STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

Research

Summary:
Kentucky Power Co.

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Summary:

Kentucky Power Co.

Business Risk: STRONG

Vulnerable — Excellent

Financial Risk: SIGNIFICANT

Highly leveraged — Minimal

Anchor	Modifiers	Group/Gov't
bbb	bbb	bbb

CORPORATE CREDIT RATING

BBB/Stable/--

Rationale

Business Risk: Strong	Financial Risk: Significant
• Regulated utility that is sole provider of essential electricity service • Part of a large electric utility company that is geographically diverse with a large customer base • Credit supportive regulatory environment in Kentucky	• Large capital expenditures • Discretionary cash flow to remain negative • Exposure to environmental regulations could pressure financial measures • Net cash flow to capital spending to remain less than 100%

Outlook: Stable

The stable rating outlook on parent American Electric Power co. Inc. (AEP) and utility subsidiary Kentucky Power Co. (KP) reflects our expectation that management will focus on its regulated utilities and will not expand unregulated operations beyond the existing level. We expect the company will not incur any increased business risk by reaching regulatory outcomes that provide timely recovery of rate base investments and operating expenses. The outlook also reflects our expectations that cash flow protection and debt leverage measures will continue to remain at the currently robust levels. Our base case forecast includes adjusted funds from operations (FFO) to total debt of about 20%, supplemented by cash flow from operations (CFO) to debt of about 19%. We expect debt to EBITDA to be approximately 4x.

Downside scenario

We could lower the ratings if the business risk profile materially weakened or financial measures fall short of our base forecast on a sustained basis including not maintaining FFO to total debt above 13% or CFO to debt above 11%.

Upside scenario

We could raise the ratings if the business risk profile improves through growth in the utility operations in combination with financial measures in line with our base case forecast. We could also raise ratings if KP maintains its current business risk profile and financial measures strengthen to the "intermediate" financial risk profile category.

Standard & Poor's Base-Case Scenario

Assumptions	Key Metrics
• Economic conditions in the service territory are improving, which will likely increase customer usage • Supportive regulatory outcomes in Kentucky and current rate recovery maintained • Capital spending and dividend payouts lead to negative discretionary cash flow, indicating external funding needs	In our base case, we expect KP's key adjusted financial measures to approximate historical performance during the next few years. We expect FFO to debt to be about 18%, which is in the "significant" category under our medial volatility benchmarks. We forecast debt to EBITDA to be roughly 4x, indicating debt leverage in line with the "significant" category benchmarks. We forecast the supplemental ratio of CFO to debt to be over 16%. We expect discretionary cash flow to remain negative over the next few years, reflecting capital spending and dividend payments to parent company AEP. Beyond our base-case forecast, we expect to see similar financial measures.

Business Risk: Strong

We base our assessment of KP's business risk profile on the company's "satisfactory" competitive position, "very low" industry risk derived from the regulated utility industry, and the "very low" country risk of the U.S. where the utility operates. KP's competitive position 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.

Financial Risk: Significant

Based on the medial volatility financial ratio benchmarks, our assessment of KP's financial risk profile is "significant". This reflects the recurring cash flow from being a fully regulated vertically integrated electric utility. Capital spending is necessary for maintenance purposes and new projects. Recovery of costs has generally been adequate. We expect financial measures to remain about the same as existing levels. Negative discretionary cash flow over the forecast period indicates internal cash flow is not great enough to cover capital spending and dividend payments. Therefore, KP will need external funding sources. Measures could improve if spending is lower than expected or cost recovery is higher than expected. Steady cost recovery through the regulatory process will be required to maintain cash flow coverages. For 12 months ended Dec. 31, 2013, FFO to debt was 18.3%, CFO to debt was 15.9%, and debt to EBITDA was 4.2x. Our baseline forecast includes FFO to debt of about 18%, CFO to debt over 16%, and debt to EBITDA of roughly 4x.

Liquidity: Adequate

KP's liquidity reflects that of parent AEP, which we consider "adequate", as our criteria defines the term. We believe the company's liquidity sources are likely to cover its uses by more than 1.1x over the next 12 months and to meet cash outflows even with a 10% decline in EBITDA.

There are large debt maturities over the next three years and we expect the company to refinance these given its satisfactory standing in the credit markets.

Principal Liquidity Sources	Principal Liquidity Uses
• Cash on hand of roughly $500 million in 2014 • FFO of roughly $4.2 billion in 2014 • Credit facility availability of about $2.5 billion in 2014 • Working capital of about $350 million in 2014	• Debt maturities of about $1.5 billion in 2014 • Capital spending of about $4.3 billion in 2014 • Dividends of about $970 million in 2014

Other Modifiers

Other modifiers have no impact on the rating outcome.

Group Influence

The SACP of 'bbb' for KP reflects its business risk and financial risk profiles; the same as the GCP for AEP, which is currently 'bbb'. Under our group rating methodology, we consider KP to be core subsidiary of the AEP group and therefore, the ICR for KP is equal to the AEP GCP.

Ratings Score Snapshot

Corporate Credit Rating

BBB/Stable/--

Business risk: Strong

- **Country risk:** Very low
- **Industry risk:** Very low
- **Competitive position:** Satisfactory

Financial risk: Significant

- **Cash flow/Leverage:** Significant

Anchor: bbb

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Financial policy:** Neutral (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile : bbb

- **Group credit profile:** bbb
- **Entity status within group:** Core (no impact)

Related Criteria And Research

- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014

- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008
- 2008 Corporate Criteria: Commercial Paper, April 15, 2008
- Criteria - Corporates - Utilities: Notching Of U.S. Investment-Grade Investor-Owned Utility Unsecured Debt Now Better Reflects Anticipated Absolute Recovery, Nov. 10, 2008

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	Intermediate	**Significant**	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	**bbb**	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-