and to maintain its current Capex plans (excluding the purchase Mitchell, which would not close if financing were not available) and dividend levels for at least four quarters without fully exhausting its committed credit facilities. KPCo participates in the AEP Utility Money Pool with a borrowing limit of \$250 million, which provides access to the parent company's liquidity. As of 9/30/12, KPCo had a balance of \$34 million invested in the Money Pool, compared to the \$70 million invested as of 12/31/11. KPCo also utilizes AEP's receivable securitization facility.

For the twelve months ending September 2012, KPCo generated approximately \$85 million of cash from operations, invested approximately \$94 million in capital expenditures and made \$34 million in upstream dividend payments to AEP, resulting in approximately \$43 million of negative free cash flow. In 2013, we expect KPCo to generate approximately \$80 million of cash from operations, invest approximately \$90 million in capital expenditures and pay minimal upstream dividends to its parent due to the asset purchase. KPCo has no long-term debt maturities until 2017.

AEP's liquidity is adequate. AEP has two syndicated credit facilities totaling \$3.25 billion that were renewed and extended in mid-2011. One is a \$1.5 billion facility expiring June 2015. The other is a \$1.75 billion facility (upsized from \$1.5 billion) expiring in July 2016. The facilities permit same-day borrowing and have a combined letter of credit sub-limit of \$1.35 billion. The facilities contain a covenant requiring that AEP's consolidated debt to capitalization (as defined) will not exceed 67.5% (AEP states the actual ratio was 50% at 9/30/12, indicating substantial headroom). AEP is not required to make a representation with respect to either material adverse change or material litigation in order to borrow under the facility. Default provisions exclude payment defaults and insolvency/bankruptcy of subsidiaries that are not significant subsidiaries per the SEC definition (in general, this would exclude subsidiaries representing less than 10% of assets or income, but AEP Texas Central and Southwestern Electric Power Company are also effectively excluded as significant subsidiaries due to definitional adjustments in the credit facilities). In June 2012, AEP renewed its \$700 million accounts receivable securitization (down from \$750 million), of which only the \$315 million multi-year portion is included as an available source in Moody's liquidity testing.

As of 9/30/12, AEP had \$443 million of cash on hand and approximately \$2.6 billion of availability under its two syndicated revolving credit facilities after giving effect to \$520 million of commercial paper outstanding and \$132 million of issued letters of credit.

On a consolidated basis for the 12 months ended 9/30/12, AEP generated approximately \$3.9 billion in cash from operations, made approximately \$3.2 billion in capital investments and net asset purchases and paid about \$920 million in dividends, resulting in roughly \$220 million of negative free cash flow. Including securitization bonds, puttable bonds and other amortizations, AEP has debt maturities of approximately \$1.79 billion in 2013, and \$995 million in 2014. Over the next two years, we estimate that AEP will generate roughly \$4.1 billion annually in cash from operations, spend about \$3.9 billion annually in capital expenditures and pay approximately \$925-950 million in dividends annually, yielding negative free cash flow of about \$750 million per year.

### **Rating Outlook**

The stable rating outlook for KPCo is primarily based on our expectation that the company will continue to maintain a constructive relationship with the KPSC during the serial rate increase requests expected during the next 12-24 months, and that AEP will provide the capital injections needed for KPCo to maintain the stabilized key financial credit metrics that support the current rating.

#### **What Could Change the Rating - Up**

Rating upgrades appear unlikely over the near to intermediate term horizon, primarily due to our expectation that KPCo will be challenged to maintain its financial profile in light of its plant acquisition plans. However, KPCo could be considered for a rating upgrade if it were to achieve key financial credit metrics, including CFO pre-W/C plus interest over interest of approximately 4.5x and CFO pre-W/C to debt of approximately 20% on a sustainable basis.

What Could Change the Rating - Down

KPCo's ratings could be downgraded if the regulatory environment were to take a more adversarial tone, especially with respect to the recent asset acquisition filing; if material progress were not made in the next 12 months in meeting KPCo's post-Big Sandy capacity shortfall; if equity contributions from AEP were not forthcoming in a manner to maintain an appropriate capital structure; if there were a material, sustained decrease in retail sales and revenues (especially from industrial customers); or if there were a sustained deterioration in key financial credit metrics, for instance, a Coverage Ratio below 3.0x or CFO Pre-WC to debt in the low-teens.

Rating Factors

Kentucky Power Company

Regulated Electric and Gas Utilities Industry [1][2]	Current 9/30/2012		Moody's 12-18 month Forward View* As of February 2013	
	Measure	Score	Measure	Score
<b>Factor 1: Regulatory Framework (25%)</b> a) Regulatory Framework		Baa		Baa
<b>Factor 2: Ability To Recover Costs And Earn Returns (25%)</b> a) Ability To Recover Costs And Earn Returns		Baa		Baa
<b>Factor 3: Diversification (10%)</b> a) Market Position (5%) b) Generation and Fuel Diversity (5%)		Baa B		Baa B
<b>Factor 4: Financial Strength, Liquidity And Key Financial Metrics (40%)</b> a) Liquidity (10%) b) CFO pre-WC + Interest/ Interest (3 Year Avg) (7.5%) c) CFO pre-WC / Debt (3 Year Avg) (7.5%) d) CFO pre-WC - Dividends / Debt (3 Year Avg) (7.5%) e) Debt/Capitalization (3 Year Avg) (7.5%)		Baa 3.5x 16.1% 11.8% 44.0%		Baa Baa Baa Baa Ba 3.0 - 3.5x 11 - 14% 13 - 17% 43 - 46%
<b>Rating:</b> a) Indicated Rating from Grid b) Actual Rating Assigned		Baa2 Baa2		Baa3 Baa2

\* THIS REPRESENTS MOODY'S FORWARD VIEW; NOT THE VIEW OF THE ISSUER; AND UNLESS NOTED IN THE TEXT DOES NOT INCORPORATE SIGNIFICANT ACQUISITIONS OR DIVESTITURES

[1] All ratios are calculated using Moody's Standard Adjustments. [2] As of 9/30/2012; Source: Moody's Financial Metrics



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Moody's Investors Service

## Credit Opinion: Kentucky Power Company

Global Credit Research - 02 Feb 2009

Ashland, Kentucky, United States

### Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Baa2
Senior Unsecured	Baa2
<b>Parent: American Electric Power Company, Inc.</b>	
Outlook	Stable
Sr Unsec Bank Credit Facility	Baa2
Senior Unsecured	Baa2
Jr Subordinate	Baa3
Commercial Paper	P-2

### Contacts

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### Key Indicators

#### [1] Kentucky Power Company

	LTM 3Q 08	2007	2006	2005
(CFO Pre-W/C + Interest) / Interest Expense	4.0x	3.7x	3.8x	3.4x
(CFO Pre-W/C) / Debt	20.0%	16.9%	16.6%	14.2%
(CFO Pre-W/C - Dividends) / Debt	18.2%	14.5%	13.6%	13.7%
(CFO Pre-W/C - Dividends) / Capex	73.0%	106.1%	87.1%	128.2%
Debt / Book Capitalization	41.7%	45.1%	45.5%	48.9%
EBITA Margin %	13.1%	13.3%	14.0%	11.8%

[1] All ratios calculated in accordance with the Global Regulated Electric Utilities Rating Methodology using Moody's standard adjustments

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

### Opinion

#### Rating Drivers

Stable key financial metrics and adequate liquidity profile a credit positive

Constructive regulatory environment viewed positively

Sizeable capital expenditure could pressure rating

All coal generation modestly constrains rating and requires prudent management of increasingly stringent environmental mandates

Acute economic recessionary pressures only somewhat mitigated with business plan

#### Corporate Profile

Kentucky Power Company (KYP Co, Baa2 senior unsecured) is a vertically integrated electric utility company and is a wholly owned subsidiary of American Electric Power Company (AEP, Baa2 senior unsecured). KYP Co's approximately \$0.9 billion rate base is under



the jurisdiction of the Kentucky Public Service Commission (KY PSC). KYPCo owns approximately 1GW of 100% coal fired generating capacity.

#### **SUMMARY RATING RATIONALE**

KYPCo's Baa2 issuer rating primarily reflects its stable financial profile, the reasonably constructive relationship with the KPSC, and the potential rating constraints as a result of its large capex spending, single fuel source and the particular economic region it operates within.

#### **DETAILED RATING CONSIDERATIONS**

##### **MAINTAINING STABLE FINANCIAL CREDIT METRICS KEY TO RATING**

KYPCo's key financial credit metrics have been reasonably consistent within its Baa2 senior unsecured rating category, but does not leave a lot of cushion for a sustained deterioration in cash flows. For the last 5 year, 3 year and twelve month period ended September 2008, KYPCo's ratio of cash from operations pre working capital adjustments (CFO pre-w/c) to debt averaged about 17%, 16% and 20%, respectively. The ratio of CFO pre-w/c interest coverage averaged 3.8x, 3.7x and 4.0x, respectively for the same periods. While these metrics showed some good improvement for the latest twelve month period ended September 2008, it will be important for KYPCo to maintain these financial metrics on a prospective basis.

Within the Baa2 universe excluding KYPCo, CFO pre-w/c to debt averaged about 23%, 22% and 21% for the last 5 year, 3 year and twelve months ended September 2008, respectively. CFO pre-w/c interest coverage averaged about 4.7x, 4.4x and 4.5x over the same periods. The peers for KYPCo within the Baa2 universe include companies such as Consumers Energy (Baa2 senior unsecured), Indianapolis Power & Light (Baa2 senior unsecured) and Entergy Arkansas (Baa2 senior unsecured). Within Kentucky, KYPCo is noticeably weaker than Kentucky Utilities (A2 senior unsecured) and Louisville Gas & Electric (A2 senior unsecured), which produced an average CFO pre w/c to debt ratio of approximately 26% over the past five years versus KYPCo's 17%.

##### **CONSTRUCTIVE REGULATORY ENVIRONMENT A CREDIT POSITIVE**

Moody's views the regulatory environment in Kentucky as reasonably supportive to long-term credit stability, a material credit positive. KYPCo is primarily regulated by the Kentucky Public Service Commission (KYPSC) which we consider a constructive jurisdiction. KYPCo has a rate base of approximately \$0.9 billion and an authorized return on equity of 10.5%, which was established in March 2006. KYPCo currently has a monthly fuel clause tracker (a credit positive), and environmental surcharge rider, among other recovery mechanisms (i.e., demand side management and system sales riders).

##### **SIZEABLE CAPITAL EXPENDITURE PROGRAM COULD PRESSURE RATINGS**

KYPCo's cumulative long-term capital investment program is large given its size, almost doubling its existing rate base over the next few years. While we generally view investments in rate base positively, we would be concerned if KYPCo's spending plans resulted in a consistent negative free cash flow position that was primarily funded with internal or external debt. Should this situation materialize, KYPCo's financial profile could become stressed given its Baa2-rating category.

##### **COAL FIRED GENERATION REQUIRES EXTREMELY PRUDENT OPERATION POLICY**

In a recent filing as part of regulatory examination of fuel adjustment clauses, KYPCo disclosed that 50% of its coal supply in the six months ending April 30, 2008 was purchased through long-term contracts, which we observe is lower than some of its peers. Though the fuel costs are mostly pass-through via the fuel clause, KYPCo's operational risks may rise as it manages its fuel supply (which is actually accomplished through the AEP enterprise).

##### **ACUTE ECONOMIC RECESSIONARY PRESSURES REPRESENT A RISK GIVEN LARGE INDUSTRIAL LOADS**

The State of Kentucky is considered to be in a deep protracted recession, in part due to its heavy exposure to the automotive manufacturing industry. Approximately 50% of KYPCo's volume sales in 2008 were industrial. Among the top 10 industrial customers, KYPCo's second largest customer has a primary presence in automotive industry. The other 9 are mostly involved in coal refining and mining which is less cyclical, but also facing pressures.

##### **COAL GENERATING ASSETS VULNERABLE TO SIGNIFICANT ENVIRONMENTAL LEGISLATION**

We observe the potential for significant environmental legislation, especially related to carbon dioxide emissions, as a material risk affecting KYPCo's coal-fired generating assets. Moody's incorporates a view that the timing of compliance requirements within any potential new legislation may be many years in the future and that the costs associated with any new legislation regarding emissions will generally be recovered through rates (either through existing fuel clause pass-through mechanisms or other incremental rate riders). Nevertheless, we remain concerned that there is the potential for recovery lag given the realities of increasing costs on an economy suffering from a severe recession.

#### **Liquidity**

KYPCo participates in the AEP Utility Money Pool, which provides access to the parent company's liquidity up to \$250 million. As of January 21, 2009, \$97 million is available.

AEP has four separate credit facilities that total \$3.9 billion; two of which are \$1.5 billion five year credit facilities - expiring in March 2011 and April 2012. These facilities contain an adjusted debt to capitalization limit of 67.5%. AEP asserts that it remains in compliance. There is a \$300 million letter of credit capacity on each facility (\$600 million in total), a \$500 million accordion feature for each facility (for a total accordion of \$1.0 billion) and a one-year extension option. There are no material adverse change restrictions on drawings, no litigation representation provision at the time of borrowing and a definition adjustment to exclude one of AEP's subsidiaries, AEP Texas Central, as a "significant subsidiary" to prevent cross-acceleration in the event of a default. The other two credit facilities are \$627 million and \$337 million expiring in April 2011 and April 2009, with covenant restrictions similar to the

primary 5-year facilities.

AEP's liquidity appears to be adequate at this time, but only if we incorporate a view that it maintains unfettered access to the capital markets. AEP drew down \$2.0 billion in November 2008, and the credit facilities have approximately \$681 million utilized in support of commercial paper outstanding and roughly \$439 million of LC's posted, leaving approximately \$2.7 billion of capacity available. In 2009 and 2010, AEP has scheduled maturities of \$282 million and \$1.3 billion, respectively. For the twelve months ended September 2008, AEP generated approximately \$3 billion in cash from operations, which will cover approximately 80% of its \$3.9 billion of capital investment requirements and paid roughly \$650 million in shareholder dividends, resulting in roughly \$1.5 billion of negative free cash flow.

Over the latest twelve months ended September 2008, KYPCo generated \$81 million of cash from operations, invested \$118 million in capital expenditures and made a \$9 million upstream dividend payment to AEP, resulting in approximately \$46 million of negative free cash flow. KYPCo has no significant debt maturities until September 2017.

#### Rating Outlook

The stable rating outlook for KYPCo is primarily based on our expectation that the company will continue to maintain a reasonably constructive relationship with the KYPSC, be successful in meeting its infrastructure spending plans and attaining reasonably good recovery on a timely basis and maintain key financial credit metrics that justify the rating.

#### What Could Change the Rating - Up

Rating upgrades appear unlikely over the near to intermediate term horizon, primarily due to our expectation that KYCo's financial profile will not be in a position to exhibit the improvements necessary to justify a Baa1-rating category. This is partly due to our understanding of KYCo's longer term capital investment and financing plans. However, KYCo could be considered for a ratings upgrade if it were to achieve key financial credit metrics, including a ratio of CFO pre w/c plus interest divided by interest of approximately 5x and CFO pre w/c to debt of approximately 20% on a sustainable basis.

#### What Could Change the Rating - Down

Ratings could be downgraded if the regulatory environment took a more adversarial tone, its capital expenditure program requires substantial amount of debt financing or if the key financial credit metrics began to exhibit a prolonged deterioration. These metrics would include a ratio of CFO pre w/c of closer to 3.0x or CFO pre w/c to debt closer to the low-teens.

### Rating Factors

#### Kentucky Power Company

##### Select Key Ratios for Global Regulated Electric Utilities

Rating	Aa	Aa	A	A	Baa	Baa	Ba	Ba
Level of Business Risk	Medium	Low	Medium	Low	Medium	Low	Medium	Low
CFO pre-W/C to Interest (x) [1]	>6	>5	3.5-6.0	3.0-5.7	2.7-5.0	2-4.0	<2.5	<2
CFO pre-W/C to Debt (%) [1]	>30	>22	22-30	12-22	13-25	5-13	<13	<5
CFO pre-W/C - Dividends to Debt (%) [1]	>25	>20	13-25	9-20	8-20	3-10	<10	<3
Total Debt to Book Capitalization (%)	<40	<50	40-60	50-75	50-70	60-75	>60	>70

[1] CFO pre-W/C, which is also referred to as FFO in the Global Regulated Electric Utilities Rating Methodology, is equal to net cash flow from operations less net changes in working capital items



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# MOODY'S

## INVESTORS SERVICE

### Credit Opinion: Kentucky Power Company

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Global Credit Research - 07 Feb 2012

Ashland, Kentucky, United States

#### Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Baa2
Senior Unsecured	Baa2
<b>Parent: American Electric Power Company, Inc.</b>	
Outlook	Stable
Senior Unsecured	Baa2
Jr Subordinate	Baa3
Commercial Paper	P-2

#### Contacts

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#### Key Indicators

##### [1] Kentucky Power Company

	LTM 9/30/2011	2010	2009	2008
(CFO Pre-W/C + Interest) / Interest Expense	3.9x	3.4x	3.9x	2.5x
(CFO Pre-W/C) / Debt	18%	15%	18%	9%
(CFO Pre-W/C - Dividends) / Debt	14%	11%	15%	7%
Debt / Book Capitalization	44%	46%	46%	50%

[1] All ratios calculated in accordance with the Global Regulated Electric Utilities Rating Methodology using Moody's standard adjustments.

Note: For definitions of Moody's most common ratio terms please see the accompanying [User's Guide](#).

#### Opinion

##### Rating Drivers

Constructive regulatory environment viewed positively

Planned environmental expenditures enormous relative to the company's size

Key financial metrics have improved but likely to be stressed by the capital spending program

Maintenance of current ratings will depend on capital injections from the parent

Industrial sales have benefitted from high component of mining and energy-related industries

### **Corporate Profile**

Kentucky Power Company (KPCo, Baa2 senior unsecured, stable outlook) is a vertically integrated electric utility company headquartered in Frankfort, Kentucky and is a wholly owned subsidiary of American Electric Power Company (AEP, Baa2 senior unsecured, stable outlook). KPCo is one of AEP's smaller subsidiaries, with about \$1 billion in rate base (about 6% of AEP's state jurisdictional total) and \$1.6 billion assets (3% of AEP consolidated). KPCo's primary regulator is the Kentucky Public Service Commission (KPSC). KPCo's total owned generation capacity is 1,078 MW, entirely at the Big Sandy plant, and it purchases approximately 390 MW from affiliate AEP Generating's share of the Rockport plant under two long-term unit power agreements. KPCo's total capacity of approximately 1,468 MW is 100% coal. KPCo's 2010 peak demand was reported as 1,543 MW, leaving a negative reserve margin of approximately 5%, which KPCo has primarily met with purchases from its affiliates in the AEP Power Pool.

### **SUMMARY RATING RATIONALE**

KPCo's Baa2 senior unsecured rating primarily reflects the reasonably constructive relationship with the KPSC, financial metrics that have improved to a level that is consistent with the rating, and the company's position as a member of the AEP family, balanced against an enormous planned capital expenditure program that could stress financial metrics, a need for capital injections during the construction period and the impact of an expected near doubling of rate base on retail rates.

### **DETAILED RATING CONSIDERATIONS**

#### **CONSTRUCTIVE REGULATORY ENVIRONMENT A CREDIT POSITIVE**

Moody's views the regulatory environment in Kentucky as reasonably supportive to long-term credit stability, a material credit positive. In June, 2010, the KPSC approved a not overly-generous rate settlement agreement for KPCo authorizing a \$64 million rate increase, based on a 10.5% authorized ROE with 43% equity, and recovery of \$23 million of storm costs over five years. However, electric utilities have generally been allowed to earn a return on essentially all construction work in progress. Utilities can start to collect interim rates approximately six months after filing a rate case if the KPSC has not acted on it. There are also various riders and cost recovery mechanisms that help to avoid regulatory lag, including a fuel adjustment clause, an energy efficiency rider and, most significantly, an environmental cost recovery rider. Proceedings for the latter are conducted every two years. The KPSC has authorized significant amounts of environmental spending for some of the state's other investor-owned utilities, and Moody's expects that KPCo would be granted similar treatment for reasonable costs to upgrade its coal plants.

#### **CAPITAL EXPENDITURE PROGRAM COULD PRESSURE RATINGS OVER THE MEDIUM TO LONG TERM**

KPCo's cumulative long-term capital investment program is extremely large relative to its size. KPCo terminated its installation of jet bubbling reactor technology at Big Sandy 2 due to technical problems and expects to install dry flue gas desulfurization at unit two (800 MW), while retiring unit one (278 MW). On 12/5/11, KPCo filed with the KPSC to approve the project at an estimated cost of \$940 million including AFUDC. KPCo proposes to defer a return on the project until it is complete (estimated in 2016) implying

environmental capex of about \$270 million/year, compared to average annual total capex of \$80 million for 2006-2010. KPCo will also be responsible for a portion of the cost of the Rockport upgrades, but KPCo will pay these costs over a longer period of time through higher capacity costs. To maintain its current rating, KPCo will require additional equity injections from AEP (the last received was in 2009), especially if cash returns are deferred as proposed. Based in part on our expectation that coal-friendly investments will receive timely rate base treatment in Kentucky, we expect that the parent will take appropriate steps to maintain adequate financial metrics at KPCo.

Another potential concern regarding environmental expenditures is the impact on rates. KPCo's average residential rate of 8.85 cents/KWh in 2010 was the highest among investor-owned utilities in the state, and 16% higher than the state average of 7.63 cents/KWh. KPCo estimates that the Big Sandy expenditures will raise rates by about 30% in 2016; however, rates for all utilities in the state will increase due to similarly large expenditures. Higher rates could engender demand response changes among all customer classes. Rate design will be an important consideration, as materially higher rates could discourage industrial activity and/or encourage self generation by large industrial customers, especially if shale gas keeps natural gas prices depressed.

#### **RECENTLY STABILIZED CREDIT METRICS MAY BE STRESSED BY THE ENVIRONMENTAL SPENDING**

KPCo's key financial credit metrics have historically been somewhat weak for its Baa2 senior unsecured rating category but have improved since 2008. For the periods of 2006-2010, 2008-2010 and the twelve months ended 9/30/11, KPCo's ratio of cash from operations before working capital adjustments (CFO pre-W/C) to debt averaged about 14.5%, 13.7% and 18.3%, respectively. The ratio of CFO pre-w/c interest coverage averaged 3.6x, 3.3x and 3.7x, respectively for the same periods. Balance sheet leverage has also improved, with debt to capitalization of 44.2% at 9/30/11, down from 50.5% at 12/31/08. In the near to intermediate term, we expect financial metrics to stabilize. However, metrics will likely be stressed after mid-2013, due to large increases in capital expenditures, potentially with no current return on investment if the KPSC agrees to the proposed deferral. Thus, our expectation that AEP will provide sufficient equity capital to maintain metrics is crucial to the continuance of the current ratings.

#### **INDUSTRIAL SALES HAVE HELD STEADY, BOOSTED BY COAL MINING AND ENERGY**

Although KPCo's service territory is in the easternmost part of the state, with few urban areas other than Ashland, industrial sales represent a high percentage of total production, - about 44% of retail KWh sales and 34% of retail revenues. Of the 10 largest industrial customers, which represent 66% of industrial sales, there are four coal mining companies, two energy companies, two steel manufacturers, and two chemical companies. Industrial sales have been quite stable over the past five years, in part because high coal prices have kept the mines active. Recent Central Appalachian coal price declines could negatively affect overall KWh demand; however, KPCo's territory is on the western edge of the Utica shale formation, which may spur further energy development.

#### **DISSOLUTION OF THE AEP POWER POOL ADDS A MODICUM OF UNCERTAINTY**

In December 2010, all the members of the AEP Power Pool gave notice to terminate the Interconnection Agreement under which they purchase and sell power and share the costs of capacity, effective January 2014 or as determined by FERC. While this notice is revocable, we believe the Interconnection Agreement will be cancelled or materially modified. KPCo is weakly positioned to serve its own load; however, the expected de-regulation of AEP Ohio's generation in stages through mid-2015 provides a potential source of long-term power and capacity for KPCo.

#### **Liquidity**

KPCO's liquidity is adequate. KPCO participates in the AEP Utility Money Pool with a borrowing limit of \$250 million, which provides access to the parent company's liquidity. As of 9/30/11, KPCO had a balance

of \$96 million invested in the Money Pool, compared to the \$67 million invested as of 12/31/10. KPCo also utilizes AEP's receivable securitization facility.

For the twelve months ending September 2011, KPCo generated approximately \$140 million of cash from operations, invested approximately \$64 million in capital expenditures and made \$24 million in upstream dividend payments to AEP, resulting in approximately \$52 million of positive free cash flow. In 2012, we expect KPCo to generate approximately \$120 million of cash from operations, invest approximately \$120 million in capital expenditures and continue to contribute approximately \$20 million in upstream dividends to its parent. KPCo has no long-term debt maturities until 2017.

AEP has two syndicated credit facilities totaling \$3.25 billion that were renewed and extended in mid-2011. One is a \$1.5 billion facility expiring June 2015. The other is a \$1.75 billion facility (upsized from \$1.5 billion) expiring in July 2016. The combined letter of credit sub-limits under these facilities is \$1.35 billion. The facilities contain a covenant requiring that AEP's consolidated debt to capitalization (as defined) will not exceed 67.5% (AEP states the actual ratio was 50.3% at 9/30/11, indicating substantial headroom). AEP is not required to make a representation with respect to either material adverse change or material litigation in order to borrow under the facility. Default provisions exclude payment defaults and insolvency/bankruptcy of subsidiaries that (like KPCo) are not significant subsidiaries per the SEC definition (AEP Texas Central and Southwestern Electric Power Company are also effectively excluded as significant subsidiaries due to definitional adjustments). Also in 2011, AEP allowed a \$478 million letter of credit facility to expire but renewed its \$750 million accounts receivable securitization (only the multi-year portion of the latter is included as an available source in Moody's liquidity testing).

As of 9/30/11, AEP had \$546 million of cash on hand and approximately \$2.6 billion of availability under the syndicated revolving credit facilities after giving effect to \$529 million of commercial paper outstanding and \$103 million of issued letters of credit.

For the 12 months ended 9/30/11, AEP generated approximately \$4.6 billion in cash from operations, made approximately \$3.1 billion in capital investments and net asset purchases and paid about \$890 million in dividends, resulting in roughly \$610 million of positive free cash flow.

Including securitization bonds, AEP has approximately \$690 million of long-term debt due in 2012, \$1.7 billion due in 2013, and \$1.0 billion in 2014. Over the next two years, we estimate that AEP will generate roughly \$3.5 billion in cash from operations, spend about \$3.3 billion annually in capital expenditures and pay approximately \$900-950 million in dividends annually, yielding negative free cash flow of about \$700 million per year.

### **Rating Outlook**

The stable rating outlook for KPCo is primarily based on our expectation that the company will continue to maintain a constructive relationship with the KPSC, including reasonably good recovery of planned environmental upgrade expenditures, and that parent AEP will provide the capital injections needed for KPCo to maintain the recently stabilized key financial credit metrics that support the current rating.

### **What Could Change the Rating - Up**

Rating upgrades appear unlikely over the near to intermediate term horizon, primarily due to our expectation that KPCo will be challenged to maintain its financial profile in light of the capital investment plan. However, KPCo could be considered for a ratings upgrade if it were to achieve key financial credit metrics, including CFO pre W/C plus interest over interest of approximately 5x and CFO pre W/C to debt of approximately 20% on a sustainable basis.

### **What Could Change the Rating - Down**

Ratings could be downgraded if the regulatory environment were to take a more adversarial tone,

especially with respect to the recent environmental capex filing, if KPCo's capital expenditure program experienced material cost over-runs, if equity contributions from AEP were not forthcoming in a manner to maintain financial metrics commensurate with the current rating, if there were a material, sustained decrease in retail sales and revenues (especially from industrial customers), or the key financial credit metrics exhibited a deterioration that we expected would be prolonged, for instance, a ratio of CFO pre W/C plus interest over interest below 3.0x or CFO pre W/C to debt in the low-teens.

## Rating Factors

### Kentucky Power Company

Regulated Electric and Gas Utilities Industry [1][2]	Current 12/31/2010		Moody's 12-18 month Forward View* As of February 2012	
	Measure	Score	Measure	Score
<b>Factor 1: Regulatory Framework (25%)</b> a) Regulatory Framework		Baa		Baa
<b>Factor 2: Ability To Recover Costs And Earn Returns (25%)</b> a) Ability To Recover Costs And Earn Returns		Baa		Baa
<b>Factor 3: Diversification (10%)</b> a) Market Position (5%) b) Generation and Fuel Diversity (5%)		Baa B		Baa B
<b>Factor 4: Financial Strength, Liquidity And Key Financial Metrics (40%)</b> a) Liquidity (10%) b) CFO pre-WC + Interest/ Interest (3 Year Avg) (7.5%) c) CFO pre-WC / Debt (3 Year Avg) (7.5%) d) CFO pre-WC - Dividends / Debt (3 Year Avg) (7.5%) e) Debt/Capitalization (3 Year Avg) (7.5%)		Baa 3.2x 13.7% 10.8% 47.3%		Baa 3.0 - 3.5x 13 - 17% 13 - 17% 45 - 55%
<b>Rating:</b> a) Indicated Rating from Grid b) Actual Rating Assigned		Baa2 Baa2		Baa2 Baa2

\* THIS REPRESENTS MOODY'S FORWARD VIEW;  
NOT THE VIEW OF THE ISSUER; AND UNLESS NOTED  
IN THE TEXT DOES NOT INCORPORATE  
SIGNIFICANT ACQUISITIONS OR DIVESTITURES

[1] All ratios are calculated using Moody's Standard Adjustments. [2] As of 12/31/2010; Source: Moody's Financial Metrics

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INVESTORS SERVICE



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Credit Opinion: Kentucky Power Company

Kentucky Power Company

Ashland, Kentucky, United States

Ratings

<b>Category</b>	<b>Moody's Rating</b>
Outlook	Stable
Issuer Rating	Baa2
Senior Unsecured	Baa2
<b>Parent: American Electric Power Company, Inc.</b>	
Outlook	Stable
Sr Unsec Bank Credit Facility	Baa2
Senior Unsecured	Baa2
Jr Subordinate Shelf	(P)Baa3
Commercial Paper	P-2

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Key Indicators

[1] Kentucky Power Company

	LTM 9/30/07	2006	2005	2004
(CFO Pre-W/C + Interest) / Interest Expense	3.8x	3.8x	3.4x	3.8x
(CFO Pre-W/C) / Debt	13%	17%	14%	16%
(CFO Pre-W/C - Dividends) / Debt	10%	14%	14%	12%
(CFO Pre-W/C - Dividends) / Capex	106%	87%	128%	181%
Debt / Book Capitalization	52%	46%	49%	51%
EBITA Margin %	13%	14%	12%	15%

[1] All ratios calculated in accordance with the Global Regulated Electric Utilities Rating Methodology using Moody's standard adjustments.

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Company Profile

Kentucky Power Company (KYPCo, Baa2 senior unsecured) is a vertically integrated electric utility company serving approximately 176,000 retail customers in Kentucky. KYPCo is a wholly owned subsidiary of American Electric Power Company (AEP, Baa2 senior unsecured). KYPCo's approximately \$0.9 billion rate base is under the jurisdiction of the Kentucky Public Service Commission (KY PSC). KYPCo owns approximately 1 GW of generating capacity.

For the twelve months ended September 2007, KYPCo reported approximately \$600 million in revenue and \$1.5 billion in assets.

## Recent Developments

On January 30, 2008, Moody's changed the rating outlook on four of AEP's subsidiary operating utility companies to negative from stable. The utility subsidiaries include: Appalachian Power Company (APCo, Baa2 senior unsecured), Ohio Power Company (OPCo, A3 senior unsecured), Southwestern Electric Power Company (SWEPCo, Baa1 senior unsecured) and AEP Texas Central (AEP TCC, Baa2 senior unsecured). The negative rating outlooks primarily reflect the relatively weak, or weakening, financial profile for those entities relative to their current rating categories in the presence of a rising business and operating risk environment. In our opinion, unless the key financial credit metrics associated with these entities improves, ratings downgrades may materialize over the intermediate term horizon (12 to 18 months).

## Rating Rationale

KPCo's Baa2 issuer rating primarily reflects the company's rate-regulated, vertically integrated electric utility operations, its reasonably constructive relationship with the KPSC and stable financial profile. Our assessment of KPCo's rating drivers is described more fully in our rating methodology for Global Regulated Electric Utilities, published in March 2005.

The most important drivers of KPCo's rating and outlook are as follows:

### MAINTAIN A STABLE FINANCIAL PROFILE

As a vertically integrated rate-regulated electric utility company, Moody's views KPCo's relatively stable and predictable earnings and cash flows as a credit positive. KPCo generates approximately \$600 million in revenues (roughly 3% of AEP's consolidated regulated revenues and 2% of AEP's consolidated total revenues). The utility has roughly \$1.5 billion in assets, a \$0.9 billion rate base, \$500 million in debt and an authorized return on equity of 10.50%. Over the past five years, KPCo generated, on average, approximately \$85 million of annual cash from operations (CFO); which is a bit higher than the annual average for the past three years of approximately \$78 million but is more in-line with the roughly \$83 million reported for the latest twelve months ended September 2007. From a credit perspective, Moody's views KPCo's over-all financial profile as consistent with its Baa2-rating category.

### CONSTRUCTIVE REGULATORY ENVIRONMENT

KPCo is primarily regulated by the Kentucky Public Service Commission (KYPSC) which is an appointed commission comprised of three commissioners. KPCo has a rate base of approximately \$0.9 billion and an authorized return on equity of 10.5%, which was established in March 2006. KYPSC's next rate case could be filed in 2008, with a year end 2007 test year. KYPSC currently has a monthly fuel clause tracker (a credit positive), and environmental surcharge rider, among other recovery mechanisms (i.e., demand side management and system sales riders).

### LARGE CAPITAL EXPENDITURE PROGRAM COULD PRESSURE RATINGS

KPCo's cumulative long-term capital investment program is large, almost doubling its existing rate base. While we generally view investments in rate base positively, we would be concerned if KPCo's spending plans resulted in a consistent negative free cash flow position that was primarily funded with debt. Should this situation materialize, KPCo's financial profile could become stressed given its Baa2-rating category. We acknowledge that a sizeable portion of the spending plan is associated with environmental expenditures, new generation, transmission and distribution investments.

### KEY FINANCIAL CREDIT METRICS VERSUS PEERS

KPCo's key financial credit metrics have been reasonably steady given its rating category; however, Moody's notes that KPCo's cash flow to debt ratios exhibited some weakness in 2006 and for the latest twelve months ended September 2007. Over the past few years, KYPSC's ratio of cash from operations pre working capital adjustments (CFO pre-W/C) to debt has declined from a high of approximately 20% in 2003 to 17% and 13% in 2006 and for the latest twelve months ended September 2007, respectively. These cash flow related metrics need to improve from their current levels, which are weak for the rating category and in relation to its peers. The peers for KYPSC include: Consumers Energy (Baa2 senior unsecured), Duke Energy Indiana (Baa1 senior unsecured), Duke Energy Kentucky (Baa1 senior unsecured), Indianapolis Power & Light (Baa2 senior unsecured), Kentucky Utilities (A2 senior unsecured), Louisville Gas & Electric (A2 senior unsecured) and Virginia Electric and Power (Baa1 senior unsecured). Within Kentucky, KPCo is noticeably weaker than Kentucky Utilities and Louisville Gas & Electric, which produced an average CFO pre w/c to debt ratio of approximately 25% over the past five years versus KPCo's 15%. From a credit perspective, Moody's believes that KPCo does not enjoy the same level of financial metric cushion that many of its Baa2-rated, regional and state peers enjoy, at its rating category. As a result, KPCo will need to carefully manage its spending plans and the financing associated with those spending plans in order to avoid potential rating pressure.

## Liquidity

KPCo participates in the AEP Utility Money Pool, which provides access to the parent company's liquidity. AEP has two separate credit facilities that total \$3.0 billion. Both are \$1.5 billion five year credit facilities - one expires in March 2011 and the other expires in April 2012. These facilities contain an adjusted debt to capitalization limit of 67.5%. There is a \$300 million letter of credit capacity on each facility (\$600 million in total), a \$500 million accordion feature for each facility (for a total accordion of \$1.0 billion) and a one-year extension option. There are no material adverse change restrictions on drawings, no litigation representation provision at the time of borrowing and a definition adjustment to exclude one of AEP's subsidiaries, AEP Texas Central, as a "significant subsidiary" to prevent cross-acceleration in the event of a default.

AEP's credit facilities have approximately \$660 million drawn in commercial paper and roughly \$65 million of LC's posted, leaving approximately \$2.4 billion of capacity available. Over the latest twelve months ended September 2007, KPCo generated \$83 million of cash from operations, invested \$65 million in capital expenditures and made a \$16 million upstream dividend payment to AEP, resulting in approximately \$3 million of free cash flow. KPCo has a \$30 million scheduled debt maturity in November 2008.

### Rating Outlook

The stable rating outlook for KPCo is primarily based on our expectation that the company will continue to maintain a reasonably constructive relationship with the KYPSC, be successful in meeting its infrastructure spending plans and attaining reasonably good recovery on a timely basis and maintain key financial credit metrics that justify the rating.

### What Could Change the Rating - Up

Rating upgrades appear unlikely over the near to intermediate term horizon, primarily due to our expectation that KYCo's financial profile will not be in a position to exhibit the improvements necessary to justify a Baa1-rating category. This is partly due to our understanding of KYCo's longer term capital investment and financing plans. However, KYCo could be considered for a ratings upgrade if it were to achieve key financial credit metrics, including a ratio of CFO pre w/c plus interest divided by interest of approximately 5x and CFO pre w/c to debt of approximately 20% on a sustainable basis.

### What Could Change the Rating - Down

Ratings could be downgraded due to contagion risks associated with its parent company, AEP. Separately, ratings could be downgraded if the regulatory environment took a more adversarial tone, or if the key financial credit metrics began to exhibit a prolonged deterioration. These metrics would include a ratio of CFO pre w/c of closer to 3.0x or CFO pre w/c to debt closer to the low-teens.

### Rating Factors

#### Kentucky Power Company

#### Select Key Ratios for Global Regulated Electric Utilities

Rating	Aa	Aa	A	A	Baa	Baa	Ba	Ba
Level of Business Risk	Medium	Low	Medium	Low	Medium	Low	Medium	Low
CFO pre-W/C to Interest (x) [1]	>6	>5	3.5-6.0	3.0-5.7	2.7-5.0	2-4.0	<2.5	<2
CFO pre-W/C to Debt (%) [1]	>30	>22	22-30	12-22	13-25	5-13	<13	<5
CFO pre-W/C - Dividends to Debt (%) [1]	>25	>20	13-25	9-20	8-20	3-10	<10	<3
Total Debt to Book Capitalization (%)	<40	<50	40-60	50-75	50-70	60-75	>60	>70

[1] CFO pre-W/C, which is also referred to as FFO in the Global Regulated Electric Utilities Rating Methodology, is equal to net cash flow from operations less net changes in working capital items

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# MOODY'S

## INVESTORS SERVICE

### Credit Opinion: Kentucky Power Company

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Global Credit Research - 14 Jan 2011

Ashland, Kentucky, United States

#### Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Baa2
Senior Unsecured	Baa2
Parent: American Electric Power Company, Inc.	
Outlook	Stable
Sr Unsec Bank Credit Facility	Baa2
Senior Unsecured	Baa2
Jr Subordinate	Baa3
Commercial Paper	P-2

#### Contacts

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#### Key Indicators

##### [1] Kentucky Power Company

	LTM 3Q 10	2009	2008	2007
(CFO Pre-W/C + Interest) / Interest Expense	3.0x	3.9x	2.4x	3.6x
(CFO Pre-W/C) / Debt	12.7%	17.6%	8.8%	15.8%
(CFO Pre-W/C - Dividends) / Debt	9.4%	14.5%	6.7%	13.6%
Debt / Book Capitalization	45.9%	46.3%	50.3%	46.0%

[1] All ratios calculated in accordance with the Regulated Electric and Gas Utilities Rating Methodology using Moody's standard adjustments

Note: For definitions of Moody's most common ratio terms please see the accompanying [User's Guide](#).

#### Opinion

##### Rating Drivers

Constructive regulatory environment viewed positively

Key financial metrics are weak but expected to stabilize

100% coal generation constrains rating and requires prudent management of increasingly stringent environmental mandates

Recessionary pressures relieved by recovery in coal industry

##### Corporate Profile

Kentucky Power Company (KYPCo, Baa2 senior unsecured) is a vertically integrated electric utility company and is a wholly owned subsidiary of American Electric Power Company (AEP, Baa2 senior unsecured). KYPCo's approximately \$1 billion rate base is under the jurisdiction of the Kentucky Public Service Commission (KY PSC). KYPCo owns approximately 1.1GW of 100% coal fired generating capacity.

##### Recent Developments

In June 2010, KYPSC issued an order approving KYPCo's \$64 million rate case settlement agreement which also include \$23 million of deferred storm restoration expenses over five years. The residential per-kilowatt-hour charge will increase from 7.19 cents to 8.59 cents. This order concluded a base rate case filed in December, 2009 when KYPCo requested a \$123.6 million (24.3%) electric rate increase premised upon an 11.75% ROE on a year-end rate base valued at \$1.012 billion for a test year ended Sept. 30, 2009. New rates became effective July 2010.

## SUMMARY RATING RATIONALE

KYPCo's Baa2 issuer rating primarily reflects the reasonably constructive relationship with the KPSC, and the potential rating constraints as a result of its coal-dependent generation profile and relatively weak financial metrics. The ratings also considers the signs of recovery for KYPCo's primary industrial customer group amid the economic stress within the region it operates.

## DETAILED RATING CONSIDERATIONS

### CONSTRUCTIVE REGULATORY ENVIRONMENT A CREDIT POSITIVE

Moody's views the regulatory environment in Kentucky as reasonably supportive to long-term credit stability, a material credit positive. KYPCo is primarily regulated by the Kentucky Public Service Commission (KYPSC) which we consider a constructive jurisdiction. KYPCo has a rate base of approximately \$1 billion and an authorized return on equity of 10.5%, which was established in June 2010. KYPCo currently has a monthly fuel clause tracker, and environmental surcharge rider, among other recovery mechanisms (i.e., demand side management and system sales riders).

### MAINTAINING STABLE FINANCIAL CREDIT METRICS KEY TO RATING

KYPCo's key financial credit metrics are somewhat weak for its Baa2 senior unsecured rating category. For the last 5 year, 3 year and twelve month period ended September 2010, KYPCo's ratio of cash from operations pre working capital adjustments (CFO pre-w/c) to debt averaged about 14.4%, 14.1% and 12.7%, respectively. The ratio of CFO pre-w/c interest coverage averaged 3.4x, 3.3x and 3.0x, respectively for the same periods. In the near to intermediate term, we expect the financial metrics to stabilize or slightly improve as a result of the return of the industrial load (discussed below) and reduced capital spending.

### CAPITAL EXPENDITURE PROGRAM COULD PRESSURE RATINGS OVER THE LONG TERM

KYPCo's cumulative long-term capital investment program is large given its size. Although the company has temporarily delayed some of the investment programs in 2009, 2010 and likely 2011, we expect the program to resume to its full force in the next few years. KYPCo received approximately \$30 million in equity contributions from its parent AEP in April 2009. However, we expect increasing up-stream dividends in the next few years and free cash flow to return to negative over the intermediate and long term horizon. While we generally view investments in rate base positively, we would be concerned if KYPCo's spending plans result in a persistent negative free cash flow position that will be primarily funded with internal or external debt. Should this situation materialize, KYPCo's financial profile could become stressed given its Baa2-rating category.

### INDUSTRIAL LOAD EXPECTED TO BENEFIT FROM COAL INDUSTRY RECOVERY

Among KYPCo's top ten industrial customers, 6 are involved in coal mining and production. According to Moody's coal industry outlook report, strong coal demand in Asia draw on U.S. supplies and maintain reasonable profit margin for U.S. coal producers, offsetting subdued U.S. demand. We expect the recovery in the coal industry to stabilize in the next several years thereby likely improving KYPCo's financial results.

### 100% COAL GENERATING ASSETS VULNERABLE TO SIGNIFICANT ENVIRONMENTAL MANDATES

We observe the potential for significant environmental regulations or legislation, especially related to carbon dioxide emissions, as a material risk affecting KYPCo's 100% coal-fired generating assets. The timing of compliance requirements could be expedited by the EPA's rule making process. Nevertheless, in the near to intermediate term, we expect the costs associated with any new rule-making regarding emissions to generally be recovered through rates (either through existing fuel clause pass-through mechanisms or other incremental rate riders).

## Liquidity

KYPCo participates in the AEP Utility Money Pool, which provides access to the parent company's liquidity.

AEP has two separate credit facilities that total approximately \$3.0 billion. One is a \$1.5 billion facility expiring June 2013 (entered in June 2010) replacing the original \$1.5 billion expiring in March 2011. The other is an amended \$1.454 billion facility expiring in April 2012. These facilities contain a debt to capitalization limit of 67.5%. AEP asserts that it remains in compliance. There is a \$600 million and \$750 million letter of credit capacity on the 2013 facility and the 2012 facility, respectively, and a \$500 million accordion feature and a one-year extension option on each facility. There are no material adverse change restrictions on drawings, no litigation representation provision at the time of borrowing and a definition adjustment to exclude one of AEP's subsidiaries, AEP Texas Central, as a "significant subsidiary" to prevent cross-acceleration in the event of a default. On June 28, 2010, AEP reduced its separate three year \$627 million LC facility to \$478 million due in April 2011 which has similar terms as the two primary facilities mentioned above. In total, AEP has committed credit facilities of \$3.432 billion.

As of September 30, 2010, the credit facilities had \$713 million utilized in supporting issued commercial paper and roughly \$602 million of LC's posted, leaving approximately \$2.2 billion of capacity available. Combined with \$1 billion of cash on hand, total liquidity amounted to \$3.2 billion.

AEP has approximately \$616 million and \$565 million of long term debt that will mature in 2011 and 2012 respectively. AEP has announced that it will spend approximately \$2.6 billion in capital expenditures in 2011 and \$2.9 billion in 2012. We estimate that approximately \$800 to \$900 million in dividends per year will be distributed in the next two years.

KYPCo has access to up to \$250 million in the AEP Utility Money Pool. As of September 30, 2010, there were no borrowings under the money pool by KYPCo.

Over the twelve months ended September 2010, KYPCo generated approximately \$130 million of cash from operations, invested approximately \$53 million in capital expenditures, made \$21 million upstream dividend payment, resulting in approximately \$56 million of positive free cash flow. KYPCo has no debt maturities until September 2017 when \$325 million senior notes are due. We expect KYPCo to remain cash flow positive in 2011 as the capital expenditure continues to be modest.

## Rating Outlook

The stable rating outlook for KYPCo is primarily based on our expectation that the company will continue to maintain a reasonably constructive



relationship with the KYPSC, be prudent in meeting its infrastructure spending plans, attain reasonably good recovery on a timely basis and improve its key financial credit metrics that justify the rating.

**What Could Change the Rating - Up**

Rating upgrades appear unlikely over the near to intermediate term horizon, primarily due to our expectation that KYCo's financial profile will not be in a position to exhibit the improvements necessary to justify a Baa1-rating category. This is partly due to our understanding of KYCo's longer term capital investment and financing plans. However, KYCo could be considered for a ratings upgrade if it were to achieve key financial credit metrics, including a ratio of CFO pre w/c plus interest divided by interest of approximately 5x and CFO pre w/c to debt of approximately 20% on a sustainable basis.

**What Could Change the Rating - Down**

Ratings could be downgraded if the regulatory environment took a more adversarial tone, its capital expenditure program requires substantial amount of debt financing or if the key financial credit metrics exhibit a prolonged deterioration. These metrics would include a ratio of CFO pre w/c plus interest divided by interest of below 3.0x or CFO pre w/c to debt closer to the low-teens over an extended period.

**Rating Factors**

**Kentucky Power Company**

Regulated Electric and Gas Utilities	Aaa	Aa	A	Baa	Ba	B
Factor 1: Regulatory Framework (25%)				X		
Factor 2: Ability to Recover Costs and Earn Returns (25%)				X		
Factor 3: Diversification (10%)						
a) Market Position (5%)				X		
b) Generation and Fuel Diversity (5%)						X
Factor 4: Financial Strength, Liquidity & Financial Metrics (40%)						
a) Liquidity (10%)				X		
b) CFO pre-WC + Interest / Interest (7.5%) (3yr Avg)				X		
c) CFO pre-WC / Debt (7.5%) (3yr Avg)				X		
d) CFO pre-WC - Dividends / Debt (7.5%) (3yr Avg)				X		
e) Debt / Capitalization or Debt / RAV (7.5%) (3yr Avg)				X		
Rating:						
a) Grid Implied Senior Unsecured Rating				Baa2		
b) Actual Senior Unsecured Rating				Baa2		



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June 23, 2010

### Summary:

## Kentucky Power Co.

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## Summary:

# Kentucky Power Co.

**Credit Rating:** BBB/Stable/--

## Rationale

The ratings on Kentucky Power Co. are based on the consolidated credit profile of its parent American Electric Power Co. Inc. (AEP), which includes regulated and unregulated operations. Kentucky Power's business risk profile is excellent and its financial risk profile is aggressive. Kentucky Power is a public utility that generates, purchases, transmits, and distributes electricity in a service territory covering eastern Kentucky. It participates in the AEP Power Pool, sharing the revenues and costs of pool sales to utilities and power marketers, and also sells directly at wholesale to municipalities. Operations are integrated with the AEP East system. Columbus, Ohio-based AEP has \$18.6 billion of outstanding debt, including junior subordinated notes and securitized debt, of which Kentucky Power comprises \$549 million.

The excellent business profile primarily reflects AEP's status as a large public utility holding company that owns regulated electric utility subsidiaries operating in 11 states in the Midwest and Southwest. The company operates as low-risk transmission and distribution wires-only businesses in regions of Texas; fully integrated regulated utilities in places such as Indiana and West Virginia; or higher-risk hybrid utilities in states developing deregulation models like Ohio. Electric generation is housed in and out of utility rate bases, but most of the generating capacity is under stabilizing regulatory oversight. The company's generating and transmission facilities are interconnected, and their operations are coordinated as an integrated electric utility system.

Electric utility operations are slightly above average, characterized by competitive rates, good reliability, a strong collection of low-cost, coal-fired generation in the eastern part of the system, and mostly supportive regulatory relationships. Service territories vary widely, ranging from manufacturing and rural areas with lower growth economies, to higher-growth, service-oriented economies like Columbus, Ohio, that are more stable. The diversity in markets and in regulation somewhat elevates credit quality, but managing the complex variety of regulatory environments can challenge AEP management and requires constant vigilance. This is evident in Arkansas where the company is building the Turk coal unit and continues to have multiple legal challenges around the construction of the unit. Over the longer term, as an overwhelmingly coal-based electric utility, material compliance costs with legislation or regulation of carbon dioxide emissions could affect credit quality.

The company's unregulated operations consist mostly of a large portfolio of domestic unregulated electric generating plants, mainly in Ohio, that primarily serve AEP's retail utility customers and continue to reside somewhere between a regulated rate base and full merchant status. AEP's long track record of solid operating performance is expected to continue and improve under the unregulated business operations. Stricter environmental laws and regulation will place financial stress and erode the fleet's competitiveness, but are not expected to completely eliminate the advantages of AEP's coal-fired plants. AEP has indicated that ultimately about 25% of its coal-fired generation may be retired, and the company has concluded to place 1,925 MW of coal-fired units in the eastern system in an extended startup mode. Although AEP's Ohio-based generation accounts for only a modest portion of the company's credit profile, any strategic move that quickly leads to a greater reliance on wholesale market prices to

generate cash and earnings from that fleet would suggest a tolerance for increased business risk that could weaken credit quality.

Kentucky Power's financial risk profile reflects AEP's consolidated financial risk profile, which is considered aggressive. This reflects a large capital spending program and financial measures in line for the rating. The company's considerable capital expenditures are needed to fund its environmental-compliance programs for stricter air-quality standards and for new generation to meet load growth. AEP also intends to spend substantial amounts of capital on its transmission and distribution system. The elevated spending levels could result in negative free cash flow for several years, and will likely require ongoing rate relief to maintain operating cash flow at the utilities. For 12 months ended March 31, 2010, funds from operations (FFO) to total debt was about 16%, total debt to total capital was around 61%, and debt to EBITDA was 5x. The ratios are in line for the rating and reflect a large common equity issuance in the spring of 2009 and ongoing rate relief and capital spending reduction. FFO interest coverage was 3.5x, net cash flow (FFO post dividends) to capital expenditures was approximately 95% and the dividend payout ratio was 55%. Adjustments reflect capital and operating leases, and pension-related items, intermediate equity treatment of the junior subordinated notes, and securitized debt. Given AEP's business risks, sustainable financial expectations are for debt leverage to be under 60% and FFO to debt to approach 20% in order to comfortably maintain the current ratings.

#### **Short-term credit factors**

The company's liquidity is dependent on and managed by its parent AEP. AEP's liquidity reflects high cash balances of roughly \$1 billion and substantial availability of roughly 70% under the company's \$3.6 billion of credit facilities, all as of March 31, 2010. AEP's commercial paper program is backed by its credit facilities that mature in 2011 (\$1.5 billion) and 2012 (\$1.5 billion). The company has a third \$627 million credit agreement that matures in April 2011 against which letters of credit can be issued. As of March 31, 2010, there was \$399 million of outstanding CP and \$652 million of issued LCs. Liquidity for the domestic electric subsidiaries is largely from AEP's money pool and the sale of accounts receivables. The strength of the liquidity also incorporates the stability of the regulated businesses that reliably produce operating cash flow. In 2010, the \$1.8 billion of debt maturities will continue to require prudent financing. Debt maturities are manageable in 2011 and 2012.

## **Outlook**

The stable outlook for AEP and its subsidiaries assumes timely recovery of rate base investments for environmental compliance, system reliability, and continued strategic emphasis on regulated operations. Maintaining the company's balance sheet and other key credit measures will be necessary for continued ratings stability. Higher ratings would be possible over time if AEP demonstrates consistency in its regulated utility strategy and more commitment to improve its financial profile. Rising capital spending or a series of harmful regulatory decisions that impede the company's recovery of those and other costs could lead to a negative outlook or lower ratings.

## **Related Criteria And Research**

- 2008 Corporate Criteria: Analytical Methodology
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded
- 2008 Corporate Criteria: Ratios And Adjustments

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**The McGraw-Hill Companies**

June 19, 2012

### Summary:

# Kentucky Power Co.

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## Summary:

# Kentucky Power Co.

**Credit Rating:** BBB/Stable/--

## Rationale

Standard & Poor's Ratings Services bases its ratings on Kentucky Power Co. on the consolidated credit profile of parent American Electric Power Co. Inc. (AEP), which includes regulated and unregulated operations. We consider Kentucky Power's business risk profile as "excellent" and financial risk profile as "aggressive". It is a vertically integrated, fully regulated electric utility that serves eastern Kentucky. The utility participates in the AEP Power Pool, sharing the revenues and costs of pool sales to utilities and power marketers, and also sells directly at wholesale to municipalities and electric cooperatives. Operations are integrated with the AEP East system. We consider AEP's business risk profile as excellent and its financial risk profile as aggressive.

The excellent consolidated business risk profile primarily reflects AEP's status as a large public utility holding company that owns regulated electric utility subsidiaries operating in 11 states in the Midwest and Southwest. These subsidiaries consist of low-risk transmission and distribution wires-only businesses in Texas; fully integrated regulated utilities in states such as Indiana and West Virginia; and higher-risk hybrid operations in Ohio. Although a portion of generation assets are outside rate base, most of the consolidated generating capacity is under stabilizing regulatory oversight. The company's generating and transmission facilities are interconnected, and its operations are coordinated as an integrated electric utility system.

Electric utility operations are slightly above average, characterized by competitive rates, good reliability, a strong collection of low-cost, coal-fired generation in the eastern part of the system, and supportive regulatory relationships in numerous jurisdictions. Service territories vary widely, ranging from manufacturing and rural areas with lower-growth economies to higher-growth, service-oriented economies, like in the Columbus, Ohio, metropolitan area, that are more stable. The diversity in markets and in regulation somewhat elevates credit quality, but managing the complex variety of regulatory environments can be challenging and requires constant vigilance. This is evident in Ohio, where the regulatory commission approved a stipulated resolution to transition utility customers to competitive generation. Ohio Power Co. was also to transfer its generation assets to an unregulated affiliate. The Ohio commission subsequently retracted its approval of this stipulated resolution and initially opened up generation shopping to all the utility's retail customers, but subsequently limited shopping to a certain percentage of customers. This has provided greater cash flow certainty to Ohio Power. The commission's ruling in the utility's electricity security plan by mid-summer 2012 should provide more clarity around the level of shopping that can take place. Over the longer term, with roughly 25,000 megawatts (MW) of coal-fired generation, including those owned by Ohio Power, material compliance costs related to numerous environmental rules could pressure credit quality. In addition to these coal assets, AEP has 9,000 MW of gas generation and a 2,200 MW nuclear plant.

The company's unregulated operations consist mostly of a large portfolio of quasi-regulated electric generating plants, mainly in Ohio, that to date have been primarily serving AEP's retail utility customers at a commission approved generation rate. We expect AEP's track record of good operating performance in its unregulated business operations to continue. Stricter environmental regulation will place financial stress on the company and erode the



fleet's competitiveness, but we don't expect these pressures to completely eliminate the advantages of AEP's coal plants. AEP has indicated that it will retire roughly 5,500 MW of additional coal-fired assets and retrofit other coal assets with pollution-control equipment. Although AEP's Ohio-based generation accounts for only a portion of the company's credit profile, absent more robust financial measures, a shift to a greater reliance on market prices to generate cash would increase business risk and could ultimately weaken credit quality.

Kentucky Power's financial risk profile reflects AEP's consolidated financial risk profile, which we consider aggressive and includes adjusted financial measures that are in line with the rating. This assessment reflects large capital expenditures mostly for environmental-compliance programs and for new generation and transmission. The elevated spending and dividend payments could result in negative discretionary cash flow for several years, and will require vigilant cost recovery to maintain cash flow measures. We expect consolidated financial measures, including ratios of debt to EBITDA, funds from operations (FFO) to total debt, and debt to capital, to remain in line with the rating. For the 12 months ended March 31, 2012, FFO to total debt was about 17.5%, total debt to total capital was about 57%, and debt to EBITDA was 4.7x. After reducing cash flow from operations by capital expenditures and dividends, discretionary cash flow was a negative \$250 million and net cash flow (FFO after dividends) to capital expenditures dropped to 81%. Both indicate a need for external financing to fund both capital expenditures and dividends. FFO interest coverage continued to be around 3.9x and the dividend payout ratio was manageable at 56%. Adjustments include capital and operating leases, pension-related items, intermediate equity treatment of the junior subordinated notes, and securitized debt.

### Liquidity

The company's liquidity depends on and is managed by parent AEP. We consider AEP's liquidity position "adequate" under Standard & Poor's liquidity methodology. We base our liquidity assessment on the following factors and assumptions:

- We expect AEP's liquidity sources over the next 12 months, including cash, FFO, and credit facility availability, to exceed uses by 1.2x. Uses include necessary capital spending, working capital, debt maturities, and shareholder distributions.
- Debt maturities are manageable over the next 12 months.
- We believe liquidity sources would exceed uses even if EBITDA declined 15%.
- In our assessment, AEP has good relationships with its banks, and has a good standing in the credit markets, having successfully issued debt during the recent credit crisis.

In our analysis of liquidity over the next 12 months, we assume \$7.3 billion of liquidity sources, consisting of FFO and credit facility availability. We estimate liquidity uses of \$4.8 billion for capital spending, maturing debt, working capital, and shareholder distributions.

AEP's credit agreements include a financial covenant requiring that debt to total capitalization be no greater than 67.5%. As of year-end 2011, the company was in compliance with the covenant at 51%.

Debt maturities are manageable through 2016. Including amortizing AEP Texas Central Co. securitization bonds, \$1.4 billion is due in 2012, \$1.4 billion in 2013, \$1.1 billion in 2014, \$1.5 billion in 2015, and \$700 million in 2016. We expect that the company will refinance most of the maturing debt.

## **Outlook**

The stable outlook for the ratings on AEP and its subsidiaries assumes timely recovery of rate base investments for environmental compliance, system reliability, and continued strategic emphasis on regulated operations. Our base forecast includes adjusted FFO to total debt of at least 15%, debt to EBITDA under 5x, and debt leverage to total capital of no more than 60%, all of which are consistent with our expectations for the 'BBB' rating. We could lower the ratings if financial measures fall short of our base forecast on a sustained basis to adjusted FFO to total debt below 12%, debt to EBITDA over 5.2x, and debt leverage over 62%. We could raise the ratings if there is greater certainty regarding business risks and if financial measures exceed our baseline forecast, including FFO to total debt in excess of 20%, debt to EBITDA below 4x, and debt to total capital under 55%.

## **Related Criteria And Research**

- Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- Ratios And Adjustments, April 15, 2008
- Analytical Methodology, April 15, 2008

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**McGRAW-HILL**

June 29, 2009

**Summary:**

**Kentucky Power Co.**

**Primary Credit Analyst:**

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## Summary:

# Kentucky Power Co.

**Credit Rating:** BBB/Stable/--

## Rationale

The ratings on Kentucky Power Co. are based on the consolidated credit profile of its parent American Electric Power Co. Inc. (AEP), which includes regulated and unregulated operations. The company's business risk profile is excellent, and its financial risk profile is aggressive. Kentucky Power is a public utility that generates, purchases, transmits, and distributes electricity in a service territory covering eastern Kentucky. It participates in the AEP Power Pool, sharing the revenues and costs of pool sales to utilities and power marketers, and also sells directly at wholesale to municipalities. Operations are integrated with the AEP East system.

The excellent business profile primarily reflects that AEP is a large public utility holding company that owns regulated electric utility subsidiaries operating in 11 states in the U.S. Midwest and Southwest. The company operates as either low-risk "wires" businesses in regions of Texas; moderate-risk, fully integrated regulated utilities in places such as Indiana and West Virginia; or higher-risk hybrid utilities in states developing deregulation models like Ohio. Electric generation is housed in and out of utility rate bases, but most capacity is subject to stabilizing regulatory oversight. The company's generating and transmission facilities are interconnected, and their operations are coordinated as an integrated electric utility system.

Electric utility operations are slightly above average, characterized by competitive rates, good reliability, a strong collection of low-cost, coal-fired generation in the eastern part of the system, and mostly supportive regulatory relationships. Service territories vary widely, ranging from manufacturing and rural areas with lower growth economies, to higher-growth, service economy-oriented regions like Columbus, Ohio, which are much more resistant to economic cycles. The diversity in markets and regulation somewhat elevates credit quality, but managing the complex variety of regulatory environments creates a challenge for AEP management and requires constant vigilance. Over the longer term, as an overwhelmingly coal-based electric utility, credit quality could be affected if certain scenarios related to carbon legislation are enacted.

The company's unregulated operations primarily consists of a large portfolio of domestic unregulated electric generating plants, mainly in Ohio, that primarily serve AEP's retail utility customers and continue to reside somewhere between a regulated rate base and full merchant status. AEP's long track record of solid operating performance is expected to continue and improve under the unregulated business operations. Stricter environmental laws and regulation will place financial stress and erode the fleet's competitiveness, but are not expected to completely eliminate the advantages of AEP's coal-fired plants. Although AEP's Ohio-based generation accounts for only a modest portion of the company's credit profile, any strategic move that quickly leads to a greater reliance on wholesale market prices to generate cash and earnings from that fleet would suggest a tolerance for increased business risk that could lead to lower ratings.

AEP's aggressive financial profile reflects its large capital spending program and marginal financial measures for its rating. The company's considerable capital expenditures are needed to fund its environmental-compliance programs for stricter air-quality standards and for new generation to meet load growth. AEP also intends to spend substantial

amounts of capital on its transmission and distribution system to improve reliability. The elevated spending levels could result in negative free cash flow for several years, and will likely require ongoing rate changes in many of its jurisdictions to maintain operating cash flow at the utilities. Although adjusted financial measures have declined year over year, they remain in line for the rating. For 12 months ended March 31, 2009, funds from operations (FFO) interest coverage was 2.9x, FFO to total debt was about 12%, and total debt to total capital was about 66%. Net cash flow (FFO post dividends) to capital expenditures was 45% and the dividend payout ratio was 58%. Although debt to EBITDA weakened to 5.8x from one year earlier when it was 4.4x, this reflected lower EBITDA and a sizeable increase in adjusted debt. Adjustments reflect substantial purchased-power obligations, operating leases, and pension-related items, and intermediate equity treatment of the junior subordinated notes. Given AEP's business risks, sustainable financial expectations are for debt leverage to be under 60%, FFO interest coverage to approximate 3.5x, and FFO to debt ratio approaching 20% in order to comfortably maintain the current ratings.

### Liquidity

The company's liquidity is dependent on and managed by its parent AEP. AEP's liquidity reflects \$710 million cash and approximately \$1.5 billion of availability under the company's \$3.919 billion of credit facilities, all as of March 31, 2009. AEP's commercial paper program is backed by its credit facilities that mature in 2011 (\$1.5 billion) and 2012 (\$1.454 billion). The company has a third \$627 million credit agreement that matures in April 2011. A \$338 million facility expired in April 2009. Liquidity for the domestic electric subsidiaries is largely from AEP's money pool and the sale of accounts receivables. Liquidity was bolstered after \$1.25 billion of proceeds from an April 2009 common equity issuance were used to pay down the credit facilities. The strength of the liquidity also incorporates the stability of the regulated businesses that reliably produce operating cash flow. Long-term maturities in the next three years are manageable in 2009 and 2011 whereas in 2010, \$1.8 billion is due and will require a prudent financing strategy.

### Outlook

The stable outlook for AEP and subsidiaries assumes timely recovery of rate base investments for environmental compliance, system reliability, and continued strategic emphasis on regulated operations. Maintaining the company's balance sheet and other key credit measures will be necessary for continued ratings stability. Higher ratings would be possible over time if AEP demonstrates consistency in its regulated utility strategy and more commitment to improvement in its financial profile. Spiraling capital spending or a series of harmful regulatory decisions that thwart the company's recovery of those and other costs could lead to a negative stance or lower ratings.

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# MOODY'S

## INVESTORS SERVICE

### Rating Action: Moody's Affirms Ratings of Three AEP Operating Subsidiaries

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Global Credit Research - 06 Feb 2013

#### Approximately \$6 billion of securities affected

New York, February 06, 2013 – Today Moody's Investors Service affirmed the ratings of Appalachian Power Company (APCo: Baa2 Senior Unsecured), Indiana Michigan Power Company (I&M Baa2 Senior Unsecured) and Kentucky Power Company (KPCo: Baa2 Senior Unsecured). The outlook for all three issuers remains stable. APCo, I&M and KPCo are all operating subsidiaries of American Electric Power Company, Inc. (AEP: Baa2 Senior Unsecured, stable outlook).

"APCo, I&M and KPCo are similar in that their regulators have been, on balance, reasonably supportive of long-term credit quality, and all will have cases in front of their respective commissions over the next 12-24 months relating to material planned increases in rate base, resulting from capital expenditures for required plant retro-fits at I&M and for plant acquisitions to address substantial reserve shortfalls at APCo and KPCo in conjunction with plant closures and the upcoming termination of AEP's Interconnection Agreement," said Bill Hunter, Vice President and Senior Analyst.

"While our ratings for all three issuers incorporate a view that they will receive reasonable regulatory outcomes, we will be most focused on decisions relating to APCo and KPCo. APCo has had financial metrics that score below the mid-Baa level for several years. As a result, any downward re-assessment of APCo's Ability to Recover Costs and Eam Returns (an important component in our methodology) would likely precipitate a negative ratings action. While KPCo's recent historical metrics have been in line with its rating, the need to replace all of its owned generation in the 2015-2016 timeframe due to the retirement of Big Sandy has the potential to materially stress its metrics and test its ability to obtain rate increases sufficient to recover the additional costs."

#### RATINGS RATIONALE:

APCo's ratings and stable outlook reflect a vertically integrated electric utility company operating in states that have been somewhat restrictive but are, on balance, currently viewed as reasonably supportive to long term credit quality, financial metrics (especially leverage as measured by CFO Pre-WC/Debt) that are weak for the rating but have improved relative to their 2007-2008 low point, and an announced plan to alleviate APCo's substantial reserve margin deficit. These positive factors are balanced against the financial requirements that the capacity acquisition plan will create, a need for positive rate actions in the next 18-24 months, and a traditionally weak service territory that has demonstrated some inflection risk.

I&M's ratings and stable outlook reflect the generally supportive regulatory jurisdiction in both Indiana and Michigan, a low-cost generating fleet, and historical financial metrics that have been strong for the rating category, balanced against significant upcoming expenditures at both its coal and nuclear plants that have the potential to pressure metrics, and an industrialized and recession-sensitive service territory.

KPCo's ratings and stable outlook primarily reflect its reasonably constructive relationship with the Kentucky Public Service Commission, historical financial metrics that have improved to a level that is consistent with the rating, and the company's position as one of the smaller members the AEP family, balanced against a reserve deficit that will need to be addressed in serial rate filings, rates that are already high relative to in-state peers, and financial metrics that will likely be materially stressed as a result of planned asset acquisitions and other capacity purchases/construction that will be required to replace Big Sandy.

Rating upgrades for APCo appear unlikely over the near to intermediate term horizon, primarily due to our expectation that APCo's financial profile, and especially its ratio of cash from operations before changes in working capital (CFO Pre-WC) to debt, will not become robust, especially in light of major planned asset purchases. However, APCo's ratings could be upgraded if the credit supportiveness of its combined regulatory environments were to continue to improve, if it were able to purchase capacity that materially decreased its reserve margin deficit while maintaining a balanced Debt/Capitalization ratio around 45%, and if its cash flow financial metrics were to strengthen on a sustainable basis such that CFO Pre-WC to debt approached 20% and CFO Pre-WC + Interest to Interest (Coverage Ratio) approached 4.5x.



Given the size and scope of the environmental and nuclear capital spending program at I&M, a ratings upgrade in the near-to-medium term appears unlikely. Nevertheless, I&M's rating could be upgraded if it were to maintain a strong financial profile during this period. More specifically, if I&M generated a ratio of CFO Pre-W/C to Debt near 20% and a Coverage Ratio near 4.5x while keeping Debt/Capitalization near or below 50% on a sustainable basis, there would be upward rating pressure.

For KPCo, rating upgrades also appear unlikely over the near to intermediate term horizon, primarily due to our expectation that it will be challenged to maintain its financial profile in light of its plant acquisition plans. However, KPCo could be considered for a rating upgrade if it were to achieve improvements in key financial credit metrics on a sustainable basis, including a Coverage Ratio of approximately 4.5x and CFO pre-W/C to Debt of approximately 20%.

APCo's ratings could be downgraded if it were to encounter a more contentious regulatory environment in either Virginia or West Virginia as it seeks approval for the acquisition of new capacity, securitization and fuel-change retro-fits. Any downward change in the scoring of the Ability to Recover Costs and Earn a Return factor, which represents 25% of the grid-implied rating, would most likely cause a negative rating action. Furthermore, ratings could be downgraded if APCo's capacity purchases resulted in an unbalanced capital structure, or if its financial profile deteriorated such that CFO Pre-WC to Debt remained in the low-teens level or the Coverage Ratio fell to 3.0x for a sustained period after completion of the asset purchase.

I&M's ratings could fall under pressure if its capex budget were materially accelerated or there were material cost over-runs in plant retro-fits, if it were to experience an increased lag in cost recovery in future rate case decisions (including for environmental and nuclear expenditures) or if the key financial metrics were to deteriorate over a sustained period such that CFO Pre-W/C to debt reached the low-to-mid teens range or the Coverage Ratio declined to around 3.0x, especially if Debt/Capitalization were in the mid-high 50% range.

KPCo's ratings could be downgraded if the regulatory environment were to take a more adversarial tone, especially with respect to the recent asset acquisition filing; if material progress were not made in the next 12 months in meeting KPCo's post-Big Sandy capacity shortfall; if equity contributions from AEP were not forthcoming in a manner to maintain an appropriate capital structure; if there were a material, sustained decrease in retail sales and revenues (especially from industrial customers); or if there were a sustained deterioration in key financial credit metrics, for instance, a Coverage Ratio below 3.0x or CFO Pre-WC to debt in the low-teens.

The following ratings of Appalachian Power Company are affirmed with stable outlook:

Long-term Issuer Rating Baa2

Senior Unsecured Baa2

Senior Unsecured Medium Term Note Program (P)Baa2

Senior Unsecured Shelf (P)Baa2

BACKED Senior Unsecured Baa2

Underlying Senior Unsecured Baa2

The following ratings of Indiana Michigan Power Company are affirmed with stable outlook:

Long-term Issuer Rating Baa2

Senior Unsecured Rating Baa2

Senior Unsecured Medium Term Note Program (P)Baa2

Secured Lease Obligation Bonds Baa2

The following ratings of Kentucky Power Company are affirmed with stable outlook:

Long-term Issuer Rating Baa2

Senior Unsecured Rating Baa2

The principal methodology used in these ratings was Regulated Electric and Gas Utilities published in August

2009. Please see the Credit Policy page on [www.moodys.com](http://www.moodys.com) for a copy of this methodology.

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January 25, 2008

**Summary:**

**Kentucky Power Co.**

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Rationale

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## Summary:

# Kentucky Power Co.

**Credit Rating:** BBB/Stable/--

## Rationale

The ratings on Kentucky Power Co. (KP) are based on the consolidated credit profile of American Electric Power Co. Inc. (AEP), which include its regulated and non-regulated subsidiaries. The AEP rating reflects its excellent business risk profile, and aggressive financial risk profile. (The business profile is ranked as excellent, strong, satisfactory, weak, or vulnerable, and the financial profile is ranked as modest, intermediate, aggressive, or highly leveraged.)

The excellent business profile primarily reflects the stability of the regulated utility operations marginally affected by the more risky unregulated business and management's recent strategic initiative in Ohio.

KP is a public utility that generates, purchases, transmits, and distributes electricity in a service territory covering eastern Kentucky. It participates in the AEP Power Pool, sharing the revenues and costs of pool sales to utilities and power marketers, and also sells directly at wholesale to municipalities. Operations are integrated with the AEP East system.

AEP is a large public utility holding company that owns directly or indirectly all of the common stock of electric utility subsidiaries operating in 11 states in the U.S. Midwest and Southwest. The company operates as either low-risk "wires" businesses; moderate-risk, fully integrated regulated utilities; or higher-risk hybrid utilities in states with unsettled deregulation models. Electric generation is housed in and out of utility rate bases, but most capacity is directly or virtually subject to stabilizing regulatory oversight. The company's generating and transmission facilities are interconnected, and their operations are coordinated as an integrated electric utility system.

Electric utility operations are slightly above average, characterized by competitive rates, good reliability, a strong collection of low-cost, coal-fired generation in the eastern part of the system, and mostly supportive regulatory relationships. Service territories vary widely, ranging from "Rust Belt" and rural areas that exhibit less-than-favorable economic profiles, to higher-growth, service economy-oriented regions like Columbus, Ohio, which are much more resistant to economic cycles. The diversity in markets and regulation somewhat elevates credit quality, but managing the complex variety of regulatory environments is a challenge for AEP management and requires constant vigilance. Over the longer term, its status as an overwhelmingly coal-based electric utility company could imperil credit quality if the global warming issue becomes a permanent part of the political landscape.

The company's unregulated operations primarily consists of a large portfolio of domestic merchant electric generating plants, mainly in Ohio, which are primarily used to serve AEP's retail utility customers and continue to reside somewhere between a regulated rate base and full merchant status. AEP's long track record of solid operating performance is expected to continue and improve under the unregulated business operations. Stricter environmental laws and regulation will place financial stress and erode the fleet's competitiveness, but are not expected to completely eliminate the advantages of AEP's coal-fired plants.

Also influencing the business profile is management's support for market prices in Ohio. A sudden move to market

would have a harsh effect on AEP Ohio's customers' bills. Although AEP's Ohio-based generation accounts for only a portion of the company's credit profile, management's strategy could lead to a greater reliance on wholesale market prices to generate cash and earnings from a large fleet of electric plants and may suggest a tolerance for increased future business risk.

AEP's aggressive financial profile reflects its large capital programs and marginal financial measures for its rating.

The company's considerable capital expenditures are needed to fund its environmental-compliance programs, strategic investment in transmission, and for new generation to meet load growth. The company projects an environmental capital-expenditure program totaling almost \$4 billion through 2010 to meet stricter air-quality standards and approximately \$4.5 billion to develop new power plants. AEP also intends to spend substantial amounts of capital on its transmission and distribution system to improve reliability. The elevated spending levels indicate that the company will experience negative free cash flow for several years, and can expect lower utility returns such that AEP will need to continually pursue higher rates in many of its jurisdictions.

Given AEP's business risks, sustainable financial expectations are for debt leverage to be around 55% to 60%, funds from operations (FFO) interest coverage to approximate 3.5x, and FFO to debt ratio greater than 20%.

For the 12 months ended Sept. 30, 2007, adjusted debt to total capital rose to 61.8% from 60.3% at the end of 2006. Cash flow measures were also weak for the rating. For the 12 months ended Sept. 30, 2007, after adjustments, consolidated FFO interest coverage was 3.2x, down from 3.7x at the end of 2006 and FFO to total debt was at 15.7%, lower than the 19.8% at the end of 2006.

#### Short-term credit factors

KP's liquidity is managed by its parent. AEP's short-term rating is 'A-2'. AEP has adequate liquidity, with \$196 million of cash on hand as of Sept. 30, 2007, stable regulated businesses that can reliably produce operating cash flow, and sufficient capacity under its bank facilities to meet working-capital needs. Long-term maturities due are approximately \$590 million in 2008, \$480 million in 2009, \$1.7 billion in 2010, and \$590 million in 2011. The company operates a money pool and sells accounts receivables to provide liquidity for the domestic electric subsidiaries.

Liquidity is primarily provided through a commercial paper program at the parent that lends to subsidiaries through intercompany notes. The commercial paper program is backed by \$3 billion in bank facilities that mature in 2011 (\$1.5 billion) and 2012 (\$1.5 billion).

## Outlook

The stable outlook for AEP and subsidiaries assumes timely recovery of rate base investments for environmental compliance, system reliability, and continued strategic emphasis on regulated operations. Maintaining the improving trend in the company's balance sheet and other key credit measures will be necessary for continued ratings stability. Higher ratings would be possible over time if AEP demonstrates consistency in its regulated utility strategy and gradual improvement in its financial profile. Spiraling capital spending or a series of harmful regulatory decisions that thwart the company's recovery of those and other costs could lead to a negative stance or lower ratings.

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## Summary:

# Kentucky Power Co.

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## Summary:

# Kentucky Power Co.

**Credit****Rating:** BBB/Stable/--

## Rationale

Standard & Poor's Ratings Services bases its ratings on Kentucky Power Co. on the consolidated credit profile of parent American Electric Power Co. Inc. (AEP), which includes regulated and unregulated operations. We consider Kentucky Power's business risk profile as "excellent" and financial risk profile as "aggressive". It is a vertically integrated, fully regulated electric utility that serves eastern Kentucky. The utility participates in the AEP Power Pool, sharing the revenues and costs of pool sales to utilities and power marketers, and also sells directly at wholesale to municipalities and electric cooperatives. Operations are integrated with the AEP East system. We consider AEP's business risk profile as excellent and its financial risk profile as aggressive.

The excellent consolidated business risk profile primarily reflects AEP's status as a large public utility holding company that owns regulated electric utility subsidiaries operating in 11 states in the Midwest and Southwest. These subsidiaries consist of low-risk transmission and distribution wires-only businesses in Texas; fully integrated regulated utilities in states such as Indiana and West Virginia; and higher-risk hybrid operations in Ohio. Although a portion of generation assets are outside rate base, most of the consolidated generating capacity is under stabilizing regulatory oversight. The company's generating and transmission facilities are interconnected, and its operations are coordinated as an integrated electric utility system.

Electric utility operations are slightly above average, characterized by competitive rates; good reliability; a strong collection of low-cost, coal-fired generation in the eastern part of the system; and supportive regulatory relationships in numerous jurisdictions. Service territories vary widely, ranging from manufacturing and rural areas with lower-growth economies to higher-growth, service-oriented economies, like in the Columbus, Ohio, metropolitan area, that are more stable. The diversity in markets and in regulation somewhat elevates credit quality, but managing the complex variety of regulatory environments can be challenging and requires constant vigilance.

Ohio Power continues to transition to a competitive generation market with shopping for generation service available to all retail customers and Public Utilities Commission of Ohio (PUCO) approval to transfer all its generation assets out of the utility, including to an unregulated generation affiliate.

Over the longer term, with roughly 25,000 megawatts (MW) of coal-fired generation, including those owned by Ohio Power, material compliance costs related to numerous environmental rules could pressure credit quality without adequate cost recovery. In addition to these coal assets, AEP has 9,700 MW of gas generation and a 2,200 MW nuclear plant.

The company's unregulated operations will grow to include about 8,900 MW of former Ohio Power generation assets

following Ohio Power's 2,400 MW transfer to affiliate utilities and its coal plant closures. We expect AEP's track record of good operating performance in its unregulated business operations to continue. Stricter environmental regulation will erode the fleet's competitiveness, but we do not expect these pressures to completely eliminate the advantages of AEP's coal plants. AEP has indicated that it will retire roughly 5,500 MW of additional coal-fired assets, including Ohio Power's closures, and retrofit other coal assets with pollution-control equipment. Although AEP's Ohio-based generation accounts for only a portion of its credit profile, absent more robust financial measures, a shift to a greater reliance on market prices to generate cash would increase business risk and could ultimately weaken credit quality.

Reflected in the business risk profile is our assessment of the company's management and governance as "satisfactory".

Kentucky Power's financial risk profile reflects AEP's consolidated financial risk profile, which we consider aggressive, and includes adjusted financial measures that are in line with the rating. This assessment reflects large capital expenditures, mostly for environmental-compliance programs and for new generation and transmission. We forecast that the elevated spending and recurring dividend payments could result in negative discretionary cash flow for several years, and will require vigilant cost recovery to maintain cash flow measures. We expect consolidated financial measures, including ratios of debt to EBITDA, funds from operations (FFO) to total debt, and debt to capital, to remain in line with the rating. For the 12 months ended Sept. 30, 2012, FFO to total debt was about 18.3%, total debt to total capital was about 57%, and debt to EBITDA was 4.5x. After reducing cash flow from operations by capital expenditures and dividends, discretionary cash flow was negative \$470 million and net cash flow (FFO after dividends) to capital expenditures was 91%. Both indicate a need for external financing to fund both capital expenditures and dividends. FFO interest coverage was robust at 4.2x, and the dividend payout ratio was manageable at 62%. In addition, even though it is committed to credit quality, we consider the company's financial policies to be aggressive. Adjustments include capital and operating leases, pension-related items, intermediate equity treatment of the junior subordinated notes, and securitized debt.

Our base forecast of between 15% and 16% adjusted FFO to total debt, 4.4x adjusted debt to EBITDA, and about 58% adjusted total debt to total capital continues to reflect steady operating cash flows and execution on the transition in Ohio. Our rating on AEP reflects our view of a mostly regulated utility strategy that will include continuous capital spending and timely cost recovery through various regulatory mechanisms. We expect this to lead to steady cash flow measures and manageable debt leverage.

### Liquidity

The company's liquidity depends on and is managed by parent AEP. We consider AEP's liquidity position "adequate" under Standard & Poor's liquidity methodology. We base our liquidity assessment on the following factors and assumptions:

- We expect AEP's liquidity sources over the next 12 months, including cash, FFO, and credit facility availability, to exceed uses by 1.2x. Uses include necessary capital spending, working capital, debt maturities, and shareholder distributions.
- Debt maturities are manageable over the next 12 months.
- We believe liquidity sources would exceed uses even if EBITDA decreased 15%.
- In our assessment, AEP has good relationships with its banks and has a good standing in the credit markets, having

successfully issued debt during the recent credit crisis.

In our analysis of liquidity over the next 12 months, we assume \$5.8 billion of liquidity sources, including FFO and credit facility availability. We estimate liquidity uses of \$4.6 billion for capital spending, maturing debt, working capital, and shareholder distributions.

AEP's credit agreements include a financial covenant requiring that debt to total capitalization, excluding securitization debt, junior subordinated notes, and debt of AEP Credit, to be no greater than 67.5%. As of Sept. 30, 2012, the company was in compliance with the covenant at 49.5%.

Debt maturities are manageable through 2016. Including amortizing AEP Texas Central Co. securitization bonds, \$1.8 billion is due in 2013, \$1 billion in 2014, \$1.3 billion in 2015, \$940 million in 2016, and \$1.2 billion in 2017. We expect that the company will refinance most of the maturing debt.

## **Outlook**

The stable outlook on the ratings on AEP and its subsidiaries assumes timely recovery of rate base investments for environmental compliance, system reliability, and continued strategic emphasis on regulated operations. Our base forecast includes adjusted FFO to total debt of at least 15%, debt to EBITDA of less than 5x, and debt leverage to total capital of no more than 60%, all of which are consistent with our expectations for the 'BBB' rating. We could lower the ratings if financial measures fall short of our base forecast on a sustained basis to adjusted FFO to total debt of less than 12%, debt to EBITDA of more than 5.2x, and debt leverage of more than 62%. We could raise the ratings if there is greater certainty regarding business risks and if financial measures exceed our baseline forecast, including FFO to total debt in excess of 20%, debt to EBITDA of less than 4x, and debt to total capital of less than 55%.

## **Related Criteria And Research**

- Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Business Risk/Financial Risk Matrix Expanded, Sept. 18, 2012
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012

Temporary contact numbers: Gerrit Jepsen 917-584-2786; Dimitri Nikas 646-584-8438

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**McGRAW-HILL**

December 15, 2011

## Kentucky Power Co.

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# Kentucky Power Co.

## Major Rating Factors

### Strengths:

- Steady utility operating cash flow;
- Part of a electric utility company that is geographically diverse and has a large customer base; and
- Low-cost generation fleet.

**Corporate Credit Rating**

BBB/Stable/--

### Weaknesses:

- Financial measures could be pressured from exposure to environmental regulations;
- Marketing operations weaken creditworthiness; and
- Increased unregulated generation may pressure business profile.

## Rationale

Standard & Poor's Ratings Services' ratings on Kentucky Power Co. are based on the consolidated credit profile of parent American Electric Power Co. Inc. (AEP), which includes regulated and unregulated operations. We consider Kentucky Power's business risk profile excellent and financial risk profile aggressive. It is a vertically integrated, fully regulated electric utility that serves eastern Kentucky. The utility participates in the AEP Power Pool, sharing the revenues and costs of pool sales to utilities and power marketers, and also sells directly at wholesale to municipalities and electric cooperatives. Operations are integrated with the AEP East system. We consider AEP's business risk profile excellent and its financial risk profile aggressive. (For more on business risk and financial risk, see "Business Risk/Financial Risk Matrix Expanded," published on May 27, 2009, on RatingsDirect.)

The excellent consolidated business profile primarily reflects AEP's status as a large public utility holding company that owns regulated electric utility subsidiaries operating in 11 states in the Midwest and Southwest. The company operates low-risk transmission and distribution wires-only businesses in Texas; fully integrated regulated utilities in states such as Indiana and West Virginia; and higher-risk hybrid utilities in Ohio. Although a portion of generation assets are outside the rate base, most of the consolidated generating capacity is under stabilizing regulatory oversight. The company's generating and transmission facilities are interconnected, and its operations are coordinated as an integrated electric utility system.

Electric utility operations are slightly above average, characterized by competitive rates, good reliability, a strong collection of low-cost, coal-fired generation in the eastern part of the system, and mostly supportive regulatory relationships. Service territories vary widely, ranging from manufacturing and rural areas with lower-growth economies to higher-growth, service-oriented economies, like the Columbus, Ohio, metropolitan area, that are more stable. The diversity in markets and in regulation somewhat elevates credit quality, but managing the complex variety of regulatory environments can be challenging and requires constant vigilance. This is evident in Arkansas, where the company is continuing to build the Turk coal unit while multiple legal challenges are pending, including litigation in connection with the unit's water intake. Over the longer term, with roughly 25,000 megawatts (MW) of coal-fired generation, including those in Ohio, material compliance costs related to numerous environmental rules could pressure credit quality. In addition to these coal assets, there are 9,000 MW of gas generation and 2,200 MW

of nuclear.

The company's unregulated operations consist mostly of a large portfolio of quasi-regulated electric generating plants, mainly in Ohio, that have been primarily serving AEP's retail utility customers. We expect AEP's long track record of solid operating performance in its unregulated business operations to continue. Stricter environmental regulation will place financial stress on the company and erode the fleet's competitiveness, but we don't expect these pressures to completely eliminate the advantages of AEP's coal fleet. AEP has indicated that it will retire 5,109 MW of coal-fired assets and retrofit part of the fleet with pollution control equipment. Although AEP's Ohio-based generation accounts for only a portion of the company's credit profile, absent more robust financial measures, a strategic shift to a greater reliance on wholesale market prices to generate cash would increase business risk and could ultimately weaken credit quality.

Kentucky Power's financial risk profile reflects AEP's consolidated financial risk profile, which we consider aggressive. This assessment reflects financial measures that are in line with the rating, along with large capital expenditures. The company's considerable capital spending is mostly for environmental compliance programs and for new generation and transmission. The elevated spending levels and dividend payments could result in negative discretionary cash flow for several years, and will require vigilant cost recovery to maintain cash flow measures. For the 12 months ended Sept. 30, 2011, funds from operations (FFO) to total debt was 21%, total debt to total capital was around 58%, and debt to EBITDA was 4.3x. The ratios are in line with the rating. Discretionary cash flow is positive and net cash flow (FFO after dividends) to capital expenditures exceeded 130%. FFO interest coverage was 4.5x and the dividend payout ratio was a manageable 58%. Adjustments include capital and operating leases, pension-related items, intermediate equity treatment of the junior subordinated notes, and securitized debt.

### Liquidity

The company's liquidity depends on and is managed by parent AEP. We consider AEP's liquidity adequate under Standard & Poor's liquidity methodology. (We categorize liquidity in five standard descriptors. See "Liquidity Descriptors For Global Corporate Issuers," published on Sept. 28, 2011.) We base our liquidity assessment on the following factors and assumptions:

- We expect AEP's liquidity sources over the next 12 months, including cash, FFO, and credit facility availability, to exceed uses by 1.2x. Uses include necessary capital spending, working capital, debt maturities, and shareholder distributions.
- Debt maturities are manageable over the next 12 months.
- We believe liquidity sources would exceed uses even if EBITDA declined 15%.
- In our assessment, AEP has good relationships with its banks, and has a good standing in the credit markets, having successfully issued debt during the recent credit crisis.

In our analysis of liquidity over the next 12 months, we assume \$7.2 billion of liquidity sources, consisting of FFO and credit facility availability. We estimate liquidity uses of \$4.9 billion for capital spending, maturing debt, working capital, and shareholder distributions.

AEP's credit agreements include a financial covenant requiring that debt to total capitalization be no greater than 67.5%. As of Sept. 30, 2011, the company was in compliance with the covenant at 50.3%.

Debt maturities are manageable through 2016. Excluding amortizing AEP Texas Central securitization bonds, \$690 million is due in 2012, \$1.4 billion in 2013, \$1 billion in 2014, \$1.3 billion in 2015, and \$500 million in 2016. We



expect that the company will refinance a majority of the maturing debt.

## Outlook

The stable outlook for the ratings on AEP and its subsidiaries assumes timely recovery of rate base investments for environmental compliance, system reliability, and continued strategic emphasis on regulated operations. Our base forecast includes adjusted FFO to total debt of at least 15%, debt to EBITDA under 5x, and debt leverage to total capital of no more than 60%, all of which are consistent with our expectations for the 'BBB' rating. We could lower the ratings if financial measures fall short of our base forecast on a sustained basis to adjusted FFO to total debt below 12%, debt to EBITDA over 5.2x, and debt leverage over 62%. We could raise the ratings if there is greater certainty regarding business risks and if financial measures exceed our baseline forecast, including FFO to total debt in excess of 20%, debt to EBITDA below 4x, and debt to total capital under 55%.

## Related Criteria And Research

- Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- Ratios And Adjustments, April 15, 2008
- Analytical Methodology, April 15, 2008

Table 1

<b>American Electric Power Co. Inc. -- Peer Comparison</b>					
<b>Industry Sector: Energy</b>					
	<b>American Electric Power Co. Inc.</b>	<b>Duke Energy Corp.</b>	<b>Southern Co.</b>	<b>Progress Energy Inc.</b>	<b>Xcel Energy Inc.</b>
<b>Rating as of Dec. 14, 2011</b>	BBB/Stable/A-2	A-/Stable/A-2	A/Stable/A-1	BBB+/Watch Pos/A-2	A-/Stable/A-2
<b>--Average of past three fiscal years--</b>					
<b>(Mil. \$)</b>					
Revenues	13,871.7	13,403.3	15,645.6	9,747.3	10,385.6
EBITDA	4,190.0	4,474.4	4,921.6	3,089.4	2,524.8
Net income from cont. oper.	1,314.7	1,219.7	1,664.9	823.0	694.4
Funds from operations (FFO)	3,256.9	3,985.8	3,955.5	2,218.9	2,004.8
Capital expenditures	3,182.0	4,530.2	4,191.1	2,547.3	2,052.6
Free operating cash flow	(568.1)	(549.7)	(596.1)	(459.7)	(67.7)
Dividends paid	762.6	1,232.7	1,402.8	724.3	422.9
Discretionary cash flow	(1,330.7)	(1,782.4)	(1,998.8)	(1,184.0)	(490.5)
Cash and short-term investments	767.0	1,416.3	498.9	505.3	155.1
Debt	20,743.2	18,503.2	21,358.2	14,718.8	10,963.4
Preferred stock	187.8	0.0	747.0	182.5	252.5
Equity	12,672.8	21,896.7	15,532.3	9,574.2	7,696.0
Debt and equity	33,416.0	40,399.9	36,890.6	24,293.0	18,659.4
<b>Adjusted ratios</b>					
EBITDA margin (%)	30.2	33.4	31.5	31.7	24.3

Table 1

American Electric Power Co. Inc. -- Peer Comparison (cont.)					
EBIT interest coverage (x)	2.5	3.2	3.3	2.5	2.7
Return on capital (%)	7.7	6.8	8.3	8.8	8.0
FFO int. cov. (X)	3.5	5.1	4.5	3.4	4.1
FFO/debt (%)	15.7	21.5	18.5	15.1	18.3
Free operating cash flow/debt (%)	(2.7)	(3.0)	(2.8)	(3.1)	(0.6)
Discretionary cash flow/debt (%)	(6.4)	(9.6)	(9.4)	(8.0)	(4.5)
Net cash flow/capex (%)	78.4	60.8	60.9	58.7	77.1
Debt/EBITDA (x)	5.0	4.1	4.3	4.8	4.3
Total debt/debt plus equity (%)	62.1	45.8	57.9	60.6	58.8
Return on capital (%)	7.7	6.8	8.3	8.8	8.0
Return on common equity (%)	9.9	4.3	10.4	7.4	8.2
Common dividend payout ratio (un-adj.) (%)	56.8	99.7	86.4	84.1	64.2

Table 2

Kentucky Power Co. -- Financial Summary					
Industry Sector: Electric					
--Fiscal year ended Dec. 31--					
	2010	2009	2008	2007	2006
Rating history	BBB/Stable/--	BBB/Stable/--	BBB/Stable/--	BBB/Stable/--	BBB/Stable/--
(Mil. \$)					
Revenues	683.7	632.5	665.6	588.0	585.9
EBITDA	142.2	119.6	112.7	122.6	128.5
Net income from continuing operations	35.3	23.9	24.5	32.5	35.0
Funds from operations (FFO)	93.9	110.6	62.0	85.6	83.0
Capital expenditures	53.5	63.6	129.5	71.3	79.0
Dividends paid	21.0	19.5	14.0	12.0	15.0
Debt	590.9	607.2	617.8	519.4	530.2
Preferred stock	0.0	0.0	0.0	0.0	0.0
Equity	446.2	431.8	398.0	387.0	369.7
Debt and equity	1,037.1	1,039.0	1,015.8	906.4	899.9
Adjusted ratios					
EBITDA margin (%)	20.8	18.9	16.9	20.8	21.9
EBIT interest coverage (x)	2.4	1.8	1.7	2.4	2.6
FFO int. cov. (x)	3.4	4.0	2.4	3.6	3.5
FFO/debt (%)	15.9	18.2	10.0	16.5	15.7
Discretionary cash flow/debt (%)	12.5	(4.5)	(15.6)	2.2	1.5
Net cash flow/capex (%)	136.4	143.3	37.1	103.2	86.1
Debt/debt and equity (%)	57.0	58.4	60.8	57.3	58.9
Return on capital (%)	6.7	5.2	5.6	6.8	7.3
Return on common equity (%)	7.7	5.6	5.6	8.4	9.5

Table 2

**Kentucky Power Co. -- Financial Summary (cont.)**

Common dividend payout ratio (un-adj.) (%)	59.5	81.5	57.1	37.0	42.8
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Table 3

**Reconciliation Of Kentucky Power Co. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. \$)**

--Fiscal year ended Dec. 31, 2010--

**Kentucky Power Co. reported amounts**

	Debt	Shareholders' equity	Revenues	EBITDA	Operating income	Interest expense	Cash flow from operations	Cash flow from operations	Dividends paid	Capital expenditures
Reported	550.7	446.2	683.7	141.7	88.9	36.4	143.6	143.6	21.0	54.1

**Standard & Poor's adjustments**

Trade receivables sold or securitized	--	--	--	--	--	0.0	--	--	--	--
Operating leases	3.2	--	--	0.4	0.4	0.4	1.1	1.1	--	--
Postretirement benefit obligations	26.6	--	--	(0.1)	(0.1)	--	4.4	4.4	--	--
Capitalized interest	--	--	--	--	--	0.6	(0.6)	(0.6)	--	(0.6)
Asset retirement obligations	2.7	--	--	0.3	0.3	0.3	(0.4)	(0.4)	--	--
Reclassification of nonoperating income (expenses)	--	--	--	--	1.0	--	--	--	--	--
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	--	(54.1)	--	--
Debt - Accrued interest not included in reported debt	7.6	--	--	--	--	--	--	--	--	--
Total adjustments	40.2	0.0	0.0	0.5	1.5	1.2	4.4	(49.7)	0.0	(0.6)

**Standard & Poor's adjusted amounts**

	Debt	Equity	Revenues	EBITDA	EBIT	Interest expense	Cash flow from operations	Funds from operations	Dividends paid	Capital expenditures
Adjusted	590.9	446.2	683.7	142.2	90.4	37.7	148.0	93.9	21.0	53.5

**Ratings Detail (As Of December 15, 2011)****Kentucky Power Co.**

Corporate Credit Rating

BBB/Stable/--

Senior Unsecured (2 Issues)

BBB

**Ratings Detail (As Of December 15, 2011) (cont.)****Corporate Credit Ratings History**

07-Mar-2003	BBB/Stable/--
24-Jan-2003	BBB+/Watch Neg/--
23-May-2002	BBB+/Stable/--

**Business Risk Profile**

Excellent

**Financial Risk Profile**

Aggressive

**Related Entities****AEP Texas North Co.**

Issuer Credit Rating	BBB/Stable/--
Senior Unsecured (1 Issue)	BBB
Senior Unsecured (1 Issue)	BBB/Developing

**American Electric Power Co. Inc.**

Issuer Credit Rating	BBB/Stable/A-2
Commercial Paper	
<i>Local Currency</i>	A-2
Junior Subordinated (1 Issue)	BB+
Senior Unsecured (1 Issue)	BBB

**Appalachian Power Co.**

Issuer Credit Rating	BBB/Stable/--
Senior Unsecured (18 Issues)	BBB
Senior Unsecured (1 Issue)	BBB/Developing

**Columbus Southern Power Co.**

Issuer Credit Rating	BBB/Stable/--
Senior Unsecured (8 Issues)	BBB
Senior Unsecured (2 Issues)	BBB/Negative

**Indiana Michigan Power Co.**

Issuer Credit Rating	BBB/Stable/--
Senior Unsecured (11 Issues)	BBB

**Ohio Power Co.**

Issuer Credit Rating	BBB/Stable/--
Senior Unsecured (13 Issues)	BBB

**Public Service Co. of Oklahoma**

Issuer Credit Rating	BBB/Stable/--
Preferred Stock (2 Issues)	BB+
Senior Unsecured (5 Issues)	BBB
Senior Unsecured (1 Issue)	BBB/Developing

**RGS (AEGCO) Funding Corp.**

Issuer Credit Rating	BBB/Stable/--
Senior Unsecured (2 Issues)	BBB-

**RGS (I&M) Funding Corp.**

Issuer Credit Rating	BBB/Stable/--
Senior Unsecured (2 Issues)	BBB-

\*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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December 29, 2009

## Kentucky Power Co.

**Primary Credit Analyst:**

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# Kentucky Power Co.

## Major Rating Factors

### Strengths:

- Steady utility operating cash flow;
- Part of a large, diverse regulated electric utility operation; and
- Parent's low-cost generation asset portfolio.

### Weaknesses:

- Parent's marketing operations, though small, detract from credit profile; and
- Aggressive consolidated debt leverage.

**Corporate Credit Rating**

BBB/Stable/–

## Rationale

The ratings on Kentucky Power Co. are based on the consolidated credit profile of its parent American Electric Power Co. Inc. (AEP), which includes regulated and unregulated operations. Kentucky Power's business risk profile is excellent and its financial risk profile is aggressive. Kentucky Power is a public utility that generates, purchases, transmits, and distributes electricity in a service territory covering eastern Kentucky. It participates in the AEP Power Pool, sharing the revenues and costs of pool sales to utilities and power marketers, and also sells directly at wholesale to municipalities. Operations are integrated with the AEP East system. Columbus, Ohio-based AEP has \$17.6 billion of outstanding debt of which Kentucky Power comprises \$549 million.

AEP has an excellent business risk profile that primarily reflects its status as a large public utility holding company that owns regulated electric utility subsidiaries operating in 11 states in the Midwest and Southwest. The company operates as low-risk transmission and distribution wires-only businesses in regions of Texas; fully integrated regulated utilities in places such as Indiana and West Virginia; or higher-risk hybrid utilities in states developing deregulation models like Ohio. Electric generation is housed in and out of utility rate bases, but most of the generating capacity is under stabilizing regulatory oversight. The company's generating and transmission facilities are interconnected, and their operations are coordinated as an integrated electric utility system.

Electric utility operations are slightly above average, characterized by competitive rates, good reliability, a strong collection of low-cost, coal-fired generation in the eastern part of the system, and mostly supportive regulatory relationships. Service territories vary widely, ranging from manufacturing and rural areas with lower growth economies, to higher-growth, service-oriented economies like Columbus, Ohio, that are more stable. The diversity in markets and in regulation somewhat elevates credit quality, but managing the complex variety of regulatory environments can challenge AEP management and requires constant vigilance. Over the longer term, as an overwhelmingly coal-based electric utility, credit quality could be affected if legislation is enacted regarding carbon dioxide emissions that would result in material compliance costs.

The company's unregulated operations primarily consists of a large portfolio of domestic unregulated electric generating plants, mainly in Ohio, that primarily serve AEP's retail utility customers and continue to reside somewhere between a regulated rate base and full merchant status. AEP's long track record of solid operating performance is expected to continue and improve under the unregulated business operations. Stricter environmental

laws and regulation will place financial stress and erode the fleet's competitiveness, but are not expected to completely eliminate the advantages of AEP's coal-fired plants. AEP has indicated that ultimately about 25% of its coal-fired generation may be retired. Although AEP's Ohio-based generation accounts for only a modest portion of the company's credit profile, any strategic move that quickly leads to a greater reliance on wholesale market prices to generate cash and earnings from that fleet would suggest a tolerance for increased business risk that could weaken credit quality.

Kentucky Power's financial risk profile reflects AEP's consolidated financial risk profile, which is considered aggressive. This reflects a large capital spending program and financial measures inline for its rating. The company's considerable capital expenditures are needed to fund its environmental-compliance programs for stricter air-quality standards and for new generation to meet load growth. AEP also intends to spend substantial amounts of capital on its transmission and distribution system to improve reliability. The elevated spending levels could result in negative free cash flow for several years, and will likely require ongoing rate changes in many of its jurisdictions to maintain operating cash flow at the utilities. Although adjusted financial measures have declined year over year, they remain in line for the rating. For 12 months ended Sept. 30, 2009, funds from operations (FFO) interest coverage was about 3.29x, FFO to total debt was about 15.5%, and total debt to total capital was about 60%. Net cash flow (FFO post dividends) to capital expenditures was 63% and the dividend payout ratio was 58%. All these ratios improved from those as of 12 months ended March 31, 2009, before the company's common equity issuance and incremental rate relief. Debt to EBITDA also showed improvement to 5.0x from 5.8x as of March. Adjustments reflect capital and operating leases, and pension-related items, intermediate equity treatment of the junior subordinated notes, and securitized debt. Given AEP's business risks, sustainable financial expectations are for debt leverage to be under 60%, FFO interest coverage to approximate 3.5x, and FFO to debt ratio approaching 20% in order to comfortably maintain the current rating.

### Liquidity

The company's liquidity is dependent on and managed by its parent AEP. AEP's liquidity reflects high cash balances of \$877 million and substantial availability of roughly 80% under the company's \$3.6 billion of credit facilities, all as of Sept. 30, 2009. AEP's commercial paper program is backed by its credit facilities that mature in 2011 (\$1.5 billion) and 2012 (\$1.5 billion). The company has a third \$627 million credit agreement that matures in April 2011 against which letters of credit can be issued. As of Sept. 30, 2009, there was \$347 million of outstanding CP and \$372 million of issued LCs. Liquidity for the domestic electric subsidiaries is largely from AEP's money pool and the sale of accounts receivables. The strength of the liquidity also incorporates the stability of the regulated businesses that reliably produce operating cash flow. Except for 2010 when \$1.8 billion matures, and will require a prudent financing, debt maturities are manageable through 2012.

### Outlook

The stable outlook for AEP and its subsidiaries assumes timely recovery of rate base investments for environmental compliance, system reliability, and continued strategic emphasis on regulated operations. Maintaining the company's balance sheet and other key credit measures will be necessary for continued ratings stability. Higher ratings would be possible over time if AEP demonstrates consistency in its regulated utility strategy and ongoing commitment to improve its financial profile. Rising capital spending or a series of harmful regulatory decisions that thwart the company's recovery of those and other costs could lead to a negative outlook or lower ratings.



Table 1.

<b>American Electric Power Co. Inc. -- Peer Comparison*</b>				
<b>Industry Sector: Energy</b>				
	<b>American Electric Power Co. Inc.</b>	<b>Duke Energy Corp.</b>	<b>Southern Co.</b>	<b>MidAmerican Energy Holdings Co.</b>
Rating as of Dec. 22, 2009	BBB/Stable/A-2	A-/Positive/A-2	A/Stable/A-1	BBB+/Stable/--
<b>--Average of past three fiscal years--</b>				
<b>(Mil. \$)</b>				
Revenues	13,319.9	14,217.3	14,591.1	11,781.6
Net income from cont. oper.	1,168.0	1,630.0	1,549.8	1,318.4
Funds from operations (FFO)	2,769.0	4,149.1	3,352.8	2,540.0
Capital expenditures	3,794.8	3,878.1	3,233.1	3,355.3
Debt	17,266.0	17,312.7	17,438.6	19,652.0
Equity	10,154.5	23,111.8	13,225.8	10,565.1
<b>Adjusted ratios</b>				
Oper. income (bef. D&A)/revenues (%)	29.9	32.5	31.1	32.5
EBIT interest coverage (x)	2.4	3.1	3.4	2.4
EBITDA interest coverage (x)	3.7	4.4	4.9	3.1
Return on capital (%)	8.1	7.1	8.8	9.4
FFO/debt (%)	16.0	24.0	19.2	12.9
Debt/EBITDA (x)	4.5	3.8	3.9	5.2

\*Fully adjusted (including postretirement obligations).

Table 2.

<b>Kentucky Power Co. -- Financial Summary*</b>					
<b>Industry Sector: Electric</b>					
<b>--Fiscal year ended Dec. 31--</b>					
	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
Rating history	BBB/Stable/--	BBB/Stable/--	BBB/Stable/--	BBB/Stable/--	BBB/Stable/--
<b>(Mil. \$)</b>					
Revenues	665.6	588.0	585.9	531.3	449.0
Net income from continuing operations	24.5	32.5	35.0	20.8	25.9
Funds from operations (FFO)	62.0	85.6	83.0	57.9	85.6
Capital expenditures	129.5	71.3	79.0	59.0	37.9
Cash and short-term investments	0.6	0.7	0.7	0.5	0.1
Debt	617.8	519.4	530.2	542.9	552.6
Preferred stock	0	0	0	0	0
Equity	398.0	387.0	369.7	347.8	321.0
Debt and equity	1,015.8	906.4	899.9	890.7	873.6
<b>Adjusted ratios</b>					
EBIT interest coverage (x)	1.7	2.4	2.6	2.0	2.0
FFO int. cov. (x)	2.4	3.6	3.5	2.7	3.6
FFO/debt (%)	10.0	16.5	15.7	10.7	15.5

Table 2.

Kentucky Power Co. -- Financial Summary* (cont.)					
Discretionary cash flow/debt (%)	(13.3)	2.2	2.5	(0.4)	6.0
Net Cash Flow / Capex (%)	37.1	103.2	86.1	93.9	174.7
Debt/debt and equity (%)	60.8	57.3	58.9	60.9	63.3
Return on common equity (%)	5.6	8.4	9.5	6.0	7.9
Common dividend payout ratio (un-adj.) (%)	57.1	37.0	42.8	12.0	75.3

\*Fully adjusted.

Table 3.

Reconciliation Of Kentucky Power Co. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. S)*								
--Fiscal year ended Dec. 31, 2008--								
Kentucky Power Co. reported amounts								
	Debt	Operating income (before D&A)	Operating income (before D&A)	Operating income (after D&A)	Interest expense	Cash flow from operations	Cash flow from operations	Capital expenditures
Reported	550.0	111.9	111.9	63.8	34.5	61.3	61.3	129.6
Standard & Poor's adjustments								
Trade receivables sold or securitized	55.8	--	--	--	2.8	--	--	--
Operating leases	9.9	2.2	0.7	0.7	0.7	1.5	1.5	1.6
Capitalized interest	--	--	--	--	1.7	(1.7)	(1.7)	(1.7)
Asset retirement obligations	2.1	0.1	0.1	0.1	0.1	0.3	0.3	--
Reclassification of nonoperating income (expenses)	--	--	--	3.1	--	--	--	--
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	0.5	--
Total adjustments	67.8	2.3	0.8	3.9	5.2	0.2	0.7	(0.1)
Standard & Poor's adjusted amounts								
	Debt	Operating income (before D&A)	EBITDA	EBIT	Interest expense	Cash flow from operations	Funds from operations	Capital expenditures
Adjusted	617.8	114.2	112.7	67.7	39.8	61.5	62.0	129.5

\*Kentucky Power Co. reported amounts shown are taken from the company's financial statements but might include adjustments made by data providers or reclassifications made by Standard & Poor's analysts. Please note that two reported amounts (operating income before D&A and cash flow from operations) are used to derive more than one Standard & Poor's-adjusted amount (operating income before D&A and EBITDA, and cash flow from operations and funds from operations, respectively). Consequently, the first section in some tables may feature duplicate descriptions and amounts.

### Ratings Detail (As Of December 29, 2009)

#### Kentucky Power Co.

Corporate Credit Rating	BBB/Stable/--
Senior Unsecured (4 Issues)	BBB

#### Corporate Credit Ratings History

07-Mar-2003	BBB/Stable/--
24-Jan-2003	BBB+/Watch Neg/--
23-May-2002	BBB+/Stable/--

**Ratings Detail (As Of December 29, 2009) (cont.)**

<b>Business Risk Profile</b>	Excellent
<b>Financial Risk Profile</b>	Aggressive
<b>Related Entities</b>	
<b>AEP Texas North Co</b>	
Issuer Credit Rating	BBB/Stable/--
Preferred Stock (2 Issues)	BB+
Senior Unsecured (1 Issue)	A/Developing
Senior Unsecured (2 Issues)	BBB
<b>American Electric Power Co. Inc.</b>	
Issuer Credit Rating	BBB/Stable/A-2
Commercial Paper	
<i>Local Currency</i>	A-2
Junior Subordinated (1 Issue)	BB+
Senior Unsecured (2 Issues)	BBB
<b>Appalachian Power Co.</b>	
Issuer Credit Rating	BBB/Stable/--
Senior Secured (4 Issues)	BBB
Senior Secured (1 Issue)	BBB/Negative
Senior Unsecured (1 Issue)	A/Developing
Senior Unsecured (1 Issue)	AAA/Stable
Senior Unsecured (17 Issues)	BBB
<b>Columbus &amp; Southern Ohio Electric Co.</b>	
Issuer Credit Rating	BBB/Stable/--
Senior Secured (1 Issue)	AAA/Negative
Senior Unsecured (1 Issue)	BBB
<b>Columbus Southern Power Co.</b>	
Issuer Credit Rating	BBB/Stable/--
Preferred Stock (1 Issue)	BB+
Senior Unsecured (8 Issues)	BBB
Senior Unsecured (2 Issues)	BBB/Negative
<b>Indiana Michigan Power Co.</b>	
Issuer Credit Rating	BBB/Stable/--
Senior Unsecured (12 Issues)	BBB
Subordinated (1 Issue)	BBB-
<b>Ohio Power Co.</b>	
Issuer Credit Rating	BBB/Stable/--
Senior Secured (1 Issue)	BBB
Senior Unsecured (18 Issues)	BBB
Subordinated (1 Issue)	BBB-
<b>Public Service Co. of Oklahoma</b>	
Issuer Credit Rating	BBB/Stable/--
Preferred Stock (4 Issues)	BB+
Senior Unsecured (1 Issue)	A/Developing

**Ratings Detail (As Of December 29, 2009) (cont.)**

Senior Unsecured (8 Issues)	BBB
<b>RGS (AEGCO) Funding Corp.</b>	
Issuer Credit Rating	BBB/Stable/--
Senior Unsecured (2 Issues)	BBB-
<b>RGS (I&amp;M) Funding Corp.</b>	
Issuer Credit Rating	BBB/Stable/--
Senior Unsecured (2 Issues)	BBB-
<b>Southwestern Electric Power Co.</b>	
Issuer Credit Rating	BBB/Stable/--
Preferred Stock (1 Issue)	BB+
Senior Secured (1 Issue)	A-
Senior Unsecured (1 Issue)	A/Developing
Senior Unsecured (9 Issues)	BBB

\*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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**The McGraw-Hill Companies**

December 16, 2010

## Kentucky Power Co.

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# Kentucky Power Co.

## Major Rating Factors

### Strengths:

- Steady utility operating cash flow;
- Part of a large, diverse regulated electric utility operation; and
- Parent's low-cost generation asset portfolio.

**Corporate Credit Rating**

BBB/Stable/--

### Weaknesses:

- Parent's marketing operations, though small, detract from credit profile;
- Parent exposure to pending environmental regulations could pressure financial measures; and
- Aggressive consolidated debt leverage.

## Rationale

The ratings on Kentucky Power Co. are based on the consolidated credit profile of its parent American Electric Power Co. Inc. (AEP), which includes regulated and unregulated operations. Kentucky Power's business risk profile is considered as 'excellent' and its financial risk profile as 'aggressive'. Kentucky Power is a vertically-integrated fully-regulated electric utility that serves eastern Kentucky. It participates in the AEP Power Pool, sharing the revenues and costs of pool sales to utilities and power marketers, and also sells directly at wholesale to municipalities. Operations are integrated with the AEP East system. Columbus, Ohio-based AEP has \$18.7 billion of outstanding debt of which Kentucky Power comprises \$550 million.

AEP has an 'excellent' business risk profile that primarily reflects its status as a large public utility holding company that owns regulated electric utility subsidiaries operating in 11 states in the Midwest and Southwest. The company operates as low-risk transmission and distribution wires-only businesses in regions of Texas; fully integrated regulated utilities in places such as Indiana and West Virginia; and, higher-risk hybrid utilities in Ohio. Although a portion of generation assets reside outside rate base, most of the consolidated generating capacity is under stabilizing regulatory oversight. The company's generating and transmission facilities are interconnected, and their operations are coordinated as an integrated electric utility system.

Electric utility operations are slightly above average, characterized by competitive rates, good reliability, a strong collection of low-cost, coal-fired generation in the eastern part of the system, and mostly supportive regulatory relationships. Service territories vary widely, ranging from manufacturing and rural areas with lower growth economies, to higher-growth, service-oriented economies like Columbus, Ohio, that are more stable. The diversity in markets and in regulation somewhat elevates credit quality, but managing the complex variety of regulatory environments can be challenging and requires constant vigilance. This is evident in Arkansas where the company is building the Turk coal unit and continues to have multiple legal challenges around the construction of the unit. Over the longer term, with roughly 25,000 MW of coal-fired generation, material compliance costs related to multiple forthcoming and pending emissions rules could pressure credit quality. Although the majority of the generation portfolio is coal based, there are 9,000 MW of natural gas and 2,200 MW of nuclear generation too.

The company's unregulated operations consist mostly of a large portfolio of domestic unregulated electric generating

plants, mainly in Ohio, that primarily serve AEP's retail utility customers and continue to remain quasi-regulated. AEP's long track record of solid operating performance is expected to continue and improve under the unregulated business operations. Stricter environmental laws and regulation will place financial stress and erode the fleet's competitiveness, but are not expected to completely eliminate the advantages of AEP's coal-fired plants. AEP has indicated that it may ultimately retire a significant amount of coal-fired assets and 1,925 MW of coal-fired units in the eastern system were placed in an extended startup mode. Although AEP's Ohio-based generation accounts for only a modest portion of the company's credit profile, any strategic move that quickly leads to a greater reliance on wholesale market prices to generate cash and earnings from that fleet would increase business risk that could ultimately weaken credit quality without stronger financial measures.

Kentucky Power's financial risk profile reflects AEP's consolidated financial risk profile, which is considered as 'aggressive'. This includes a large capital spending program and financial measures inline for the rating. The company's considerable capital expenditures are needed to fund its environmental-compliance programs for stricter air-quality standards and for new generation and transmission. The elevated spending levels could result in negative free cash flow for several years, and will likely require vigilant cost recovery to maintain operating cash flow. For 12 months ended Sept. 30, 2010, funds from operations (FFO) to total debt was about 15%, total debt to total capital was around 61%, and debt to EBITDA was 5x. The ratios are in line for the rating. FFO interest coverage was 3.5x, net cash flow (FFO post dividends) to capital expenditures exceeded 1x and the dividend payout ratio was 62%. Adjustments reflect capital and operating leases, and pension-related items, intermediate equity treatment of the junior subordinated notes, and securitized debt. Given AEP's business risks, sustainable financial expectations are for debt leverage to be under 60% and FFO to debt to approach 20% in order to comfortably maintain the current ratings.

### Short-term credit factors

The company's liquidity is dependent on and managed by its parent AEP. We consider AEP's liquidity as 'adequate' under Standard & Poor's liquidity methodology, which categorizes liquidity in five standard descriptors, and this supports AEP's 'BBB' issuer credit rating. Projected sources of liquidity, mainly operating cash flow and available bank lines, exceed projected uses largely for necessary capital expenditures, debt maturities, and common dividends, by more than 1.2x. Furthermore, AEP has the ability to absorb high-impact, low-probability events with limited need for refinancing; flexibility to lower capital spending; sound bank relationships; solid standing in credit markets, and generally prudent risk management. As of Sept. 30, 2010, the company had cash of \$1.4 billion and 62% availability under its \$3.4 billion of credit facilities after excluding outstanding commercial paper and letters of credit. These facilities consist of a \$1.45 billion expiring April 2012, \$1.5 billion expiring June 2013, and \$478 million expiring April 2011. The company currently maintains liquidity that more than adequately addresses potential collateral calls under a stressed scenario comprised of a negative credit event and an adverse movement in commodity prices. Long-term debt maturities are manageable in 2011 (\$616 million) and 2012 (\$565 million) but, in 2013, there may be refinancing risk with \$1.64 billion maturing.

## Outlook

The stable outlook for AEP and its subsidiaries assumes timely recovery of rate base investments for environmental compliance, system reliability, and continued strategic emphasis on regulated operations. Maintaining the company's balance sheet and other key credit measures will be necessary for continued ratings stability. Our base forecast includes adjusted FFO to total debt of at least 15%, debt to EBITDA under 5x, and debt leverage to total



capital of no more than 60%, all consistent with our expectations for the 'BBB' rating. We could revise the outlook to negative and subsequently lower ratings if financial measures do not remain at our expected levels on a sustained basis because construction projects are not completed on time and budget, a series of harmful regulatory decisions impede the company's recovery of capital expenditures and other costs, or the company funds itself in a less creditworthy manner. We could revise the outlook to positive and ratings could subsequently be raised with greater certainty regarding business risks and financial measures exceed our base line forecast, including FFO to total debt in excess of 20%, debt to EBITDA below 4x, and debt to total capital under 55%.

## Related Criteria And Research

- 2008 Corporate Criteria: Analytical Methodology
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded
- 2008 Corporate Criteria: Ratios And Adjustments

Table 1.

American Electric Power Co. Inc. -- Peer Comparison*					
Industry Sector: Energy					
	American Electric Power Co. Inc.	Duke Energy Corp.	Southern Co.	Progress Energy Inc.	Xcel Energy Inc.
Rating as of Dec. 8, 2010	BBB/Stable/A-2	A-/Stable/A-2	A/Stable/A-1	BBB+/Negative/A-2	A-/Stable/A-2
--Average of past three fiscal years--					
<b>(Mil. \$)</b>					
Revenues	13,566.2	12,886.0	14,996.9	9,401.7	10,293.3
Net income from cont. oper.	1,291.3	1,288.0	1,562.4	767.3	635.7
Funds from operations (FFO)	3,051.8	4,105.3	3,552.5	2,014.5	1,893.7
Capital expenditures	3,609.5	4,024.6	3,902.7	2,402.3	1,932.2
Cash and short-term investments	711.3	1,231.3	421.0	387.0	136.0
Debt	19,403.3	16,429.5	19,610.3	13,590.0	10,265.3
Preferred stock	135.5	0.0	746.7	182.3	185.8
Equity	11,439.5	21,472.3	14,259.7	9,067.0	7,035.2
Debt and equity	30,842.8	37,901.8	33,870.0	22,657.0	17,300.4
<b>Adjusted ratios</b>					
EBIT interest coverage (x)	2.4	3.3	3.3	2.4	2.5
FFO int. cov. (X)	3.4	5.7	4.3	3.4	3.9
FFO/debt (%)	15.7	25.0	18.1	14.8	18.4
Discretionary cash flow/debt (%)	(9.2)	(9.8)	(9.8)	(10.0)	(4.8)
Net cash flow / capex (%)	65.4	73.1	58.0	55.0	77.3
Total debt/debt plus equity (%)	62.9	43.3	57.9	60.0	59.3
Return on common equity (%)	10.9	4.9	10.9	7.3	8.1
Common dividend payout ratio (un-adj.) (%)	52.8	89.4	85.5	85.9	65.6

\*Fully adjusted (including postretirement obligations).

Table 2.

<b>Kentucky Power Co. -- Financial Summary*</b>					
<b>Industry Sector: Electric</b>					
<b>--Fiscal year ended Dec. 31--</b>					
	<b>2009</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>
Rating history	BBB/Stable/--	BBB/Stable/--	BBB/Stable/--	BBB/Stable/--	BBB/Stable/--
<b>(Mil. \$)</b>					
Revenues	632.5	665.6	588.0	585.9	531.3
Net income from continuing operations	23.9	24.5	32.5	35.0	20.8
Funds from operations (FFO)	110.6	62.0	85.6	83.0	57.9
Capital expenditures	63.6	129.5	71.3	79.0	59.0
Cash and short-term investments	0.5	0.6	0.7	0.7	0.5
Debt	607.2	617.8	519.4	530.2	542.9
Preferred stock	0.0	0.0	0.0	0.0	0.0
Equity	431.8	398.0	387.0	369.7	347.8
Debt and equity	1,039.0	1,015.8	906.4	899.9	890.7
<b>Adjusted ratios</b>					
EBIT interest coverage (x)	1.8	1.7	2.4	2.6	2.0
FFO int. cov. (x)	4.0	2.4	3.6	3.5	2.7
FFO/debt (%)	18.2	10.0	16.5	15.7	10.7
Discretionary cash flow/debt (%)	(4.5)	(13.3)	2.2	2.5	(0.4)
Net Cash Flow / Capex (%)	143.3	37.1	103.2	86.1	93.9
Debt/debt and equity (%)	58.4	60.8	57.3	58.9	60.9
Return on common equity (%)	5.6	5.6	8.4	9.5	6.0
Common dividend payout ratio (un-adj.) (%)	81.5	57.1	37.0	42.8	12.0

\*Fully adjusted.

Table 3.

<b>Reconciliation Of Kentucky Power Co. Reported Amounts With Standard &amp; Poor's Adjusted Amounts (Mil. \$)*</b>								
<b>--Fiscal year ended Dec. 31, 2009--</b>								
<b>Kentucky Power Co. reported amounts</b>								
	<b>Debt</b>	<b>Operating income (before D&amp;A)</b>	<b>Operating income (before D&amp;A)</b>	<b>Operating income (after D&amp;A)</b>	<b>Interest expense</b>	<b>Cash flow from operations</b>	<b>Cash flow from operations</b>	<b>Capital expenditures</b>
Reported	549.2	118.8	118.8	66.8	33.8	54.8	54.8	64.0
<b>Standard &amp; Poor's adjustments</b>								
Trade receivables sold or securitized	41.0	--	--	--	2.1	--	--	--
Operating leases	7.3	2.0	0.5	0.5	0.5	1.5	1.5	--
Accrued interest not included in reported debt	7.5	--	--	--	--	--	--	--
Capitalized interest	--	--	--	--	0.4	(0.4)	(0.4)	(0.4)
Asset retirement obligations	2.3	0.3	0.3	0.3	0.3	(0.2)	(0.2)	--

Table 3.

Reconciliation Of Kentucky Power Co. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. S)* (cont.)								
Reclassification of nonoperating income (expenses)	--	--	--	0.6	--	--	--	--
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	54.9	--
Total adjustments	58.0	2.3	0.8	1.4	3.3	0.9	55.8	(0.4)
Standard & Poor's adjusted amounts								
	Debt	Operating income (before D&A)	EBITDA	EBIT	Interest expense	Cash flow from operations	Funds from operations	Capital expenditures
Adjusted	607.2	121.1	119.6	68.2	37.1	55.7	110.6	63.6

\*Kentucky Power Co. reported amounts shown are taken from the company's financial statements but might include adjustments made by data providers or reclassifications made by Standard & Poor's analysts. Please note that two reported amounts (operating income before O&A and cash flow from operations) are used to derive more than one Standard & Poor's-adjusted amount (operating income before O&A and EBITDA, and cash flow from operations and funds from operations, respectively). Consequently, the first section in some tables may feature duplicate descriptions and amounts.

**Ratings Detail (As Of December 16, 2010)\***

**Kentucky Power Co.**

Corporate Credit Rating BBB/Stable/--  
 Senior Unsecured (4 Issues) BBB

**Corporate Credit Ratings History**

07-Mar-2003 BBB/Stable/--  
 24-Jan-2003 BBB+/Watch Neg/--  
 23-May-2002 BBB+/Stable/--

**Business Risk Profile**

Excellent

**Financial Risk Profile**

Aggressive

**Related Entities**

**AEP Texas North Co**

Issuer Credit Rating BBB/Stable/--  
 Preferred Stock (2 Issues) BB+  
 Senior Unsecured (1 Issue) A/Developing  
 Senior Unsecured (1 Issue) BBB

**American Electric Power Co. Inc.**

Issuer Credit Rating BBB/Stable/A-2  
 Commercial Paper  
*Local Currency* A-2  
 Junior Subordinated (1 Issue) BB+  
 Senior Unsecured (1 Issue) BBB

**Appalachian Power Co.**

Issuer Credit Rating BBB/Stable/--  
 Senior Secured (2 Issues) BBB  
 Senior Secured (1 Issue) BBB/Negative  
 Senior Unsecured (1 Issue) A/Developing  
 Senior Unsecured (18 Issues) BBB

**Ratings Detail (As Of December 16, 2010) (cont.)****Columbus & Southern Ohio Electric Co.**

Issuer Credit Rating BBB/Stable/--

**Columbus Southern Power Co.**

Issuer Credit Rating BBB/Stable/--

Preferred Stock (1 Issue) BB+

Senior Unsecured (8 Issues) BBB

Senior Unsecured (2 Issues) BBB/Negative

**Indiana Michigan Power Co.**

Issuer Credit Rating BBB/Stable/--

Senior Unsecured (12 Issues) BBB

Subordinated (1 Issue) BBB-

**Ohio Power Co.**

Issuer Credit Rating BBB/Stable/--

Senior Unsecured (18 Issues) BBB

Subordinated (1 Issue) BBB-

**Public Service Co. of Oklahoma**

Issuer Credit Rating BBB/Stable/--

Preferred Stock (4 Issues) BB+

Senior Unsecured (1 Issue) A/Developing

Senior Unsecured (6 Issues) BBB

**RGS (AEGCO) Funding Corp.**

Issuer Credit Rating BBB/Stable/--

Senior Unsecured (2 Issues) BBB-

**RGS (I&M) Funding Corp.**

Issuer Credit Rating BBB/Stable/--

Senior Unsecured (2 Issues) BBB-

\*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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## Kentucky Power Co.

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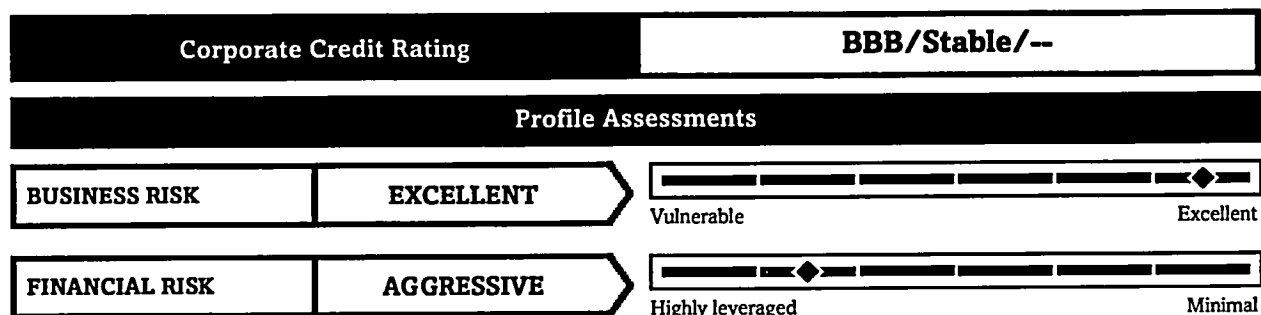
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**Summary:**

# Kentucky Power Co.



## Rationale

<b>Business Risk: Excellent</b>	<b>Financial Risk: Aggressive</b>
<ul style="list-style-type: none"> <li>• Regulated utility that is sole provider of essential electricity service</li> <li>• Part of a large electric utility company that is geographically diverse with a large customer base</li> <li>• "Credit supportive" regulatory environment in Kentucky</li> <li>• Unregulated affiliate operations that are materially riskier than regulated businesses</li> <li>• Parent's low-cost coal and nuclear generation</li> </ul>	<ul style="list-style-type: none"> <li>• Based on parent American Electric Power Co. Inc. (AEP)</li> <li>• Cash flow erosion from transition in Ohio</li> <li>• Large capital expenditures</li> <li>• Discretionary cash flow to remain negative</li> <li>• Exposure to environmental regulations could pressure financial measures</li> <li>• Net cash flow to capital spending to remain less than 100%</li> <li>• Marketing operations weaken creditworthiness</li> </ul>

## **Outlook: Stable**

The stable rating outlook on Kentucky Power Co. reflects our expectation of AEP's timely recovery of rate base investments for environmental compliance, system reliability, and continued strategic emphasis on regulated operations. Our base forecast includes adjusted funds from operations (FFO) to total debt of at least 15%, debt to EBITDA of less than 5x, and debt leverage to total capital of no more than 60%, all of which are consistent with our expectations for the 'BBB' rating.

### **Downside scenario**

We could lower the ratings if financial measures fell short of our base forecast on a sustained basis to adjusted FFO to total debt of less than 12%, debt to EBITDA of more than 5.2x, and debt leverage of more than 62%.

### **Upside scenario**

We could raise the ratings if there were greater certainty regarding business risks and if financial measures exceeded our baseline forecast, including FFO to total debt in excess of 20%, debt to EBITDA of less than 4x, and debt to total capital of less than 55%.

## **Standard & Poor's Base-Case Scenario**

Our AEP base case scenario, on a consolidated basis, results in EBITDA growth, capital spending growth, and mostly steady debt leverage.



Assumptions	Key Metrics
-------------	-------------

- Economic conditions in the company's service territories are improving, which will likely increase customer usage
- EBITDA growth consisting of revenue increases and customer growth is likely to be about the same as in recent years, but increase as capacity prices return to higher levels as demonstrated by the recent PJM reliability pricing model (RPM) capacity auction.
- Retail stability rider recovery of about \$500 million through the Ohio transition period ending May 31, 2015.
- Capital spending and dividend payouts lead to negative discretionary cash flow, indicating external funding needs

	2013§	2013E	2014E
FFO/Total debt	17.4%	15%-17.5%	14.5%-16.5%
Total debt/EBITDA	4.8x	4x-5x	3.8x-4.7x
Total debt/Total capital	58.2%	56.5%-59%	56.5%-58.5%

A—Actual. E—Estimate. §Last 12 months ended March 31, 2013. \*Standard & Poor's adjusted consolidated financial measures for AEP include adjustments to debt for operating leases (\$2.9 bil.), securitized stranded cost (negative \$2.18 bil.), pension-related items (\$514 mil.), asset-retirement obligations (\$322 mil.), accrued interest not in reported debt (\$241 mil.), and other debt (\$816 mil.). EBITDA adjustments include securitized stranded costs (negative \$608 mil.), operating leases (\$140 mil.), asset-retirement obligations (\$85 mil.), pension-related items (\$30 mil.), and share-based compensation expense (\$49 mil.). FFO adjustments include securitized stranded costs (negative \$420 mil.), operating leases (\$243 mil.), pension-related items (\$184 mil.), capitalized interest (negative \$71 mil.), and asset-retirement obligations (negative \$51 mil.). We do not expect these adjustments to change materially in 2013 and 2014.

## Business Risk: Excellent

Our assessment of Kentucky Power's business risk profile as "excellent" incorporates the strengths of a vertically integrated, fully regulated electric utility that serves eastern Kentucky. It participates in the AEP Power Pool, sharing the revenues and costs of pool sales to utilities and power marketers, and also sells directly at wholesale to municipalities and electric cooperatives. Operations are integrated with the AEP East system. The excellent business risk profile of parent AEP reflects its status as a large public utility holding company that owns regulated electric utility subsidiaries operating in 11 states in the Midwest and Southwest. These subsidiaries consist of low-risk transmission and distribution wires-only businesses in Texas; fully integrated regulated utilities in states such as Indiana and West Virginia; and higher-risk hybrid operations in Ohio. Although a portion of generation assets is outside rate base, most of the consolidated generating capacity is in regulated rate base. The company's generating and transmission facilities are interconnected, and its operations are coordinated as an integrated electric utility system. Electric utility operations

are slightly above average, characterized by competitive rates, good reliability, low-cost coal-fired generation in the eastern part of the system, and supportive regulatory relationships in numerous jurisdictions. Service territories vary widely, including both manufacturing and rural areas with lower-growth economies and higher-growth, service-oriented economies, like in the Columbus, Ohio, metropolitan area, that are more stable. The diversity in markets and in regulation somewhat elevates credit quality, but managing the complex variety of regulatory environments can be challenging and requires constant engagement.

## Financial Risk: Aggressive

Kentucky Power's financial risk profile reflects that of parent AEP, which is "aggressive". This reflects adjusted consolidated financial measures for the 12 months ended March 31, 2013, including FFO to total debt of 17.4%, debt to EBITDA of 4.8x, and debt to total capital of 58.2%, all in line with the rating. In addition, even though it is committed to credit quality, we consider the company's financial policies to be aggressive. The company has a generally transparent business model and pursues activities and projects that mostly add to the regulated rate base and regulated cash flows. Capital spending and dividend payments translate to negative discretionary cash flow over the forecast period, requiring management to maintain robust cost recovery and tight cost controls to maintain cash flow measures. This negative discretionary cash flow also indicates external funding needs. Our base forecast suggests mostly steady key credit measures over the next several years and continues to reflect steady operating cash flows and execution of the transition in Ohio. We expect cash flow measures will slightly weaken from current levels, due to decreasing deferred taxes, with between 15% and 16% adjusted FFO to total debt. However, debt leverage measures are expected to modestly improve, with adjusted debt to total capital trending slightly less than 58% and adjusted debt to EBITDA projected to hover at about 4.4x. We expect net cash flow to capital spending to decrease to about 60% and begin improving after environmental spending begins to taper off. Our rating on AEP reflects our view of a mostly regulated utility strategy that will include continuous capital spending and timely cost recovery through various regulatory mechanisms. We expect this to lead to steady cash flow measures and manageable debt leverage.

## Liquidity: Adequate

Kentucky Power's liquidity position reflects that of parent AEP, which is "adequate" under our liquidity methodology. We expect that AEP's liquidity sources will exceed its uses by 1.2x over the next 12 months. We do expect that AEP will need to externally fund a portion of its liquidity needs for debt maturities over the next few years.

Principal Liquidity Sources	Principal Liquidity Uses
<ul style="list-style-type: none"><li>• FFO of roughly \$3.1 billion in 2013</li><li>• Assumed credit facility availability of about \$2.1 billion in 2013</li><li>• Working capital of about \$500 million in 2013</li></ul>	<ul style="list-style-type: none"><li>• Debt maturities of \$1.8 billion in 2013</li><li>• Necessary capital spending of about \$1.9 billion in 2013</li><li>• Shareholder distributions of about \$900 million</li></ul>

## Covenants

AEP's credit agreements include a financial covenant requiring that debt to total capitalization, excluding securitization debt, junior subordinated notes, and debt of AEP Credit, be no greater than 67.5%. As of March 31, 2013, the company was in compliance with the covenant at 51.4%. Headroom could erode somewhat if debt rises rapidly without adequate growth in equity during the capital spending phase.

## Related Criteria And Research

- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008
- Business Risk/Financial Risk Matrix Expanded, Sept. 18, 2012
- 2008 Corporate Ratings Criteria: Ratios And Adjustments, April 15, 2008
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008
- 2008 Corporate Criteria: Commercial Paper, April 15, 2008
- Corporate Criteria: Assessing U.S. Utility Regulatory Environments, Nov. 7, 2007
- Corporate Criteria: Standard & Poor's Methodology For Imputing Debt For U.S. Utilities' Power Purchase Agreements, May 7, 2007
- Parent/Subsidiary Links; General Principles; Subsidiaries/Joint Ventures/Nonrecourse Projects; Finance Subsidiaries; Rating Link to Parent, Oct. 28, 2004

### Business And Financial Risk Matrix

Business Risk	Financial Risk					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly Leveraged
Excellent	AAA/AA+	AA	A	A-	BBB	--
Strong	AA	A	A-	BBB	BB	BB-
Satisfactory	A-	BBB+	BBB	BB+	BB-	B+
Fair	--	BBB-	BB+	BB	BB-	B
Weak	--	--	BB	BB-	B+	B-
Vulnerable	--	--	--	B+	B	B- or below

**Note:** These rating outcomes are shown for guidance purposes only. The ratings indicated in each cell of the matrix are the midpoints of the likely rating possibilities. There can be small positives and negatives that would lead to an outcome of one notch higher or lower than the typical matrix outcome. Moreover, there will be exceptions that go beyond a one-notch divergence. For example, the matrix does not address the lowest rungs of the credit spectrum (i.e., the 'CCC' category and lower). Other rating outcomes that are more than one notch off the matrix may occur for companies that have liquidity that we judge as "less than adequate" or "weak" under our criteria, or companies with "satisfactory" or better business risk profiles that have extreme debt burdens due to leveraged buyouts or other reasons. For government-related entities (GREs), the indicated rating would apply to the standalone credit profile, before giving any credit for potential government support.

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**The McGraw-Hill Companies**

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## Kentucky Power Co.

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# Kentucky Power Co.

## Major Rating Factors

### Strengths:

- Part of a large, diverse regulated electric utility operation;
- Parent's low-cost generation asset portfolio; and
- A history of commitment to credit quality.

### Weaknesses:

- Parent's marketing operations, though small, detract from credit profile; and
- Leverage is high for the rating.

**Corporate Credit Rating**

BBB/Stable/--

## Rationale

The ratings on Kentucky Power Co. are based on the consolidated credit profile of its parent American Electric Power Co. Inc. (AEP), which includes regulated and unregulated operations. The company's business risk profile is excellent, and its financial risk profile is aggressive. (The business profile is ranked as excellent, strong, satisfactory, weak, or vulnerable, and the financial profile is ranked as minimal, modest, intermediate, aggressive, or highly leveraged.) Kentucky Power is a public utility that generates, purchases, transmits, and distributes electricity in a service territory covering eastern Kentucky. It participates in the AEP Power Pool, sharing the revenues and costs of pool sales to utilities and power marketers, and also sells directly at wholesale to municipalities. Operations are integrated with the AEP East system.

AEP's excellent business profile primarily rests on the stability of the regulated utility operations and is marginally affected by the more risky unregulated business and ongoing uncertainty of the regulatory paradigm in Ohio.

AEP is a large public utility holding company that owns directly or indirectly all of the common stock of electric utility subsidiaries operating in 11 states in the U.S. Midwest and Southwest. The company operates as either low-risk "wires" businesses; moderate-risk, fully integrated regulated utilities; or higher-risk hybrid utilities in states with unsettled deregulation models. Electric generation is housed in and out of utility rate bases, but most capacity is directly or virtually subject to stabilizing regulatory oversight. The company's generating and transmission facilities are interconnected, and their operations are coordinated as an integrated electric utility system.

Electric utility operations are slightly above average, characterized by competitive rates, good reliability, a strong collection of low-cost, coal-fired generation in the eastern part of the system, and mostly supportive regulatory relationships. Service territories vary widely, ranging from "Rust Belt" and rural areas that exhibit less-than-favorable economic profiles, to higher-growth, service economy-oriented regions like Columbus, Ohio, which are much more resistant to economic cycles. The diversity in markets and regulation somewhat elevates credit quality, but managing the complex variety of regulatory environments is a challenge for AEP management and requires constant vigilance. Over the longer term, its status as an overwhelmingly coal-based electric utility company could imperil credit quality if the global warming issue becomes a permanent part of the political landscape.

AEP's unregulated operations primarily consists of a large portfolio of domestic merchant electric generating plants, mainly in Ohio, which are primarily used to serve AEP's retail utility customers and continue to reside somewhere

between a regulated rate base and full merchant status. AEP's long track record of solid operating performance is expected to continue and improve under the unregulated business operations. Stricter environmental laws and regulation will place financial stress and erode the fleet's competitiveness, but are not expected to completely eliminate the advantages of AEP's coal-fired plants.

Although AEP's Ohio-based generation accounts for only a modest portion of the company's credit profile, any strategic move that quickly leads to a greater reliance on wholesale market prices to generate cash and earnings from that fleet would suggest a tolerance for increased business risk that could lead to lower ratings. The new legislation in Ohio, and the Public Utility Commission of Ohio's management of the transition process stemming from it, do not appear to support a hasty shift to market-based prices for AEP's Ohio generation.

AEP's aggressive financial profile reflects its large capital programs and marginal financial measures for its rating. The company's considerable capital expenditure program is needed to fund its environmental-compliance programs, strategic investment in transmission, and for new generation to meet load growth. The company projects an environmental capital-expenditure program totaling almost \$4 billion through 2010 to meet stricter air-quality standards and approximately \$4.5 billion to develop new power plants. AEP also intends to spend substantial amounts of capital on its transmission and distribution system to improve reliability. The elevated spending levels indicate that the company will experience negative free cash flow for several years, and can expect lower utility returns such that AEP will need to continually pursue higher rates in many of its jurisdictions. Given AEP's business risks, sustainable financial expectations are for debt leverage to be under 60%, funds from operations (FFO) interest coverage to approximate 3.5x, and FFO to debt ratio approaching 20% in order to comfortably maintain the current ratings.

### Liquidity

The company's liquidity is dependent on and managed by its parent AEP. The adequate liquidity of AEP reflects cash and investments of \$1.37 billion and \$1.33 billion of availability under the company's \$3.919 billion of credit facilities, all as of Oct. 28, 2008. Adequate liquidity also incorporates the stability of the regulated businesses that reliably produce operating cash flow. Long-term maturities in the next two years are significant, particularly the \$1.7 billion due in 2010, and will require a prudent financing strategy. Liquidity for the domestic electric subsidiaries is largely from AEP's money pool and the sale of accounts receivables. AEP's commercial paper program is backed by its credit facilities that mature in 2011 (\$1.5 billion) and 2012 (\$1.454 billion). Additionally, the company has a \$627 million credit agreement that matures in April 2011 and a \$338 million credit agreement that matures in April 2009.

### Outlook

The stable outlook for AEP and subsidiaries assumes timely recovery of rate base investments for environmental compliance, system reliability, and continued strategic emphasis on regulated operations. Maintaining the company's balance sheet and other key credit measures will be necessary for continued ratings stability. Higher ratings would be possible over time if AEP demonstrates consistency in its regulated utility strategy and more commitment to improvement in its financial profile. Spiraling capital spending or a series of harmful regulatory decisions that thwart the company's recovery of those and other costs could lead to a negative stance or lower ratings.

Table 1

**American Electric Power Co. Inc. -- Peer Comparison\*****Industry Sector: Energy**

	--Average of past three fiscal years--			
	American Electric Power Co. Inc.	Duke Energy Corp.	Southern Co.	MidAmerican Energy Holdings Co.
Rating as of July 15, 2008	BBB/Stable/A-2	A-/Stable/NR	A/Stable/A-1	A-/Stable/--
<b>(Mil. \$)</b>				
Revenues	12,624.5	15,396.9	13,577.6	9,930.7
Net income from cont. oper.	1,055.0	2,048.0	1,509.4	887.5
Funds from operations (FFO)	2,486.0	3,841.4	3,414.7	2,102.9
Capital expenditures	3,257.0	3,142.3	2,659.6	2,443.6
Cash and short-term investments	599.0	1,554.3	170.8	644.0
Debt	15,293.4	17,112.3	15,995.6	16,187.9
Preferred stock	61.0	0	1,046.8	1,205.9
Equity	9,185.2	21,515.0	12,340.4	8,303.5
Debt and equity	24,478.6	38,627.3	28,336.0	24,491.5
<b>Adjusted ratios</b>				
EBIT interest coverage (x)	2.4	3.6	3.6	2.3
FFO int. cov. (X)	3.2	4.4	5.0	3.0
FFO/debt (%)	16.3	22.4	21.3	13.0
Discretionary cash flow/debt (%)	(8.2)	(5.4)	(5.5)	(3.0)
Net cash flow / capex (%)	58.2	81.8	84.2	80.9
Total debt/debt plus equity (%)	62.5	44.3	56.4	66.1
Return on common equity (%)	10.4	9.5	13.5	13.6
Common dividend payout ratio (un-adj.) (%)	56.1	61.9	74.6	0

\*Fully adjusted (including postretirement obligations).

Table 2

**Kentucky Power Co. -- Financial Summary\*****Industry Sector: Electric**

	--Fiscal year ended Dec. 31--				
	2007	2006	2005	2004	2003
Rating history	BBB/Stable/--	BBB/Stable/--	BBB/Stable/--	BBB/Stable/--	BBB/Stable/--
<b>(Mil. \$)</b>					
Revenues	588.0	585.9	531.3	449.0	412.7
Net income from continuing operations	32.5	35.0	20.8	25.9	33.5
Funds from operations (FFO)	85.6	83.0	57.9	85.6	96.7
Capital expenditures	71.3	79.0	59.0	37.9	93.3
Cash and short-term investments	0.7	0.7	0.5	0.1	0.9
Debt	519.4	530.2	542.9	552.6	566.4
Preferred stock	0	0	0	0	0
Equity	387.0	369.7	347.8	321.0	317.1



Table 2

<b>Kentucky Power Co. -- Financial Summary* (cont.)</b>					
Debt and equity	906.4	899.9	890.7	873.6	883.5
<b>Adjusted ratios</b>					
EBIT interest coverage (x)	2.4	2.6	2.0	2.0	2.2
FFO int. cov. (x)	3.6	3.5	2.7	3.6	3.9
FFO/debt (%)	16.5	15.7	10.7	15.5	17.1
Discretionary cash flow/debt (%)	2.2	2.5	(0.4)	6.0	(6.1)
Net Cash Flow / Capex (%)	103.2	86.1	93.9	174.7	85.9
Debt/debt and equity (%)	57.3	58.9	60.9	63.3	64.1
Return on common equity (%)	8.4	9.5	6.0	7.9	10.0
Common dividend payout ratio (un-adj.) (%)	37.0	42.8	12.0	75.3	49.2

\*Fully adjusted.

Table 3

<b>Reconciliation Of Kentucky Power Co. Reported Amounts With Standard &amp; Poor's Adjusted Amounts (Mil. \$)*</b>								
<b>--Fiscal year ended Dec. 31, 2007--</b>								
<b>Kentucky Power Co. reported amounts</b>								
	Debt	Operating income (before D&A)	Operating income (before D&A)	Operating income (after D&A)	Interest expense	Cash flow from operations	Cash flow from operations	Capital expenditures
Reported	467.5	122.0	122.0	74.8	28.6	93.7	93.7	68.1
<b>Standard &amp; Poor's adjustments</b>								
Trade receivables sold or securitized	41.4	--	--	--	2.1	--	--	--
Operating leases	9.9	2.3	0.5	0.5	0.5	1.7	1.7	3.8
Capitalized interest	--	--	--	--	0.6	(0.6)	(0.6)	(0.6)
Asset retirement obligations	0.6	--	--	--	--	--	--	--
Reclassification of nonoperating income (expenses)	--	--	--	2.3	--	--	--	--
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	(9.2)	--
Total adjustments	51.9	2.3	0.5	2.8	3.2	1.1	(8.1)	3.2
<b>Standard &amp; Poor's adjusted amounts</b>								
	Debt	Operating income (before D&A)	EBITDA	EBIT	Interest expense	Cash flow from operations	Funds from operations	Capital expenditures
Adjusted	519.4	124.3	122.6	77.6	31.9	94.8	85.6	71.3

\*Kentucky Power Co. reported amounts shown are taken from the company's financial statements but might include adjustments made by data providers or reclassifications made by Standard & Poor's analysts. Please note that two reported amounts (operating income before D&A and cash flow from operations) are used to derive more than one Standard & Poor's-adjusted amount (operating income before D&A and EBITDA, and cash flow from operations and funds from operations, respectively). Consequently, the first section in some tables may feature duplicate descriptions and amounts.

<b>(Ratings Detail (As Of December 19, 2008))</b>
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**Kentucky Power Co.**

Corporate Credit Rating

BBB/Stable/--

**Ratings Detail (As Of December 19, 2008) (cont)**

Senior Unsecured (4 Issues)	BBB
<b>Corporate Credit Ratings History</b>	
07-Mar-2003	BBB/Stable/--
24-Jan-2003	BBB+/Watch Neg/--
23-May-2002	BBB+/Stable/--
<b>Financial Risk Profile</b>	Aggressive
<b>Related Entities</b>	
<b>AEP Generating Co.</b>	
Senior Secured (2 Issues)	A/Negative
<b>AEP Texas North Co</b>	
Issuer Credit Rating	BBB/Stable/--
Preferred Stock (2 Issues)	BB+
Senior Unsecured (1 Issue)	AA/Negative
Senior Unsecured (2 Issues)	BBB
<b>American Electric Power Co. Inc.</b>	
Issuer Credit Rating	BBB/Stable/A-2
Commercial Paper	
<i>Local Currency</i>	A-2
Junior Subordinated (1 Issue)	BB+
Senior Unsecured (2 Issues)	BBB
<b>Appalachian Power Co.</b>	
Issuer Credit Rating	BBB/Stable/--
Senior Secured (1 Issue)	AA/Negative
Senior Secured (4 Issues)	BBB
Senior Unsecured (1 Issue)	A/Negative
Senior Unsecured (2 Issues)	AA/Negative
Senior Unsecured (1 Issue)	AAA/Stable
Senior Unsecured (15 Issues)	BBB
<b>Columbus &amp; Southern Ohio Electric Co.</b>	
Issuer Credit Rating	BBB/Stable/--
Senior Secured (1 Issue)	AAA/Watch Neg
Senior Unsecured (1 Issue)	BBB
<b>Columbus Southern Power Co.</b>	
Issuer Credit Rating	BBB/Stable/--
Preferred Stock (1 Issue)	BB+
Senior Unsecured (1 Issue)	A/Negative
Senior Unsecured (7 Issues)	BBB
<b>Indiana Michigan Power Co.</b>	
Issuer Credit Rating	BBB/Stable/--
Senior Unsecured (2 Issues)	A/Negative
Senior Unsecured (7 Issues)	BBB
Subordinated (1 Issue)	BBB-

**Ratings Detail (As Of December 19, 2008) (cont.)****Ohio Power Co.**

Issuer Credit Rating	BBB/Stable/--
Senior Secured (1 Issue)	A/Negative
Senior Unsecured (5 Issues)	A/Negative
Senior Unsecured (13 Issues)	BBB
Subordinated (1 Issue)	BBB-

**Public Service Co. of Oklahoma**

Issuer Credit Rating	BBB/Stable/--
Preferred Stock (4 Issues)	BB+
Senior Unsecured (1 Issue)	A/Negative
Senior Unsecured (1 Issue)	AA/Negative
Senior Unsecured (7 Issues)	BBB

**RGS (AEGCO) Funding Corp.**

Issuer Credit Rating	BBB/Stable/--
Senior Unsecured (2 Issues)	BBB-

**RGS (I&M) Funding Corp.**

Issuer Credit Rating	BBB/Stable/--
Senior Unsecured (2 Issues)	BBB-

**Southwestern Electric Power Co.**

Issuer Credit Rating	BBB/Stable/--
Preferred Stock (1 Issue)	BB+
Senior Secured (1 Issue)	A/Negative
Senior Unsecured (1 Issue)	A/Negative
Senior Unsecured (7 Issues)	BBB

\*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.



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