STANDARD & POOR'S RATINGS SERVICES
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Research

Summary:
American Electric Power Co. Inc.

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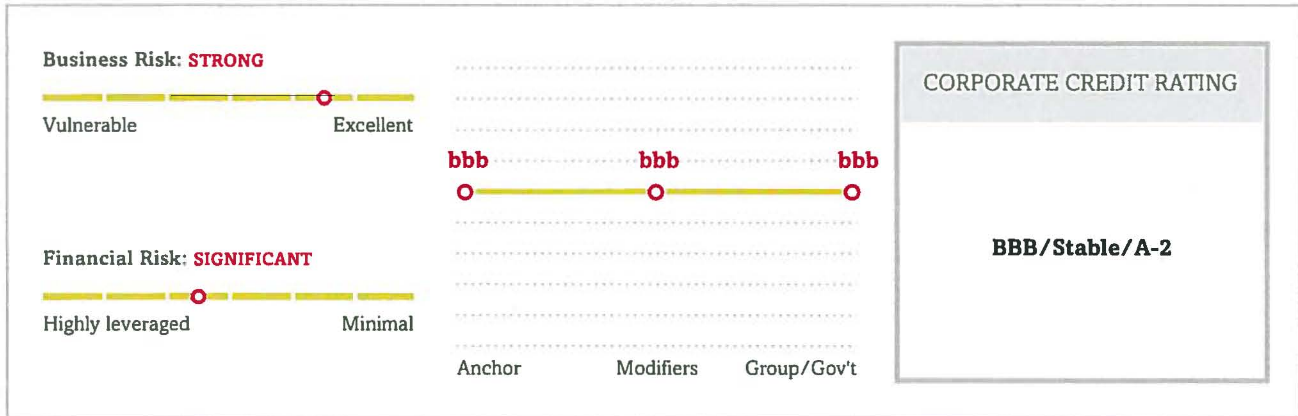
Summary:

American Electric Power Co. Inc.



Rationale

Business Risk: Strong	Financial Risk: Significant
• Sole provider (or distributor only) in its service territories of essential electricity service • Large and diverse customer base • Geographic diversity • Steady operating cash flow from regulated utilities • Low-cost coal and nuclear generation • Large coal fleet exposed to environmental standards • Unregulated operations that are much riskier than regulated businesses • Marketing operations weaken creditworthiness	• Cash flow erosion from transition in Ohio • 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%

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Outlook: Stable

The stable rating outlook on American Electric Power Co. Inc. (AEP) 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 AEP maintains the current business risk profile and financial measures strengthen to the "intermediate" financial risk profile category.

Standard & Poor's Base-Case Scenario

Assumptions

- 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

Key Metrics

	2013A	2014E	2015E
FFO/ debt (%)	20.7	19-21	19-21
Debt/EBITDA (x)	3.9	3.6-4.3	3.6-4.3
CFO/debt (%)	19.6	19-21	19-21

Note: Standard & Poor's adjusted figures. E--Estimate. FFO---funds from operations. CFO--cash flow from operations.

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Business Risk: Strong

We base our assessment of AEP's business risk profile on what we view as the company's "satisfactory" competitive position, "low" industry risk derived from the "very low" regulated utility industry and the "moderately high" unregulated power and gas industry, and the "very low" country risk of the U.S. where the company operates. AEP's competitive position reflects geographical and operational diversity consisting of numerous regulated utilities operating in 11 states in the Midwest and the 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 electric transmission and distribution operations in Ohio. 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. By June 1, 2015, Ohio Power expects to have fully transitioned to a competitive generation market that will hold auctions to provide power to standard service offer customers. During the transition, AEP is recovering transition costs through a nonbypassable retail stability rider and partly recovering from customers the difference between PJM RPM capacity prices and a Public Utilities Commission of Ohio-determined capacity price. Any unrecovered capacity deferral is to be accrued and recovered in rates through 2018. The company accelerated recovery of deferred assets through multiple securitizations, boosting cash flow.

Over the longer term, with roughly 25,000 megawatts (MW) of coal-fired generation, 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 has grown with the addition of roughly 9,000 MW of Ohio Power generation assets following transfers to affiliate utilities and 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 and retrofit other coal assets with pollution-control equipment.

Financial Risk: Significant

Based on the medial volatility financial ratio benchmarks, our assessment of AEP's financial risk profile is "significant" reflecting our expectations that financial measures will continue to meet current levels. The "significant" financial risk profile for AEP reflects a cash flow adequacy and leverage determination of "significant". For the 12 months ended Dec. 31, 2013, the core ratio of FFO to total debt was about 21%, in line with the "significant" determination, and the

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supplemental ratio of CFO to debt was about 19.6%, the low end of the "intermediate" ratio benchmarks. Under our base case forecast, we expect FFO to total debt to range between 19% and 21% over the next few years, in line with the "significant" determination, and CFO to debt to range between 19% and 21%, within the "intermediate" category. We expect debt to EBITDA to be squarely in the "significant" range at about 4x. Capital spending and dividend payments translate to rising negative discretionary cash flow over the forecast period, requiring management to maintain vigilant cost recovery to maintain cash flow measures. The negative discretionary cash flow also points to external funding needs. 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.

Liquidity: Adequate

AEP has "adequate" liquidity, as our criteria define 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

Standard & Poor's bases its 'BBB' issuer credit rating (ICR) on AEP on the consolidated group credit profile (GCP) of 'bbb' and application of our group ratings methodology. AEP, as the parent company, has a GCP that matches its 'bbb' SACP.

Ratings Score Snapshot

Corporate Credit Rating

BBB/Stable/A-2

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Business risk: Strong

- **Country risk:** Very low
- **Industry risk:** Low
- **Competitive position:** Strong

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

Related Criteria And Research

Related Criteria

- 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

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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-

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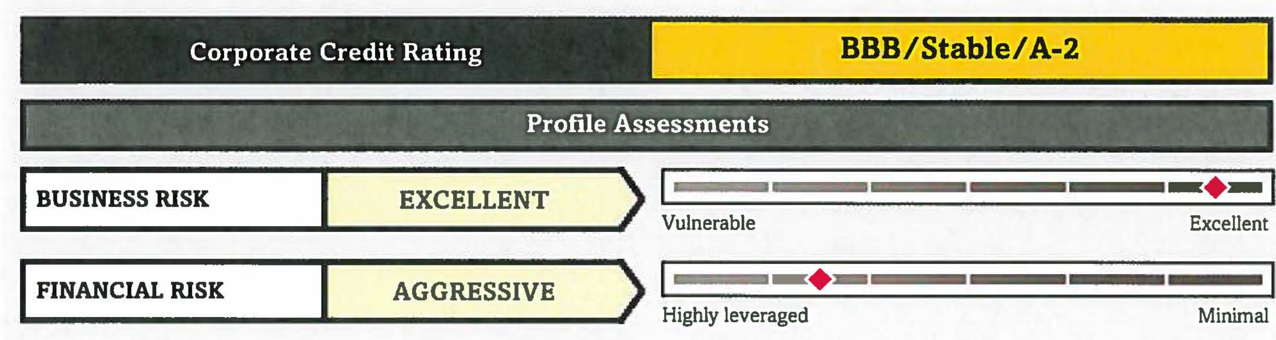

Rationale

Business Risk: Excellent	Financial Risk: Aggressive
• Sole provider (or distributor only) in its service territories of essential electricity service • Large and diverse customer base • Geographic diversity • Steady operating cash flow from regulated utilities • Low-cost coal and nuclear generation • Large coal fleet exposed to environmental standards • Growing unregulated operations that are materially riskier than regulated businesses	• Cash flow erosion from transition in Ohio • 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% • Marketing operations weaken creditworthiness

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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.

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Assumptions

- 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

Key Metrics*

	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 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

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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

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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
• FFO of roughly $3.1 billion in 2013 • Assumed credit facility availability of about $2.1 billion in 2013 • Working capital of about $500 million in 2013	• Debt maturities of $1.8 billion in 2013 • Necessary capital spending of about $1.9 billion in 2013 • Shareholder distributions of about $900 million

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

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Business And Financial Risk Matrix

	Financial Risk					
Business 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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