American Electric Power Company, Inc.

Electric Utility Holding Company

Summary Rating Rationale
American Electric Power Company’s (AEP) Baa1 rating and positive outlook are underpinned by the size and diversity of its regulatory jurisdictions and service territories. AEP’s nine retail utility subsidiaries operate under eleven different state regulatory bodies and its transmission subsidiaries are regulated by the Federal Energy Regulatory Commission (FERC). AEP benefits from a very stable earnings profile which over the past several years has yielded cash flow from operations pre-working capital (CFO pre-WC) to debt metrics in the high-teens to low twenty percent range. Cash flow stability is supported by AEP’s current corporate strategy of focusing on its core utility assets with more predictable earnings. AEP has been successful in de-risking its business by reducing its exposure to the volatile merchant power markets through its recent sale of four Midwest merchant generating plants, and agreements for the consolidation and/or shutdown of others, a credit positive. Going forward, AEP’s most significant growth area will be its transmission and distribution utilities. By 2019, we anticipate these less volatile businesses will make up over 45% of AEP’s consolidated cash flow.

Recent Developments
On January 30, 2017, AEP completed the sale of four competitive power plants, totaling about 5,200 MW, to Lightstone Generation LLC (unrated), a joint venture of Blackstone Group LP and an affiliate of ArcLight Capital Partners LLC, for approximately $2.1 billion. After accounting for taxes, fees and debt repayments, AEP netted about $1.2 billion which it is investing in its regulated businesses, including transmission and contracted renewable projects.

Following the sale, AEP’s merchant generating exposure is limited to about 2,700 MW of primarily coal-fired assets in Ohio and about 350 MW in the Electric Reliability Council of Texas with a total current book value of about $50 million. In addition, AEP has agreed to sell its Zimmer station holdings of about 330 MW to Dynegy Inc. (Dynegy, B2 stable) while simultaneously purchasing Dynegy’s 312 MW share of Conesville Unit 4. The transaction is awaiting FERC approval. AEP has also given formal consent for the shutdown of its 600 MW share of the jointly owned Stuart plant by June 2018. This will bring AEP’s remaining merchant exposure to a little over 2,000 MW. Management continues to evaluate alternatives for these assets, which could include further transfers and/or shutdowns, and will provide details later this year.
Credit Strengths

» Diversity of regulatory jurisdictions and service territories provide a strong foundation for current rating
» Continued regulatory support with timely and sufficient cost recovery
» Decreasing business risk through exit of merchant business and focus on transmission and distribution investments

Credit Challenges

» Substantial investments in regulated transmission networks and for environmental mandates will likely pressure credit metrics
» Weak demand growth in some large territories

Rating Outlook

The positive outlook for AEP assumes the positive momentum at its subsidiaries will continue as they implement their investment plans while maintaining supportive regulatory relationships. The outlook recognizes the potential for upward movement in the ratings if financial metrics remain near their current levels, for example, a ratio of CFO pre-WC to debt maintained in the high teens/low twenty percent range.

Factors that Could Lead to an Upgrade

» A ratio of CFO pre-WC to debt in the high teens to low twenty percent range on a sustainable basis
» An upgrade of AEP’s largest utility subsidiaries

Factors that Could Lead to a Downgrade

» If a more contentious regulatory environment were to develop in any of its key jurisdictions
» If environmental and nuclear investments cannot be recovered on a timely basis

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.
If AEP’s financial metrics were to deteriorate on a sustained basis resulting in CFO pre-WC to debt below 15%.

Key Indicators

Exhibit 2

<table>
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<tr>
<td>CFO pre-WC + Interest / Interest</td>
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<td>CFO pre-WC / Debt</td>
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<td>CFO pre-WC – Dividends / Debt</td>
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<td>Debt / Capitalization</td>
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Source: Moody’s Financial Metrics

Detailed Rating Considerations

Diversity of regulatory jurisdictions and service territories provide a strong foundation for current rating

AEP’s diversity in terms of regulatory jurisdictions and service territory economies is a meaningful credit strength as it provides the company with a degree of insulation from any unexpected negative developments occurring at any one of its operating companies, state regulatory bodies or state economies. This diversity has been helpful in dealing with weak demand growth in some of AEP’s service territories while it spends heavily on environmental compliance and system reliability. Going forward, the largest portion of AEP’s capital program will be for investment in its Federally regulated transmission subsidiaries along with increased investment in transmission and distribution operations at its state regulated utility subsidiaries.

AEP’s primary state regulated utilities and their respective authorities are as follows: Ohio Power Company (OPCo: A2 stable), which accounted for 18% of AEP’s total 2016 revenues, operates under the Public Utility Commission of Ohio (PUCO); Appalachian Power Company (APCo: Baa1 stable), which accounted for 18% of AEP’s total 2016 revenues, operates under the Virginia State Corporation Commission (VSCE), (covering a little over half of APCo’s customers) and the more challenging Public Service Commission of West Virginia (PSC WV); Indiana Michigan Power Company (I&M: Baa1 positive), 13% of AEP’s total 2016 revenues, is regulated by the Indiana Utility Regulatory Commission (IURC), (about ¾ of I&M’s customers) and the Michigan Public Service Commission (MPSC); Southwestern Electric Power Company (SWEPCo: Baa2 stable), 11% of AEP’s total 2016 revenues, operates under the Louisiana Public Service Commission (LPSC) (about 43% of SWEPCo customers), the Arkansas Public Service Commission (ARPS) (22% of SWEPCo customers) and the Public Utility Commission of Texas (PUCT) (35% of SWEPCo customers); Public Service Company of Oklahoma (PSO: A3 stable), 8% of AEP’s total 2016 revenues, is regulated by the Oklahoma Corporation Commission (OCC); AEP Texas (AEP Texas: Baa1 stable), which was formed by the merger of AEP Texas Central and AEP Texas North Company at year-end 2016, 9% of AEP’s total 2016 revenues, is regulated by the Public Utility Commission of Texas (PUCT); and Kentucky Power Company (KPCo: Baa2 stable), 4% of AEP’s total 2016 revenues, is under the Kentucky Public Service Commission (KPS). AEP Transmission Company LLC’s (AEP Transco: A2 stable) transmission businesses are regulated by the FERC under forward looking formulaic rate plans that result in a high degree of cash flow predictability. Operations are actively conducted through five subsidiaries within AEP’s electric utility service territories in six states, Ohio, West Virginia, Kentucky, Oklahoma, Indiana and Michigan. The company is growing rapidly, net plant has more than doubled since 2013 and the company anticipates continued investment across its subsidiaries will result in another doubling by 2019.

For further information on these service territories and subsidiaries please refer to each utility’s credit opinion on Moodys.com.

Continued regulatory support with timely and sufficient cost recovery important to credit quality

Given the significant amount of capital expenditures AEP has planned across its regulated business segments, it is essential that AEP maintain a supportive relationship with its regulators to sustain credit quality. The utility subsidiary ratings and outlooks reflect our
view that AEP will continue to receive timely and consistent long-term regulatory support across the majority of its jurisdictions. Recent regulatory filings, orders and updates for AEP are as follows:

**OPCo** - The PUCO continues to demonstrate a credit supportive view for utilities operating in the state. For the last several years, utilities have been operating under individually tailored electric security plans (ESP), which are rate plans for the supply and pricing of electric generation service. OPCo completed the sale of its generation assets to an affiliate in December of 2013 and currently purchases all of the energy and capacity needed to serve its generation service customers at auction. As OPCo was transitioning to full competition, the PUCO approved numerous ESPs including riders and fuel cost adjustment mechanisms that maintained the utility’s financial health while achieving the state's deregulation goals. Over the years, various parties, including OPCo, have challenged various elements of the PUCO’s orders, and several have been evaluated by the Supreme Court of Ohio; however, on balance the decisions have been supportive of credit quality and OPCo’s financial profile has improved. Most recently in February 2017, the PUCO approved a Global Settlement agreement among OPCo, the PUCO staff, and various intervenors, that essentially resolved all prior transitional issues and should greatly simplify future filings.

**APCo (Virginia)** – APCo’s relationship with the VSCC has generally been constructive. The utility benefits from various riders and trackers that currently incorporate an ROE of 9.4%, which is near the top of the range of 8.5% to 9.5% the VSCC determined was reasonable.

Virginia has historically biennial reviews of investor owned utility earnings; however, in February 2015, Virginia enacted legislation temporarily suspending the required biennial review, effectively freezing rates for APCo through the 2017 test year. Biennial reviews are to begin again in 2020 addressing results for the 2018 and 2019 test years. This is positive for APCo considering its last biennial review decision (issued November 2014) found that for the 2012 and 2013 test years APCo had on average earned an 11.86% ROE, which was above the upper end of the 10.4%-11.4% allowed range established for those years. APCo was required to make refunds totaling $5.8 million, and the commission set a baseline ROE of 9.7% for the biennial review for 2014 and 2015 which is significantly below the prior 10.9% baseline (although the allowable range was widened so the upper boundary would have been 10.4%). As the biennial reviews have been suspended, no refunds will be required in the event of over earning until the next review in 2020.

In February 2016, some APCo industrial customers filed a petition with the VSCC requesting a declaratory order finding the amendments to Virginia law suspending biennial reviews unconstitutional and directing APCo to make biennial review filings beginning in 2016. Oral arguments at the VSCC were held in March 2016 and the industrial petition was denied. In April 2017, oral arguments relating to an appeal filed by industrial customers in July 2016 were held before the Supreme Court of Virginia. A reinstatement of the biennial review process in advance of March of 2020 would likely reduce future cash flows and coverage metrics. For example, based on the difference between earned and allowed ROE noted above, we estimate reinstatement of the biennial process could cause APCo's ratio of cash from operations excluding changes in working capital (CFO Pre-WC) to debt to be 0.5 – 1.0 percentage points lower.

**APCo (West Virginia)** – APCo’s relationship with the WVPSC has been a bit more challenging. The WVPSC’s last order was issued in May 2015, authorizing a $99 million ($85 million for APCo / $14 million for Wheeling Power Company (WPCo)) rate increase based on a 9.75% ROE. The initial case was filed almost a year prior in June 2014 requesting a $226 million increase in annual revenues based on a 10.62% ROE. The WVPSC’s order also included the delayed billing of an additional $25 million ($22 million APCo / $3 million WPCo) to residential customers until July 2016. On a positive note, the order included approval of an annual vegetation rider of $45 million, and the commission set a baseline ROE of 9.4%, which is near the top of the range of 8.5% to 9.5% the VSCC determined was reasonable.

In 2016, APCo industrial customers filed a petition with the VSCC requesting a declaratory order finding the amendments to West Virginia law suspending biennial reviews unconstitutional and directing APCo to make biennial review filings beginning in 2016. Oral arguments at the VSCC were held in March 2016 and the industrial petition was denied. In April 2017, oral arguments relating to an appeal filed by industrial customers in July 2016 were held before the Supreme Court of Virginia. A reinstatement of the biennial review process in advance of March of 2020 would likely reduce future cash flows and coverage metrics. For example, based on the difference between earned and allowed ROE noted above, we estimate reinstatement of the biennial process could cause APCo's ratio of cash from operations excluding changes in working capital (CFO Pre-WC) to debt to be 0.5 – 1.0 percentage points lower.

**I&M (Michigan)** – The regulatory environments Michigan and Indiana are both supportive of utility credit quality. In Michigan, legislation passed in 2008, and amended in 2016, provide a framework that limits regulatory lag, allows the use of forward test years, and limits utility exposure/risk from customer participation in electric choice. Major projects go through a certificate of necessity, pre-approval process, which includes determination of rate making principles. In Indiana, utilities benefit from a suite of recovery mechanisms and trackers, including those for environmental controls.
In May 2017, I&M filed a rate case with the MPSC, requesting a $51.7 million electric rate increase premised upon a 10.6% ROE, 36% regulated equity layer and rate base valuation of $1.015 billion for a calendar 2018 test year. The rate increase request is mainly driven by costs associated with the Cook Plant Life Cycle Management (LCM) project as well as costs associated with electric delivery system updates, vegetation management, and higher depreciation costs for a coal plant. Under Michigan statutes, the MPSC is must render a final decision within ten months of the filing or the requested increase would be automatically approved. I&M currently operates under a 10.2% authorized ROE and 42% regulated equity layer, as established by its 2011 rate case.

In Indiana, a portion of the investment in the Cook LCM project has been approved for rider recovery, and a portion will be recovered in a 10.2% authorized ROE and 42% regulated equity layer, as established by its 2011 rate case.

SWEPCo (Texas – about 35% of customers) – On December 16, 2016, SWEPCo filed a rate case with the PUCT, requesting a $105.9 million electric rate increase premised upon a 10.0% ROE and a rate base valuation of $1.239 billion with a test period ending June 30, 2016. The net impact on ratepayers of the requested rate change would be approximately $69 million after amounts currently collected through riders. On May 2, 2017, the PUCT staff recommended a $83.9 million rate increase premised upon a 9.3% ROE, and a rate base of about $1.5 billion. The recommendation reflects a different treatment of the retail portion of SWEPCo’s FERC jurisdictional transmission assets, for which SWEPCo requested rider recovery rather than base rate treatment. Currently, SWEPCo operates under a 9.65% authorized ROE as established by its 2012 rate case.

PSO – In November 2016, the OCC issued a final order in PSO’s rate case, initially filed in July 2015, approving a base revenue increase of $14.5 million based on a 9.5% ROE. The order also approved deferred accounting for environmental compliance plan investment costs of approximately $27 million, and recovery of consumables through the fuel adjustment clause of approximately $4 million, bringing the total financial impact of the decision to approximately $45 million. As PSO had implemented an interim rate increase of $75 million in January 2016, refunds of approximately $56 million were due to customers. PSO initially requested to increase annual revenues by $137 million based on a 10.5% ROE in order to recover costs associated with its environmental compliance plan and other rate base additions. In addition to the ROE differential, the primary driver of the difference between the requested and authorized amounts relates to the timing of recovery of environmental compliance costs for projects that were not in service by the date required by the OCC. The assets are now in service and PSO is preparing to file a new rate case by the end of June.

KPCo – At the end of the first quarter of 2017, the earned ROE for KPCo (5% of AEP regulated rate base) was 6.3%; significantly below both its currently approved level of 10.25% and the overall AEP earned ROE of 10.4%. To address this shortfall, KPCo intends to file a rate case application by the end of June 2017.

AEP Transco - The AEP Transco subsidiaries are currently allowed a return of 11.49% in PJM and 11.20% in SPP. On October 27, 2016, American Municipal Power, Inc. (AMP, A1 Issuer Rating) and several other parties filed a joint complaint with the FERC seeking a reduction in the ROE for AEP’s transmission owning subsidiaries operating in PJM to 8.82% (8.32% base plus 0.5% RTO adder). Management previously identified the range of transmission ROEs in PJM to be 10.5% - 12.4%. We note that in recent FERC rulings on similar cases in New England and MISO, although ROEs were lowered, they remained above 10%.

In November 2016, AEP Transco subsidiaries filed an application with FERC to modify its PJM tariff formula rate calculation to include an adjustment to recover increased property taxes and to shift to projected rather than historical recovery of operating expense. Revised tariffs were implemented on January 1, 2017, subject to refund. In March 2017, FERC accepted the proposed modification filing and set the matter for hearing and settlement procedures. The requested modification is consistent with the formulaic approach approved for other transmission companies operating in PJM. As proposed, in the near term, the revision would largely offset a potential reduction in ROE stemming from the 2016 complaint.

For more details regarding any of AEP’s subsidiaries regulatory updates please refer to their pages on Moodys.com.

**Substantial investments in regulated transmission networks and environmental mandates**

AEP has been investing heavily to meet stringent environmental compliance requirements and to assure reliability throughout its service territories. High capital investment levels are expected to continue and the company has announced a program of approximately $17.3 billion for 2017 through 2019. All of the total $17.3 billion will be allocated to regulated businesses and contracted renewables as follows: transmission about 52%, distribution 22%, regulated generation 13%, contracted renewables 6%, corporate 4%
and regulated renewables 3%. AEP’s average projected capital investments of approximately $6 billion per year for 2017 through 2019 are higher than the $4.7 billion spent in 2016 and $4.6 billion spent in 2015, and a substantial increase from the $3.1 billion invested in 2012 and $2.8 billion in 2011.

Transmission and distribution (T&D) investments are expected to be recovered largely either through the transmission formula based rates or rider recovery, a credit positive. Generation investment is primarily recovered in base rates and more susceptible to lags in recovery. Given the sheer magnitude of the investment program, we anticipate intermediate term credit metrics could deteriorate somewhat.

**Additional debt financing for capex spend will put downward pressure on financial metrics - mitigated by an investment strategy focused on transmission and distribution systems**

AEP’s key financial metrics are currently strong for its rating category. As of the last twelve months ending (LTM) Q1 2017, AEP’s adjusted three year average interest coverage ratio was 5.7 times and CFO pre-WC to debt was about 20%, which respectively fall in the high “A” and “Baa” scoring ranges for these factors as indicated in our rating methodology for standard risk regulated electric and gas utilities. These metrics are similar to those observed for Xcel Energy Inc. (A3 stable) and stronger than those of Duke Energy Corporation (Baa1 stable), which are both large, multistate utility holding companies with virtually all regulated or contracted operations and relatively low business risk.

Going forward we expect AEP’s financial metrics to deteriorate slightly as the company continues to incur debt to fund its capital expenditure program. However, we expect credit metrics to remain strong for AEP’s current Baa1 rating, particularly when viewed in light of its diverse, primarily supportive regulatory environments and the strategic focus of its capital expenditure plans. For example, we anticipate an interest coverage ratio in the 5.0x-5.5x range and CFO pre-WC to debt in the high teens.

**Environmental sustainability**

Although still heavily reliant on coal generation, AEP is focused on transitioning to a cleaner, energy future that is more responsive to consumers’ needs by investing in the resilience and interoperability of its transmission and distribution systems and rebalancing its generation portfolio to include more renewables while reducing coal-fired exposure. As of 2017, AEP’s consolidated generating portfolio included about 47% coal-fired resources, versus about 66% in 1999. As a result, the company estimates that in 2017, its carbon emissions will be 56 percent below 2000 levels. AEP’s goal is to integrate energy efficiency, clean energy sources, and advanced technology into the essential energy services they provide, and to give consumers more choices.

**Structural Considerations**

AEP’s rating reflects the limited amount of structural subordination that exists within the consolidated organization. Following the sale its merchant portfolio, as of March 31, 2017, AEP had long-term parent level debt obligations of about $850 million, or 4% of AEP’s total debt, which consists of senior notes at the holding company level. It is our view that, within the context of our methodology scorecard grid, considering the modest level of parent holding company debt relative to total consolidated debt, the diversity of subsidiaries, and the low level of overall business risk, we do not apply and structural subordination notching. The weighted average rating of AEP’s subsidiary debt is currently Baa1; on the basis of cash flow, the weighted average is currently A3. AEP’s fastest growing subsidiary AEP Transmission Company, is rated A2 stable.

**Liquidity Analysis**

Assuming continued market access, AEP’s liquidity is adequate. Although we anticipate its significant investment program will result in negative free cash flow for the foreseeable future, the company has demonstrated capital markets access and its credit facilities currently provide reasonable near-term protection. For the twelve months ending March 31, 2017, AEP generated approximately $4.5 billion of cash from operations (CFO), invested $5.0 billion in capital expenditures and paid $1.1 billion in dividends resulting in a negative free cash flow (FCF) of approximately $1.6 billion. In 2016, AEP generated approximately $4.5 billion of CFO, invested $4.8 billion in capital expenditures and paid $1.1 billion in dividends resulting in a negative FCF of approximately $1.5 billion. Going forward, given AEP’s substantial level of planned capital expenditures, we anticipate the company will continue to generate negative free cash flow, which will be funded via a combination of internal and external sources including debt financing and sales proceeds.
AEP currently has one syndicated credit facility totaling $3.0 billion, with a $1.2 billion letter of credit sub-limit, expiring in June 2021. As of March 31, 2017, AEP had $964 million of commercial paper outstanding and no letters of credit outstanding under the facilities. In addition, AEP has a receivables securitization agreement of $750 million that expires in June 2018.

AEP is not required to make a representation with respect to either material adverse change or material litigation in order to borrow under the facilities. Default provisions exclude non-significant subsidiaries’ (including AGR) cross-default and insolvency/bankruptcy provisions. The facilities contain a covenant requiring that AEP’s consolidated debt to capitalization (as defined) not exceed 67.5%. AEP states the contractually defined ratio was 51.8% at March 31, 2017.

At March 31, 2017, AEP has consolidated long-term debt due within one year of approximately $2.51 billion. At the holding company level, AEP has $550 million in senior notes maturing in December 2017 and $300 million in senior notes maturing in December 2022. We expect AEP will seek to refinance its upcoming debt maturities comfortably in advance of their due dates.

**Corporate Profile**

American Electric Power Company, Inc. (AEP: Baa1 positive), headquartered in Columbus, Ohio, is a large electric utility holding company with ten vertically integrated or retail transmission and distribution utility subsidiaries operating in eleven states. The company also operates transmission companies within the eastern and southwestern regions of the United States and owns a predominately Ohio based competitive generation and marketing business which has been partially sold and for which it is evaluating strategic alternatives. AEP has a regulated rate base of approximately $35 billion and serves about 5.4 million customers across eleven states. In 2016, the company’s total generation capacity of about 35,000 MW (including power purchase agreements, approximately 6,752 MW of competitive generating assets, and reflecting about 750 MW of coal to gas conversions expected to be completed in 2016), is about 52% coal/lignite fired.
Rating Methodology and Scorecard Factors

Exhibit 3

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<th>Rating Factors</th>
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<td>Regulated Electric and Gas Utilities Industry Grid</td>
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**Factor 1 : Regulatory Framework (25%)**
- a) Legislative and Judicial Underpinnings of the Regulatory Framework  
  Measure: A  
  Score: A
- b) Consistency and Predictability of Regulation  
  Measure: A  
  Score: A

**Factor 2 : Ability to Recover Costs and Earn Returns (25%)**
- a) Timeliness of Recovery of Operating and Capital Costs  
  Measure: A  
  Score: A
- b) Sufficiency of Rates and Returns  
  Measure: A  
  Score: A

**Factor 3 : Diversification (10%)**
- a) Market Position  
  Measure: A  
  Score: A
- b) Generation and Fuel Diversity  
  Measure: Baa  
  Score: Baa

**Factor 4 : Financial Strength (40%)**
- a) CFO pre-WC + Interest / Interest (3 Year Avg)  
  Measure: 5.7x  
  Score: A
- b) CFO pre-WC / Debt (3 Year Avg)  
  Measure: 20.7%  
  Score: Baa
- c) CFO pre-WC – Dividends / Debt (3 Year Avg)  
  Measure: 15.9%  
  Score: Baa
- d) Debt / Capitalization (3 Year Avg)  
  Measure: 42.9%  
  Score: A

**Rating:**
- Grid-Indicated Rating Before Notching Adjustment  
  Measure: A3  
  Score: A3
- HoldCo Structural Subordination Notching  
  Measure: A3  
  Score: A3
- Actual Rating Assigned  
  Measure: Baa1  
  Score: Baa1

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[3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.

Source: Moody’s Financial Metrics
### Ratings

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</table>

Source: Moody's Investors Service
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REPORT NUMBER 1072583
Moody's
INVESTORS SERVICE

Rating Action: Moody's upgrades Ohio Power to A2, revises AEP rating outlook to positive from stable

Global Credit Research - 05 Jun 2017

Over $20 billion of consolidated debt and credit facilities outstanding

New York, June 05, 2017 -- Moody's Investors Service, ("Moody's") upgraded the ratings of Ohio Power Company (OPCo), including its senior unsecured bonds to A2 from Baa1, and revised the outlook for its parent company American Electric Power Company, Inc. (AEP Baa1) to positive from stable. The rating outlook for OPCo has changed to stable from positive. Concurrently, Moody's affirmed the ratings of AEP, including its Baa1 senior unsecured rating and its Prime-2 rating for commercial paper.

A full list of affected ratings is provided towards the end of this press release.

RATINGS RATIONALE

The upgrade of OPCo reflects the utility's strong financial performance and the supportive regulatory relationship that has been demonstrated in recent years as Ohio looks to finally complete the transition of its electricity markets to deregulation. The two notch upgrade in ratings reflects our general view of the supportive regulatory trend in Ohio, and OPCo's strong and predictable financial profile, which includes a ratio of cash from operations excluding changes in working capital (CFO pre-WC) to debt in the low 20% range over the long term. The upgrade also considers that many Ohio-based utilities were not upgraded in January 2014, when the majority of the US regulated utility sector was upgraded by one notch. At that time, the Ohio utilities were excluded from a broader sector upgrade due to perceived regulatory uncertainty in Ohio. As a result, OPCo's ratings remained unchanged. In the intervening time period, the Public Service Commission of Ohio (PUCO) rendered numerous credit supportive decisions, and OPCo's credit metrics have remained robust. The upgrade also considers the less volatile nature of OPCo's current operating profile, which consists entirely of regulated transmission and distribution systems.

The positive outlook for AEP recognizes the strong financial performance at OPCo along with several other of AEP's other retail subsidiaries, including Indiana Michigan Power Company (Baa1 positive), Appalachian Power Company (Baa1 stable), and AEP Transmission Company, LLC (A2 stable) and considers the company's overall strategy of focusing on growth in its transmission and distribution businesses. The outlook assumes the positive trends observed at most of AEP's subsidiaries will continue, and acknowledges financial credit metrics that are currently strong for AEP's Baa1 rating when compared to other multi-state, almost entirely regulated, utility holding companies such as Duke Energy Corporation (Baa1 stable) and Xcel Energy Inc. (A3 stable). The positive outlook also recognizes the limited amount (currently around 4%) of parent holding company debt within the consolidated AEP family.

For the last several years, as Ohio has been transitioning to a fully deregulated market for electricity, utilities in the state have been operating under individually tailored electric security plans (ESP), which are rate plans for the supply and pricing of electric generation service. The PUCO approved numerous ESPs for OPCo that included various riders and trackers and fuel cost adjustment mechanisms that supported the utility's financial health while achieving the state's deregulation goals. Most recently, in February 2017, the PUCO approved a global settlement agreement among OPCo, the PUCO staff, and various intervenors, that essentially resolved all prior transitional issues and should greatly simplify future filings.

OPCo completed the sale of its generation assets to an affiliate in December of 2013 and since mid-2015 has been purchasing all of the energy and capacity needed to serve its generation service customers at auction. Operations are now limited to transmission and distribution, and the utilities financial metrics are particularly strong when considered in light of these less volatile activities. For example, as of December 2016, OPCo's ratio of cash from operations excluding changes in working capital (CFO pre-WC) to total debt and CFO pre-WC minus dividends to total debt were about 31% and 24% respectively, which are both in the "Aa" scoring range for these metrics in our regulated electric and gas utilities methodology low risk business grids. As discussed below, although these very strong ratios are not considered sustainable, credit metrics are expected to remain appropriate for the rating.
OPCo's financial performance has been strengthened by the use of PUCO approved riders which increase cash flow predictability and reduce regulatory lag; these include a distribution investment rider, a storm damage rider and a rider for distribution revenues lost due to energy efficiency. Certain riders, including one for the phased-in recovery of prior deferred fuel balances, and another for the recovery of deferred capacity costs, were intended to manage the transition to a fully competitive generation supply. These transition riders will remain in place through 2018. As a result, we anticipate OPCo's cash flow credit metrics during this period will remain near their current levels. Post 2018, we expect OPCo's metrics to decline; however, assuming continued supportive regulatory treatment and modest rate increases, we anticipate they will remain appropriate for OPCo's current A2 rating, for example, we anticipate the ratio of CFO pre-WC to debt will remain above 20%.

AEP's ongoing earnings and cash flow have been very stable over the past several years with CFO pre-WC to debt metrics in the high-teens to low twenty percent range. Cash flow stability is supported by AEP's current corporate strategy of focusing on its core utility assets with more predictable earnings. AEP has been successful in de-risking its business by reducing its exposure to the volatile merchant power markets through its recent sale of four Midwest merchant generating plants, and agreements for the consolidation and/or shut down of others, a credit positive. Going forward, AEP's most significant growth area will be its transmission and distribution utilities. By 2019, we anticipate these less volatile businesses will make up over 45% of AEP's consolidated cash flow.

Outlook

The positive outlook for AEP assumes the positive momentum at its subsidiaries will continue as they implement their investment plans while maintaining supportive regulatory relationships. The outlook recognizes the potential for upward movement in the ratings if financial metrics remain near their current levels, for example, a ratio of CFO pre-WC to debt maintained in the high teens/low twenty percent range. The stable outlook for OPCo assumes the Ohio regulatory environment will continue to be credit supportive and that the ratio of CFO pre-WC to debt will remain above 20%.

Factors that could lead to an upgrade

At AEP an upgrade is likely if the ratio of CFO pre-WC to debt is maintained in the high teens to low twenty percent range while maintaining positive performance at its subsidiaries. An upgrade of one of its largest subsidiaries could also put upward pressure on the ratings. At OPCo, there could be upward pressure on the ratings if financial metrics remain robust beyond 2018; for example a ratio of CFO pre--WC to debt above 30% and CFO pre-WC minus dividends to debt in the twenty percent range, on a sustained basis.

Factors that could lead to a downgrade

If a more contentious regulatory environment were to develop at OPCo, or any of AEP's key jurisdictions, there could be downward pressure on the ratings. A ratio of CFO pre-WC to debt below 15% at AEP, or below 20% at APCo, for an extended period, could cause the ratings to move downward.

The principal methodology used in these ratings was Regulated Electric and Gas Utilities published in December 2013. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

LIST OF AFFECTED RATINGS

..Affirmations:


.... Junior Subordinated Shelf, Affirmed at (P)Baa2

.... Senior Unsecured Shelf, Affirmed at (P)Baa1

.... Senior Unsecured Regular Bond/Debenture, Affirmed at Baa1

.... Commercial Paper, Affirmed at P-2

..Upgrades:

Issuer: Ohio Power Company
....LT Issuer Rating, Upgraded to A2 from Baa1
....Senior Unsecured Regular Bond/Debenture, Upgraded to A2 from Baa1
....Senior Unsecured Medium-Term Note Program, Upgraded to (P)A2 from (P)Baa1
Issuer: Columbus Southern Power Company
....Senior Unsecured Regular Bond/Debenture, Upgraded to A2 from Baa1 (Assumed by Ohio Power Company)
Issuer: Ohio Air Quality Development Authority
....Senior Unsecured Revenue Bonds, Upgraded to A2 from Baa1
..Outlook Actions:
....Outlook, Changed To Positive From Stable
Issuer: Ohio Power Company
....Outlook, Changed To Stable From Positive

Headquartered in Columbus, Ohio, AEP is a large electric utility holding company with ten vertically integrated or retail electric transmission and distribution utility subsidiaries operating in eleven states. The company also operates transmission companies within the eastern and southwestern regions of the United States. AEP has a regulated rate base of approximately $35 billion and serves about 5.4 million customers. OPCo is a wholly owned subsidiary of AEP engaged in electric transmission and distribution services to approximately 1.5 million customers in Ohio.

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Laura Schumacher
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American Electric Power Company, Inc.

Electric Utility Holding Company

Summary Rating Rationale
American Electric Power Company’s (AEP) Baa1 rating is underpinned by the size and diversity of its regulatory jurisdictions and service territories. AEP’s ten retail utility subsidiaries operate under eleven different state regulatory bodies and its transmission subsidiaries are regulated by the Federal Energy Regulatory Commission (FERC). The rating reflects AEP’s stable earnings profile which over the past several years has yielded cash flow from operations pre-working capital (CFO pre-WC) to debt metrics in the high-teens to low twenty percent range. Cash flow stability is supported by AEP’s renewed corporate strategy of focusing on its core utility assets with more predictable earnings. This strategy coincides with AEP’s long-term goal of de-risking its business by reducing its exposure to the volatile merchant power markets, as evidenced by its recent agreement to sell four Midwest merchant generating plants, a credit positive. These positive credit factors are balanced against weak demand growth associated with some of its larger service territories, namely the Appalachian economies, a prolonged period of material capital investments and an increasing amount of debt.

Recent Developments
In September 2016, AEP announced that it agreed to sell about 5,200 MW of its generating assets for approximately $2.2 billion, from which it expects to net about $1.2 billion after accounting for taxes, fees and debt repayments. The sale is expected to close in the first quarter of 2017. After the completion of this transaction, AEP’s merchant generating exposure will be limited to about 2,700 MW of primarily coal-fired assets in Ohio and about 350 MW in the Electric Reliability Council of Texas. Also in September 2016, AEP recorded a pre-tax impairment of $2.3 billion on these remaining assets, bringing their net book value to $50 million. Management continues to evaluate alternatives for these assets that could include a transfer to Ohio Power Company as regulated assets, a sale to a third party, or the wind down of operations.

In August 2016, Moody’s assigned a first time Issuer Rating of A2 to AEP Transmission Company, LLC (AEP Transco), AEP’s intermediate transmission holding company subsidiary. In November, AEP Transco issued $700 million of senior unsecured notes, proceeds were used to repay debt outstanding and to fund ongoing capital expenditures.
Credit Strengths

» Diversity of regulatory jurisdictions and service territories provide a strong foundation for current rating

» Continued regulatory support with timely and sufficient cost recovery

Credit Challenges

» Substantial investments in regulated transmission networks and for environmental mandates will increase debt burden

» Financial metrics are expected to move down from recent highs due to substantial capital expenditures - though primarily for lower risk transmission and distribution investments

Rating Outlook

AEP’s stable outlook reflects its diversified regulatory jurisdictions and service territories and our expectation that those jurisdictions will remain credit supportive and not prevent or materially delay the recovery of prudently incurred costs. The outlook also considers AEP’s prudent financial management and an expectation that credit metrics may weaken somewhat but that CFO pre-WC to debt will remain in the high-teens which is appropriate for the rating.

Factors that Could Lead to an Upgrade

» Interest coverage above 5.5x and CFO pre-WC to debt above twenty percent on a sustainable basis

» An upgrade of AEP’s largest utility subsidiaries

Source: Moody’s Financial Metrics

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Factors that Could Lead to a Downgrade

» If a more contentious regulatory environment were to develop in any of its key jurisdictions
» If environmental and nuclear investments cannot be recovered on a timely basis
» If AEP’s financial metrics were to deteriorate on a sustained basis resulting in CFO pre-WC to debt in the low-teens

Key Indicators

Exhibit 2

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<th>12/31/2012</th>
<th>12/31/2013</th>
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</table>


Source: Moody’s Financial Metrics

Detailed Rating Considerations

Diversity of regulatory jurisdictions and service territories provide a strong foundation for current rating

AEP’s diversity in terms of regulatory jurisdictions and service territory economies is a meaningful credit strength as it provides AEP with a degree of insulation from any unexpected negative developments occurring at any one of its operating companies, state regulatory bodies or state economies. This diversity has been essential in helping AEP deal with an elevated capital expenditure program and weak demand growth in some of its service territories.

AEP’s primary state regulated utilities and their respective authorities are as follows: Ohio Power Company (OPCo: Baa1 positive), which accounted for 19% of AEP’s total 2015 revenues, operates under the Public Utility Commission of Ohio (PUCO); Appalachian Power Company (APCo: Baa1 stable), which accounted for 18% of AEP’s total 2015 revenues, operates under the Virginia State Corporation Commission (VSCC), (covering a little over half of APCo’s customers) and the more challenging Public Service Commission of West Virginia (PSC WV); Indiana Michigan Power Company (I&M: Baa1 stable), 13% of AEP’s total 2015 revenues, is regulated by the Indiana Utility Regulatory Commission (IURC), (about ¾ of I&M’s customers) and the Michigan Public Service Commission (MPSC); Southwestern Electric Power Company (SWEPCo: Baa2 stable), 11% of AEP’s total 2015 revenues, operates under the Louisiana Public Service Commission (LPSC) (about 43% of SWEPCo customers), the Arkansas Public Service Commission (ARPS) (22% of SWEPCo customers) and the Public Utility Commission of Texas (PUCT) (35% of SWEPCo customers); Public Service Company of Oklahoma (PSO: A3 stable), 8% of AEP’s total 2015 revenues, is regulated by the Oklahoma Corporation Commission (OCC); AEP Texas Central (TCC: Baa1 stable) and AEP Texas North Company (TNC: Baa1 stable), 7% and 2% of AEP’s total 2015 revenues, respectively, both under the Public Utility Commission of Texas (PUCT); and Kentucky Power Company (KPCo: Baa2 stable), 4% of AEP’s total 2015 revenues, is under the Kentucky Public Service Commission (KPSC).

AEP Transco’s transmission businesses are regulated by the FERC under forward looking formulaic rate plans that result in a high degree of cash flow predictability. Operations are actively conducted through five subsidiaries within AEP’s electric utility service territories in six states, Ohio, West Virginia, Kentucky, Oklahoma, Indiana and Michigan. The company is growing rapidly; net plant has more than doubled since 2013 and the company anticipates continued investment across its subsidiaries will result in another doubling by 2019.

For further information on these service territories and subsidiaries please refer to each utility’s credit opinion on Moodys.com.
Continued regulatory support with timely and sufficient cost recovery important to credit quality

Given the significant amount of capital expenditures AEP has planned across its regulated business segments, it is essential that AEP maintain a supportive relationship with its regulators to sustain credit quality. The utility subsidiary ratings and outlooks reflect our view that AEP will continue to receive timely and consistent long-term regulatory support across the majority of its jurisdictions. Recent regulatory filings, orders and updates for AEP are as follows:

OPCo - The PUCO continues to demonstrate a credit supportive view for utilities operating in the state. In March 2016, the PUCO unanimously approved a stipulation agreement related to OPCo’s application for approval of a power purchase agreement (PPA) with its affiliate AEP Generation Resources (AGR: unrated), which was intended to support the retention of generation in the state of Ohio. However, in April 2016, in response to filed complaints, the Federal Electric Regulatory Commission (FERC) rescinded AEP’s affiliate waivers and determined that the PPA between OPCo and AGR was subject to its review. As a result, management does not intend to pursue the affiliate PPA and instead filed for re-hearing of the March order to clarify / modify the remaining provisions of the settlement accordingly. In November, the PUCO approved OPCo’s request to modify the settlement agreement as proposed, including authorization of rider recovery for the difference between the costs and revenues associated with its 19.93% contractual entitlement to the output of two coal plants owned by the Ohio Valley Electric Corporation (OVEC) being sold into the PJM Interconnection market.

APCo (Virginia) - In October 2016, the VSCC concluded APCo’s generic return on equity (ROE) proceeding, initiated in March, by determining that a 9.4% base ROE should be utilized under any rate adjustment clause mechanism until its next rate case. The approved ROE is near the top of the range of 8.5% to 9.5% the VSCC determined was reasonable. APCo initially proposed a 10.43% ROE in its request for a determination of the base ROE to be used for annual adjustments under the G-RAC, the company’s energy efficiency rate adjustment clause and any other clauses approved by the company. The G-RAC relates to APCo’s investments in the 580 MW Dresden Energy Facility, and for which APCo had filed for a $3.4 million revenue requirement increase in March 2016, premised on a 10.7% ROE (9.7% approved in 2014 plus 100 basis point premium). A settlement was reached in September 2016 allowing for a $3.4 million G-RAC revenue requirement increase based on a 10% ROE, that will now be adjusted to reflect the 9.4% base ROE (plus 100 basis point premium) approved in the generic ROE case. The final decision in the G-RAC proceeding is expected by the end of November.

In February 2015, Virginia enacted legislation temporarily suspending its required biennial review of investor-owned utility earnings, effectively freezing rates for APCo through the 2017 test year. Biennial reviews are to begin again in 2020 addressing results for the 2018 and 2019 test years. This is positive for APCo considering its last biennial review decision (issued November 2014) found that for the 2012 and 2013 test years APCo had on average earned an 11.86% ROE, which was above the upper end of the 10.4%-11.4% allowed range established for those years. APCo was required to make refunds totaling $5.8 million, and the commission set a baseline ROE of 9.7% for the biennial review for 2014 and 2015 which is significantly below the prior 10.9% baseline (although the allowable range was widened so the upper boundary would have been 10.4%). As the biennial reviews have been suspended, no refunds will be required in the event of over earning until the next review in 2020.

In February 2016, some APCo industrial customers filed a petition with the VSCC requesting a declaratory order finding the amendments to Virginia law suspending biennial reviews unconstitutional and directs APCo to make biennial review filings beginning in 2016. Oral arguments at the VSCC were held in March 2016 and the industrial petition was denied. The customers have filed an appeal to the Virginia Supreme Court, where a similar case was filed related to another utility. A reinstatement of the biennial review process in advance of March of 2020 would likely reduce future cash flows and coverage metrics. For example, based on the difference between earned and allowed ROE noted above, we estimate reinstatement of the biennial process could cause APCo’s ratio of cash from operations excluding changes in working capital (CFO Pre-WC) to debt to be 0.5 – 1.0 percentage points lower.

APCo (West Virginia) - In May 2015, the WVPSICC voted to authorize APCo’s pending base rate case averaging a $99 million ($85 million for APCo / $14 million for Wheeling Power Company (WPCo)) rate increase based on a 9.75% ROE. The initial case was filed almost a year prior in June 2014 requesting a $226 million increase in annual revenues based on a 10.62% ROE. The WVPSICC’s order also included the delayed billing of an additional $25 million ($22 APCo / $3 million WPCo) to residential customers until July 2016. On a positive note, the order included approval of an annual vegetation rider of $45 million ($38 million APCo / $7 million WPCo), revised depreciation rates and recovery of $89 million in previously recorded regulatory assets over five years. The May 2015 order also resolved an ongoing ratemaking issue concerning the WVPSICC’s approach to consolidated tax adjustments (CTA). The order, which was
upheld on reconsideration in July of 2015, resolved that losses used in the CTA would be limited to those generated by APCo's parent company, AEP, rather than including the losses at non-parent affiliated subsidiaries. This resolution should allow more opportunity for APCo to earn its allowed return in West Virginia.

PSO - In November 2016, the OCC issued a final order in PSO’s rate case, initially filed in July 2015, approving a base revenue increase of $14.5 million based on a 9.5% ROE. The order also approved deferred accounting for environmental compliance plan investment costs of approximately $27 million, and recovery of consumables through the fuel adjustment clause of approximately $4 million, bringing the total financial impact of the decision to approximately $45 million. As PSO had implemented an interim rate increase of $75 million in January 2016, it will now have to refund approximately $56 million to its customers. PSO initially requested to increase annual revenues by $137 million based on a 10.5% ROE in order to recover costs associated with its environmental compliance plan and other rate base additions. In addition to the ROE differential, the primary driver of the difference between the requested and authorized amounts relates to the timing of recovery of environmental compliance costs for projects that were not in service by the date required by the OCC. The assets are now in service and we expect PSO to file a new rate case in 2017.

For more details regarding any of AEP’s subsidiaries regulatory updates please refer to their pages on Moodys.com.

Substantial investments in regulated transmission networks and environmental mandates

AEP has been investing heavily to meet stringent environmental compliance requirements and to assure reliability throughout its service territories. High capital investment levels are expected to continue and the company has announced a program of approximately $17.3 billion for 2017 through 2019. All of the total $17.3 billion will be allocated to regulated businesses and contracted renewables as follows: transmission about 52%, distribution 22%, regulated generation 13%, contracted renewables 6%, corporate 4% and regulated renewables 3%. AEP’s average projected capital investments of approximately $5.8 billion per year for 2017 through 2019 is a modest increase when compared to the over $5 billion expected to be spent in 2016 and $4.6 billion spent in 2015, but a substantial increase from the $3.1 billion invested in 2012 and $2.8 billion in 2011. Transmission and distribution (T&D) investments are expected to be recovered largely either through the transmission formula based rates or rider recovery, a credit positive. Generation investment is primarily recovered in base rates and more susceptible to lags in recovery. Given the sheer magnitude of the investment program, we anticipate intermediate term credit metrics could deteriorate somewhat. An offset to this downward pressure is the multi-year extension of bonus depreciation benefits, which will add to cash flow over the near-to-medium term and help to maintain coverage metrics that are appropriate for the rating.

Additional debt financing for capex spend will put downward pressure on financial metrics - mitigated by the primarily lower risk nature of the investments in transmission and distribution

AEP’s key financial metrics remain appropriate for its rating category. As of the last twelve months ending (LTM) Q3 2016, AEP’s adjusted three year average interest coverage ratio was 5.9 times and CFO pre-WC to debt was 21.6%, both strong for the “Baa” scoring range for this factor indicated in our rating methodology for standard risk regulated electric and gas utilities. Total adjusted consolidated debt has increased to $22.8 billion at September 30, 2016 from around $21 billion in 2013, a trend we expect to continue going forward mainly due to the required funding of capital expenditures. For the following 18-24 months we expect AEP’s financial metrics to deteriorate slightly but remain within its rating category, including an interest coverage ratio in the 4.5x-5.5x range and CFO pre-WC to debt in the high teens to low twenty percent range.

As of December 31, 2015, AEP had long-term parent level debt obligations of about $1.4 billion, or 7% of AEP’s total debt. These parent level obligations are made up of about $830 million of holding company debt and $590 million in debt guaranteed by the parent for its competitive business AGR. Debt at AGR is expected to be repaid following the sale of merchant generating facilities in Ohio. AEP is also dedicated to growing its transmission footprint through AEP Transco and several joint ventures (JVs). AEP Transco is fully regulated by the FERC and had debt of about $1.8 billion, or about 8% of AEP’s total debt as of Q3 2016.

We do not apply any structural subordination notching to AEP’s Baa1 rating relative to the average credit quality of its rated subsidiaries due to the diversity and the stability of AEP’s operating subsidiaries cash flows. It is our view that the modest level of parent holding company debt, and debt guaranteed by the parent, relative to total consolidated debt does not merit any structural subordination notching.
Liquidity Analysis

AEP's liquidity is adequate. Although we anticipate its significant investment program will result in negative free cash flow for the foreseeable future, the company has demonstrated capital markets access and its credit facilities currently provide adequate protection. For the twelve months ending September 30, 2016, AEP generated approximately $4.3 billion of cash from operations (CFO), invested $4.8 billion in capital expenditures and paid $1.1 billion in dividends resulting in a negative free cash flow (FCF) of approximately $1.6 billion. In 2015, AEP generated approximately $4.8 billion of CFO, invested $4.6 billion in capital expenditures and paid $1.1 billion in dividends resulting in a negative FCF of approximately $900 million. Going forward, given AEP's substantial level of planned capital expenditures, we anticipate the company will continue to generate negative free cash flow, which will be funded via a combination of internal and external sources including debt financing and sales proceeds.

AEP has two syndicated credit facilities totaling $3.5 billion. In June 2016, its $1.75 billion facility expiring in June 2017 was amended to $3.0 billion expiring in June 2021, with a $1.2 billion letter of credit sub-limit. Its other $1.75 billion facility expiring in July 2018 was amended to $500 million expiring in June 2018. As of September 30, 2016, AEP had $728.3 million of commercial paper outstanding and no letters of credit outstanding under the facilities.

AEP is not required to make a representation with respect to either material adverse change or material litigation in order to borrow under the facilities. Default provisions exclude non-significant subsidiaries' (including AGR) cross-default and insolvency/bankruptcy provisions. The facilities contain a covenant requiring that AEP's consolidated debt to capitalization (as defined) not to exceed 67.5%. AEP states the contractually defined ratio was 52.7% at September 30, 2016. Pro-forma for the impairment of its remaining merchant generating assets, the ratio increases to about 55%.

Including securitization bonds, put bonds and other amortizations, AEP has debt maturities of about $2.7 billion in 2017. AEP has a receivables securitization agreement of $750 million that expires in June 2018.

Corporate Profile

American Electric Power Company, Inc. (AEP: Baa1 stable), headquartered in Columbus, Ohio, is a large electric utility holding company with ten vertically integrated or retail transmission and distribution utility subsidiaries operating in eleven states. The company also operates transmission companies within the eastern and southwestern regions of the United States and owns a predominately Ohio based competitive generation and marketing business which has been partially sold and for which it is evaluating strategic alternatives. AEP has a regulated rate base of approximately $32 billion and serves about 5.4 million customers across eleven states. In 2016, the company's total generation capacity of about 35,000 MW (including power purchase agreements, approximately 6,752 MW of competitive generating assets, and reflecting about 750 MW of coal to gas conversions expected to be completed in 2016), is about 52% coal/lignite fired. For 2015, AEP's regulated retail revenue composition by customer class was about 41% residential, 24% commercial, 19% industrial, 13% wholesale and 3% other.
Rating Methodology and Scorecard Factors

Exhibit 3

Rating Factors

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>Regulated Electric and Gas Utilities Industry Grid [1][2]</td>
<td></td>
</tr>
</tbody>
</table>

Factor 1: Regulatory Framework (25%)
- a) Legislative and Judicial Underpinnings of the Regulatory Framework A A
- b) Consistency and Predictability of Regulation A A

Factor 2: Ability to Recover Costs and Earn Returns (25%)
- a) Timeliness of Recovery of Operating and Capital Costs Baa Baa
- b) Sufficiency of Rates and Returns Baa Baa

Factor 3: Diversification (10%)
- a) Market Position A A
- b) Generation and Fuel Diversity Baa Baa

Factor 4: Financial Strength (40%)
- a) CFO pre-WC + Interest / Interest (3 Year Avg) 5.5x A
- b) CFO pre-WC / Debt (3 Year Avg) 21.6% Baa
- c) CFO pre-WC - Dividends / Debt (3 Year Avg) 16.8% Baa
- d) Debt / Capitalization (3 Year Avg) 43.5% A

Rating:
- Grid-Indicated Rating Before Notching Adjustment Baa1
- HoldCo Structural Subordination Notching Baa1
- a) Indicated Rating from Grid Baa1
- b) Actual Rating Assigned Baa1
- Moody’s 12-18 Month Forward View
  - As of Date Published [3]
    - Measure Published Score
      - A A
      - Baa Baa
      - Baa Baa
      - A A
      - Baa Baa
      - 5x - 5.5x A
      - 5% - 10% Baa
      - 13% - 16% Baa
      - 43% - 47% Baa

[2] As of 9/30/2016(L)
[3] This represents Moody’s forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.
Source: Moody’s Financial Metrics

Ratings

Exhibit 4

<table>
<thead>
<tr>
<th>Category</th>
<th>Moody’s Rating</th>
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<tr>
<td>Jr Subordinate Shelf</td>
<td>(P)Baa2</td>
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<tr>
<td>Commercial Paper</td>
<td>P-2</td>
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<tr>
<td>SOUTHWESTERN ELECTRIC POWER COMPANY</td>
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<tr>
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<td>Issuer Rating</td>
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<tr>
<td>Senior Unsecured</td>
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<tr>
<td>APPALACHIAN POWER COMPANY</td>
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<tr>
<td>Outlook</td>
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<td>Issuer Rating</td>
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</tr>
<tr>
<td>Senior Unsecured</td>
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</tr>
<tr>
<td>INDIANA MICHIGAN POWER COMPANY</td>
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<tr>
<td>Senior Unsecured</td>
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<tr>
<td>COLUMBUS SOUTHERN POWER COMPANY</td>
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<tr>
<td>Outlook</td>
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<td>Senior Unsecured</td>
<td>Baa1</td>
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<td>Outlook</td>
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<td>---------------------------------------</td>
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</tr>
<tr>
<td>OHIO POWER COMPANY</td>
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<tr>
<td>PUBLIC SERVICE COMPANY OF OKLAHOMA</td>
<td>Stable</td>
</tr>
<tr>
<td>AEP TRANSMISSION COMPANY, LLC</td>
<td>Stable</td>
</tr>
<tr>
<td>AEP TEXAS CENTRAL COMPANY</td>
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<tr>
<td>RGS (AEGCO) FUNDING CORPORATION</td>
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<tr>
<td>RGS (I&amp;M) FUNDING CORPORATION</td>
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<tr>
<td>KENTUCKY POWER COMPANY</td>
<td>Stable</td>
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<tr>
<td>AEP TEXAS NORTH COMPANY</td>
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Source: Moody's Investors Service
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Corporates

Freeport’s Sale of Gulf of Mexico Oil and Gas Properties Is Credit Positive

Last Tuesday, Freeport-McMoRan Inc. (B1 negative) said that it had reached a deal to sell its deep water Gulf of Mexico oil and gas properties to Anadarko Petroleum Corp. (Ba1 negative) for $2 billion, with up to $150 million in additional contingent payments. The sale is credit positive for Freeport because it will reduce the company’s debt, improve cash flow generation, and increase the company’s focus on its core copper-mining business.

The sale proceeds, net of $582 million to be paid to the oil and gas business preferred shareholders, will be used to reduce debt, improving the company’s leverage. We estimate that Freeport’s Moody’s-adjusted debt/EBITDA ratio will be around 6x for 2016, compared with 9.5x for the 12 months that ended 30 June, with further improvement likely in 2017. Should the company achieve this degree of leverage reduction, we could change Freeport’s ratings outlook to stable.

Freeport, the world’s second-largest producer of copper and largest producer of molybdenum, struggled with the precipitous drop in copper, oil and gas prices in 2015 and early 2016. The Gulf of Mexico assets sale will allow the mining company’s strong cash flow generation from its copper assets to go toward improving the balance sheet. The company’s free cash flow generation will benefit from lower capital expenditures, which totaled $1.6 billion for Gulf of Mexico properties during the 12 months that ended 30 June. Anadarko has also agreed to assume the asset-retirement obligations associated with the properties, which had a combined book value of approximately $500 million as of 30 June.

Including the Gulf of Mexico properties, Freeport has announced asset sales of more than $6 billion this year, surpassing the requirement in its revolving credit facility that it sell $3 billion in assets by the end of 2016 or be required to secure the credit line. Freeport previously announced the sale of its interests in the Tenke mine in the Democratic Republic of Congo for $2.65 billion, an additional 13% interest in its Morenci mine in Arizona to its joint venture partner Sumitomo Metal Mining Co. Ltd. for $1 billion, and several smaller sales totaling $400 million.

The Gulf of Mexico properties generated $1 billion in revenue for the 12 months that ended 30 June, or approximately 62% of Freeport’s oil and gas segment revenues. However, the company’s copper mines in North and South America and Indonesia are the primary drivers of its revenue, earnings and cash flow, and we expect the loss of EBITDA to be more than offset by the strengthening of the balance sheet.

For the 12 months that ended 30 June, the company sold approximately 4.3 billion pounds of copper and 51.5 million barrels of oil equivalents, generating $14.6 billion in revenue. Operational issues that lowered mining and milling rates at its Indonesian operations hurt the company’s first-half performance, but the volume should be made up over the next several quarters. For 2016, Freeport estimates copper segment EBITDA of $4.5 billion, assuming a copper price of $2 per pound, and estimates capital expenditures for the mining segment of $1.7 billion.
Fertilizer Merger Is Credit Positive for Agrium, Credit Negative for PCS

Last Monday, Agrium Inc. (Baa2 review for upgrade) and Potash Corporation of Saskatchewan Inc. (PCS, A3 review for downgrade) agreed to an all-equity merger of equals to form a combined company with annual revenues of nearly $20 billion and an enterprise value of $36 billion. The companies estimate some $500 million in annual synergies for the combined company within two years. PCS shareholders will own about 52% of the unnamed new company and Agrium shareholders about 48%.

The transaction, which comes during a rough patch in the fertilizer industry, is credit positive for Agrium, which is merging with a company with stronger credit quality and high-quality assets, but credit negative for PCS, keeping its debt/EBITDA ratio above 2.0x for an extended period. Fertilizer producers today face tight spending by farmers because of low crop prices, with capacity additions further depressing fertilizer prices through at least 2018. Following the announcement, we placed PCS’ ratings on review for downgrade and Agrium’s on review for upgrade.

Since PCS has traditionally kept its leverage well below 2.0x when fertilizer prices are high, the combined company will likely have stronger financial metrics than Agrium on its own. The new company will draw most of the $500 million in annual synergies by selling PCS’ fertilizers through Agrium’s retail stores, while also shifting production to lower-cost sites and reducing corporate and procurement costs. Both PCS and Agrium have recently invested heavily in their infrastructure, cutting their capital spending needs.

Still, the ongoing downturn for fertilizer producers limits the new company’s deleveraging by reducing its earnings and free cash flow. Substantial US nitrogen fertilizer capacity is scheduled to come onstream in 2016-17, and potash capacity additions from Germany’s K+S AG (Ba1 stable) and from Russia in 2018-19 will restrain nitrogen and potash prices through at least 2018.

The combined entity would be the world’s largest crop nutrient company and North America’s second-largest nitrogen producer, and operate the largest global retail and distribution network for fertilizers. It would also have a more balanced earnings profile than either company had separately (see Exhibit 1). The stronger vertical integration of the new company’s $34 billion in assets will help stabilize its earnings and cash generation. Both companies have relatively low production costs, especially for nitrogen fertilizers, because of low natural gas feedstock prices in North America and the Caribbean.

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**EXHIBIT 1**

Comparison of Agrium’s, PCS’ and Combined Company’s Three-Year Average EBITDA

<table>
<thead>
<tr>
<th></th>
<th>Potash</th>
<th>Phosphate</th>
<th>Nitrogen</th>
<th>Retail</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agrium</td>
<td></td>
<td>48%</td>
<td>36%</td>
<td>10%</td>
</tr>
<tr>
<td>PCS</td>
<td>33%</td>
<td>51%</td>
<td>16%</td>
<td>12%</td>
</tr>
<tr>
<td>New Company</td>
<td>19%</td>
<td>35%</td>
<td>34%</td>
<td>12%</td>
</tr>
</tbody>
</table>

Sources: Agrium and PCS

Agrium generated about $14 billion in revenues for the 12 months through 30 June 2016, with EBITDA of about $2.2 billion. PCS had only about $4.7 billion in revenues for that period, but it had much higher...
margins than Agrium, with EBITDA of $1.9 billion. Agrium’s retail sales offer more stable earnings, but at far lower margins than its wholesale fertilizers.

The lower leverage and strong cash generating capabilities will help the combined entity manage the current agricultural industry downturn more effectively and invest in growth through acquisitions and capital improvements as needed. The merger implies lower debt leverage once synergies kick in. But at first, the deal implies a debt/EBITDA ratio of about 2.8x, which is a slight weakening for PCS, which had a ratio of 2.7x as of 30 June 2016, and a slight gain for Agrium from 2.9x. Synergies would imply an overall improvement to about 2.5x for both companies (see Exhibit 2), but declining nitrogen fertilizer prices will likely keep the combined group’s leverage at about 2.7x in 2017.

**EXHIBIT 2**

Agrium’s and PCS’ Combined Company Leverage Will Strengthen with Synergies

<table>
<thead>
<tr>
<th></th>
<th>EBITDA</th>
<th>Debt</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agrium</td>
<td>$2.2</td>
<td>$6.3</td>
</tr>
<tr>
<td>PCS has</td>
<td>$1.9</td>
<td>$5.1</td>
</tr>
<tr>
<td>New Company Without Synergies</td>
<td>$4.1</td>
<td>$11.5</td>
</tr>
<tr>
<td>New Company With Synergies</td>
<td>$4.6</td>
<td>$11.5</td>
</tr>
</tbody>
</table>

Sources: The companies and Moody’s Financial Metrics
Bayer and Monsanto’s Merger Is Credit Negative for Both

Last Wednesday, Germany’s Bayer AG (A3 review for downgrade) announced that it had signed a definitive agreement to acquire the Monsanto Company (A3 review for downgrade) for $128 per share in an all-cash transaction that values Monsanto at $66 billion including net debt. The acquisition is credit negative for both companies because it would significantly increase financial leverage. Following the announcement, we placed Monsanto’s ratings on review for downgrade. Bayer’s rating has been on review for downgrade since May, when the acquisition was first announced.

The transaction price is around 5% higher than the price Bayer initially offered Monsanto in May. The increase is more than offset by the larger equity component of approximately $19 billion (or 29% of the transaction’s value), which Bayer intends to raise to finance the deal through the issuance of mandatory convertible bonds, which we expect to evaluate as 100% equity in our credit analysis, and a rights offering. However, we estimate that on a pro forma basis, Moody’s-adjusted total debt/EBITDA ratio for the combined company will rise to roughly 4.0x at the end of 2017, from 2.2x for Bayer as of 30 June and 3.2x for Monsanto as of 31 May 2016. Significantly, the acquisition illustrates Bayer’s willingness to tolerate higher financial leverage, at least for the next three to four years.

Bayer agreed to pay 18.6x (based on EBITDA for the 12 months to 31 May 2016) for Monsanto’s products and technology pipeline, an especially hefty multiple when crop prices are low and farmer incomes greatly reduced. Bayer believes it will generate $1.2 billion in cost synergies and $300 million in sales synergies within three years. However, a strong US harvest, high inventories of agricultural chemicals, and the short-lived boost from Brazil’s weak harvest earlier this year all dim Monsanto’s growth prospects for 2017-18.

Agribusiness companies today are relying on new seeds and a recovery in farmer spending in 2017. But crop prices and farmer spending cannot increase sustainably without bad harvests in both the US and Brazil, and GM crops are raising farmers’ resilience to drought and improving their yields. With bad harvests less likely, Bayer will have more trouble increasing growth, maximizing synergies and quickly reducing debt.

The Bayer-Monsanto proposal, the largest acquisition in the chemical industry to date, poses significant execution and reputational risks given its size, both in terms of its monetary value and the scale of the acquired operations. In particular, financing for the acquisition will include a large rights issue relative to the size of past equity raises by European corporates. Additionally, given the wave of consolidation in the agribusiness industry, the Bayer-Monsanto merger is likely to undergo scrutiny by antitrust authorities around the world, and particularly in the European Union and US. Pending consolidation deals include the merger of The Dow Chemical Company (Baa2 stable) with E.I. du Pont de Nemours and Company (A3 negative) announced in December 2015, and ChemChina’s (unrated) February 2016 agreement to purchase Syngenta AG (A2 review for downgrade).

Bayer’s and Monsanto’s managements stress the complementary nature of their portfolios. We believe that although regulators may require some divestitures to reduce the combined group’s market shares in cotton or canola seeds, or glyphosate herbicide, these overlaps are not material to the combined businesses. However, regulators will focus on whether the sector consolidation results in reduced product innovation or more limited choices and higher prices for farmers.

Still, the deal makes strategic sense and comes when declining commodity prices and farming income, and heightened emerging market volatility negatively affect the agrochemical sector. The combination of Bayer’s crop science business with Monsanto will create the world’s largest player in the agricultural chemical and seeds sector, with 2015 pro forma sales of around €23 billion. Additionally, Monsanto’s top position in global seeds fits well with Bayer’s stronger focus on crop protection chemicals, and will create a well-balanced portfolio in terms of products and geographies. This should benefit the long-term growth and profitability of Bayer’s agricultural business.
Telia Must Pay $1.4 Billion to Settle Fraud Claim in Uzbekistan

Last Thursday, US and Dutch authorities ordered Sweden-based Telia Company AB (Baa1 stable) to pay approximately $1.4 billion (SEK12 billion) to settle claims of fraud in Uzbekistan. The allegations relate to Telia’s transactions when it entered Uzbekistan in 2007.

The $1.4 billion fine is credit negative and higher than our projected fine of up to $800 million. In addition to being one of the largest fines ever levied under the US Foreign Corrupt Practices Act, it is nearly twice the $795 million settlement VimpelCom Ltd (Ba3 stable) recently paid in a similar case in Uzbekistan.

Despite the size of the fine, we estimate that Telia’s Moody’s-adjusted gross debt to EBITDA would only increase to around 3.3x from 3.1x following this payment. Telia had around SEK16 billion in cash as of 30 June 2016, so funding the settlement is not a liquidity issue. The slight deterioration in Telia’s financial ratios and a marginal increase in its financial risk will not affect its Baa1 rating and stable outlook.

We believe that Telia’s credit metrics will not materially improve in the next two years because the company’s guidance for 2016 EBITDA is the same or slightly above its SEK25.1 billion in 2015. In the absence of substantial EBITDA growth, and with a dividend policy of 80% pay-out of free cash flow, there is little room for organic debt reduction to improve leverage.

Telia’s investments in Uzbekistan have been under investigation for bribery and money laundering by the Swedish Prosecution Authority, the US Department of Justice, the US Securities and Exchange Commission and the Dutch authorities since the spring of 2014. Telia’s management has been trying to sell its Uzbekistan subsidiary, as well as subsidiaries in Kazakhstan, Azerbaijan, Georgia and Moldova since September 2015. The company claims that there are significant unsolved legacy issues such as unwanted partner relationships in Uzbekistan and Azerbaijan, and difficulties with cash repatriation mainly in Uzbekistan. The subsidiaries also exposed Telia to the region’s foreign currency volatility. By selling these Eurasian assets, the company will avoid these risks.

The negative element of the sales is that they reduce the group’s scale and geographical diversification; Eurasia generated around 20% of the company’s consolidated revenues, 30% of its EBITDA for 2015 and was net cash positive. Even if all proceeds from the sales were used to repay debt, group metrics would not materially improve.

Telia Company is the Swedish and Finish incumbent telecom service provider. Sweden’s government has a 37.3% stake in the company, and the Finnish government has a 3.2% stake.
KazTransGas' Sale of Its Georgian Subsidiary Would Be Credit Positive

Last Wednesday, JSC KazTransGas (KTC, Baa3 negative), Kazakhstan’s national gas pipeline operator, confirmed that it is considering a sale of its Georgian subsidiary JSC KazTransGas-Tbilisi (KTGT) to Georgian Industrial Group (unrated). The company is negotiating the details of the transaction and the deal should close this year. This transaction is credit positive for KTG because it will dispose of an asset that it has not been able to control since 2009, and will strengthen KTG’s liquidity.

KTGT was founded in 2006 as a 100%-owned KTG subsidiary in accordance with the terms of an agreement between KTG and the Georgian Economy Ministry. KTGT purchased a monopoly gas distributor in Georgia’s capital city of Tbilisi for $12.5 million the same year, and invested about $130 million in 2006-09 into Georgia’s gas distribution system. In 2009, Georgian Oil and Gas Corporation (unrated) filed a lawsuit against KTGT to recover $40 million of overdue debt, which KTG disputed. That same year, following a Georgian court ruling, the country’s national regulatory commission on energy and water supply dismissed KTGT’s general manager, replacing him with its own appointee. Since that time, KTG formally lost control of KTGT despite owning 100% of it.

The issue of KTG restoring control over KTGT was the subject of multiple intergovernmental discussions between Georgia and Kazakhstan during 2009-15, but no progress has been made since then. In September 2015, KTG submitted a pre-arbitrage notice to the Georgian government, suggesting both sides negotiate the issue and emphasizing that it had a right to initiate an international arbitration process. We view this asset sale as a better alternative to a lengthy and costly international arbitration process.

The transaction would also strengthen KTG’s liquidity. Although the deal’s value has not been disclosed, we estimate that KTG will generate $30-$50 million from the sale of this stranded asset. As of 30 June 2016, KTG had $260 million in cash and short-term deposits and total debt of about $939 million, of which $546 million was long-term debt mainly composed of $444 million of borrowings from its parent KazMunayGas NC JSC (KMG, Baa3 negative), and Kazakh tenge-denominated bonds equal to $40 million, none of which are subject to financial covenants.

KTG also has short-term debt of $393 million, composed of $127.8 million of Eurobonds due in May 2017 at subsidiary Intergas Central Asia (ICA, Baa3 negative), $75 million of financial aid from KMG due for repayment in December 2016, and the remainder composed of short-term bilateral credit facilities. In July 2016, KTG used $140 million from about $335 million under loan agreements signed with the European Bank for Reconstruction and Development (EBRD) in May 2016 and which matures in 2023, thereby refinancing a substantial part of its short-term debt.

We do not expect KTG to generate material free cash flow in 2016 because of its substantial capex. As such, an increase of its cash balance following the disposal of KTGT would reduce its reliance on the EBRD loan or support from its parent in fulfilling its short-term debt obligations. ICA has an incurrence financial covenant on its remaining Eurobonds of dividends/net income not exceeding 0.5x, while bilateral credit facilities totalling about $87 million have financial covenants of debt/EBITDA not exceeding 4.5x and debt/equity not exceeding 1.5x. The EBRD loan also has financial covenants. The company as of 30 June 2016 was in compliance with its covenants.
Nassa Finco’s Planned IPO Is Credit Positive

Last Tuesday, Nassa Finco AS (Nets, B2 review for upgrade), Scandinavia’s largest payment processor, announced its intention to raise DKK5.5 billion in an initial public offering (IPO) on Nasdaq Copenhagen. The IPO is credit positive because the company will use the offering proceeds alongside its own cash to repay a payment-in-kind (PIK) loan of DKK4.2 billion as of 30 June 2016 issued by Nets parent Nassa Holdco AS and to refinance existing bank facilities with new loans of a smaller amount.

Pro forma for the transaction, we expect that Nets’ adjusted gross leverage (including our adjustments for operating leases and capitalized development costs) as of the end of 2016 will decrease toward 5.0x from our earlier estimate of nearly 6.0x. The lower leverage reflects a reduction in Nets’ outstanding loans to DKK9.0 billion from DKK10.4 billion as of 30 June 2016 as the company uses balance-sheet cash and IPO proceeds to reduce bank debt.

We expect further deleveraging in 2017 by at least half a turn as a result of continued improvement in operating performance and a significant reduction in reorganization and restructuring costs, which accounted for 7.0% of sales in 2014 and 7.5% in 2015. Nets has publicly stated its target to reduce net leverage (as reported by the company) to 2.0x-2.5x, assuming no acquisitions, from the company’s estimate of 3.75x at the point of the IPO and from 5.5x based on 2013 EBITDA pro forma for the acquisition of Nets by its current shareholders. We believe the company can achieve its target by 2018 at the earliest. Bain Capital, Advent International and Danish pension fund ATP acquired Nets in 2014 from a consortium of banks. Bain and Advent each own 47% of Nets, while ATP owns 6%.

In addition to reducing senior leverage, the IPO will remove the large PIK facility, which Nassa Holdco issued and ATP lent for a notional amount of DKK3.3 billion in 2014. The facility, which accrues at a high 13% margin over the Copenhagen Interbank Offered Rate (CIBOR), has been excluded from our leverage calculations because it lies outside the banking group of which Nets is the top entity. However, Nets’ loose additional indebtedness covenants in the legal documentation allow the company to re-lever to repay the PIK, an option that has been a drag on Nets’ credit quality. An early repayment of the PIK loan is compelling for Nets’ largest shareholders, Bain Capital and Advent (see exhibit), because the facility is growing rapidly and diluting the company’s equity.
Nets’ IPO is noteworthy because it comes approximately two and a half years after Bain and Advent acquired the company, and in part reflects the significant progress that it has made in turning around its business. We believe Nets can sustain organic revenue growth of 3%-5% per year over the next three years, compared with 1% growth recorded in 2014, and further improve EBITDA margins (as reported by the company, before restructuring and reorganization charges) to above 35% from 25.4% in 2014.
Wm Morrison’s First Half Results and Deleveraging Are Credit Positive

Last Thursday, UK grocer Wm Morrison Supermarkets plc (Morrisons, Baa3 stable) announced credit-positive results for its fiscal first half, which ended 31 July 2016. Morrisons reported stronger profits and cash flows than prior comparables and lower net debt than at the fiscal 2016 year-end (31 January 2016). The positive momentum in key metrics such as like-for-like (LFL) sales, transaction volumes and underlying profit margins all demonstrate the company’s successful execution of its operational and financial strategy.

The LFL sales growth (excluding fuel) of +2.0% in the second quarter is the strongest of three consecutive quarters of positive LFLs following 14 quarters of negative LFL sales. The turnaround is noteworthy given the highly competitive grocery market, with discounters Aldi and Lidl actively opening stores and taking market share from the established Big Four, Tesco plc (Ba1 stable), J Sainsbury plc (unrated), Asda (an unrated subsidiary of Wal-Mart Stores, Inc. (Aa2 stable)), and Morrisons. The ongoing improvement in Morrison’s underlying sales coupled with improved operating margins is therefore credit positive.

During the 2017 fiscal first half the company closed seven underperforming stores, with the negative effect on revenues offsetting the LFL gains and leaving total revenue at £8.03 billion, essentially flat against the 2016 fiscal first half. However, ongoing cost savings, which management said were £189 million, supported recovery in the reported underlying operating profit margin to 2.6%, compared to 2.0% in the first half of fiscal 2016 and 2.2% in the 2016 fiscal second half.

The company has also continued to make progress in planned working capital efficiencies and disposals of surplus property. Cumulative working capital savings over the past two and a half years now exceed the stretched medium term target of £800 million announced with the fiscal 2016 its medium-term target to £1 billion of cumulative savings. The company is also on track to meet or exceed its property disposal and cost saving targets for the three years to 31 January 2017.

The improvements in cash flow, notably in working capital, has meant that reported net debt of £1.27 billion at 31 July 2016 is lower than the company’s previously announced fiscal 2017 year-end target of £1.4-1.5 billion. The company updated year-end guidance for net debt to around £1.2 billion and expects it to fall to less than £1 billion by the end of fiscal 2018.

The company’s early redemption of £326 million of bonds contributed to a reduction in Morrison’s Moody’s-adjusted gross leverage ratio, which we estimate is now around 3.5x, versus 4.2x at the fiscal 2016 year end and our previous expectations of around 3.6x-3.7x over the next 12 months. Based on our expectations of further moderate profit growth over the next 12-18 months and some additional reduction in gross debt, we expect leverage to reduce, which, with ongoing operational momentum, would put upward pressure on the company’s rating.
Parkson’s Disposal of Loss-Making Beijing Store Is Credit Positive

On 13 September, Parkson Retail Group Limited (B2 negative) announced that it had agreed to sell its Beijing Sun Palace property for a total consideration of approximately RMB2.32 billion. The transaction, which the company expects to close by the end of this year and provide RMB1.9 billion in net proceeds, is credit positive because it improves Parkson’s net debt position and strengthens its liquidity, which gives the company more time to turn around its operations.

Parkson plans to use the proceeds to enhance its product and service offerings, especially through the expansion of its fashion and food and beverage brands, and to explore new opportunities to expand its revenue streams. Until it identifies such opportunities, it will deposit the proceeds with banks. We estimate that with the sale proceeds, Parkson’s adjusted retained cash flow to net debt will improve to around 8% in 2016 from 7% in 2015.

The transaction also includes a shareholders’ loan transfer of RMB650 million. However, this transfer will not reduce Parkson’s reported debt of RMB4 billion as of 30 June 2016, because the loan had been accounted for as intercompany and thus eliminated on a consolidated basis. With the asset sale, the company will monetize a store that has been loss making since opening in December 2010. The sale proceeds will comprise RMB2.32 billion in cash, cash on hand as of the completion date, plus expected refunds of advanced rental taxes paid through 31 August 2023 of around RMB19.5 million.

As of 30 June 2016, the company’s cash and deposits of RMB2.8 billion could cover its short-term debt of RMB729 million, although this amount will be eroded by its negative free cash flow, which we estimate at around RMB400 million this year. The company also has a RMB3.2 billion US dollar bond due in May 2018. The sale proceeds will strengthen its cash buffer, improving Parkson’s positioning to turn around its operations and refinance its debt.

Our negative rating outlook reflects the challenging conditions in China’s (Aa3 negative) retail market and uncertainty over Parkson’s ability to improve its revenue and profitability. The company’s operating revenue declined by 7% and its adjusted EBITDA margins (as a percentage of gross sales proceeds) fell 1.6 percentage points to 10.1% year on year in the first half of 2016. We expect this trend to continue in the next 12-18 months, weakening Parkson’s credit metrics.
Frasers Hospitality Trust’s Equity-Funded Acquisition of Australian Hotel Is Credit Positive

On 9 September, Singapore-based Frasers Hospitality Trust (FHT, Baa2 stable) said that it would raise gross proceeds of approximately SGD266 million from an underwritten and renounceable rights issue to fund its proposed acquisition of Novotel Melbourne on Collins for about AUD237 million (approximately SGD245 million). The equity-funded acquisition is credit positive for FHT because it will decrease the trust’s leverage and increase its diversification in Asia-Pacific.

We expect FHT’s adjusted debt/total deposited assets to decline to around 36% from 41% on a pro forma basis as of 30 June 2016, while adjusted normalized net debt/EBITDA will improve to around 7.5x from 8.7x for the 12 months to 30 June 2016 (see Exhibit 1). Additionally, the trust’s adjusted normalized EBITDA/interest expense will improve to around 5.0x from 4.8x for the 12 months to 30 June 2016.

EXHIBIT 1
Frasers Hospitality Trust’s Leverage

Frasers Centrepoint Limited (unrated), the trust’s sponsor, has committed to subscribe about SGD7.5 million of the rights issue, while strategic investor TCC Group Investments Ltd. (unrated) has committed to subscribe to SGD103.4 million. Additionally, TCC will subscribe to another SGD24.6 million of rights via an excess application option. DBS Bank Ltd. and Citigroup Global Markets Singapore Pte. Ltd. will underwrite the remaining rights shares.

In assessing FHT’s debt leverage and interest coverage ratios, we account for half of the trust’s SGD100 million perpetual issuance as debt and the other half as equity. Similarly, we have included half of the perpetual securities’ distribution as interest expense in the computation of the trust’s adjusted metrics.

Upon completion of the proposed acquisition in October 2016, FHT’s portfolio size will increase to SGD2.3 billion from SGD2.1 billion as of 30 June 2016 based on the appraised value of its properties as of 30 September 2015 and the appraised value of Maritime Hotel Dresden as of 31 March 2016. The trust will lower its asset and income concentration risk in Singapore and boost its geographic diversification (see Exhibit 2).
EXHIBIT 2
Fraser Hospitality Trust’s Geographical and Income Diversification

<table>
<thead>
<tr>
<th></th>
<th>Pre-Acquisition</th>
<th>Post-Acquisition</th>
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<tr>
<td><strong>Portfolio Value</strong></td>
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<tr>
<td>Singapore</td>
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<tr>
<td>Australia</td>
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<td>United Kingdom</td>
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<td>Germany</td>
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<tr>
<th></th>
<th>Pre-Acquisition</th>
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<tr>
<td><strong>Net Property Income</strong></td>
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<tr>
<td>Singapore</td>
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<tr>
<td>Germany</td>
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Source: The company

Acquiring Novotel Melbourne on Collins marks the trust’s maiden entrance into the Melbourne, Australia, market, allowing it to benefit from the city’s growing hospitality market. Property consultant CBRE expects average daily room rates in Melbourne to rise 3% annually in 2016 and 2017, supported by growing demand for hotel rooms.

Novotel Melbourne on Collins is a hotel managed by AccorHotels Group (unrated), with 380 rooms, two food and beverage outlets and nine conference and meeting rooms. It is strategically located on Collins Street in the heart of Melbourne’s central business district.
Fortescue Metals’ $700 Million Debt Repayment Is Credit Positive

Last Friday, Fortescue Metals Group Ltd. (Ba2 stable) made a $700 million repayment at par for its 2019 senior secured credit facility. The debt repayment is credit positive for Fortescue because it reduces the company’s total debt by 10% indicates the company’s commitment to improve its balance sheet and protect its credit quality amid weak iron ore prices.

The $700 million repayment follows approximately $2.9 billion repaid in fiscal 2016, which ended 30 June 2016. The latest repayment will lower the company’s reported total debt to around $6.1 billion, from around $6.8 billion as of 30 June 2016. This is close to a 52% reduction from Fortescue’s peak debt level of around $12.7 billion in fiscal 2013 (see exhibit). We expect the repayment to improve Fortescue’s financial leverage, as measured by adjusted gross debt/EBITDA, by 0.2x-0.3x under our base-case iron price assumption of $50 per tonne for 2016 and $45 per tonne for 2017. Fortescue’s adjusted debt/EBITDA was around 2.2x for fiscal 2016.

Fortescue Metals Group’s Reported Debt Continues to Decline

The debt repayment is an example of Fortescue management’s application of excess free cash flow to debt reduction and its focus on achieving a targeted gearing ratio, measured as the book value of debt/debt plus equity, of around 40%. This ratio was around 45% at the end of June 2016, and would improve to around 42% pro forma for the proposed transaction.

The transaction will also lower Fortescue’s total interest expense by around $26 million per annum. A lower interest cost will slightly improve the sustainability of Fortescue’s breakeven costs of production and aid future free cash flow generation. Additionally, the debt repayment reduces the refinancing risk for the significant amount of total debt maturing in 2019 by around 20% to around $3.0 billion.

We expect lower iron ore prices over the next 18-24 months to constrain Fortescue’s earnings. However, the significant debt reduction and cost reduction, combined with limited near-term capital expenditure requirements, support the company’s ability to maintain solid credit metrics and strong free cash flow generation under our iron ore price assumptions.

We could upgrade Fortescue’s ratings if it continues to generate solid free cash flow amid low iron ore prices, further reduces debt, and maintains a track record of lower operating costs. Further material debt repayments or early refinancing would reduce the refinancing risk for Fortescue’s still large fiscal 2019 maturities.
Infrastructure

**AEP’s Agreement to Sell Four Merchant Power Plants Is Credit Positive**

On Wednesday, American Electric Power Company, Inc. (AEP, Baa1 stable) announced it had agreed to sell approximately 5,200 megawatts of merchant generating plants to a joint venture of Blackstone and ArcLight Capital Partners. The sale is credit positive because it de-risks the company by reducing its exposure to volatile merchant power markets and generates significant cash proceeds.

The assets, which include a 2,600 megawatt coal plant, are all located in the PJM Interconnection region and will sell for approximately $2.17 billion. After paying taxes, fees and repaying about $370 million of debt associated with the assets, AEP expects to net about $1.2 billion. The company is currently evaluating options for the use of the proceeds, which may involve a combination of additional debt repayment, investment in its regulated businesses and share buybacks.

As of 30 June 2016, we calculated AEP’s total debt balance, including our standard adjustments, at about $23 billion with a ratio of cash flow from operations excluding changes in working capital (CFO pre-W/C) to debt of more than 20%. Pro-forma for the transaction, assuming all $1.2 billion of net proceeds are used to reduce debt, we estimate CFO pre-W/C to debt would increase to 22%. In a scenario where half of the net proceeds are used for debt reduction, the metric would move above 21%.

AEP’s long-term strategy, however, is to grow its regulated operations, primarily its lower risk transmission and distribution businesses. The company currently plans to make capital investments of $4-5 billion per year with external financing needs of more than $1 billion per year, some of which could be funded with sales proceeds. Based on AEP’s current capital plan, we anticipate AEP’s ratio of CFO pre-W/C to debt ratio will move somewhat lower to 18%-19%. To the extent sales proceeds are used to avoid future debt issuance, we estimate this metric could be 50-100 basis points higher.

The sale is consistent with AEP’s strategy to become a fully regulated company and makes significant progress toward eliminating its exposure to volatile commodities markets. After completion of the transaction, AEP’s merchant generating exposure will be limited to about 2,700 megawatts of primarily coal-fired assets in Ohio. The company plans to either sell or restructure these coal-fired assets into utility-owned assets sometime in 2017, which will bring the company’s merchant exposure to about 350 megawatts in the Electric Reliability Council of Texas, or about 1% of its current generating resources of about 34,000 megawatts.
Pelindo II Will Benefit from Commissioning of New Priok Container Terminal 1 in Jakarta

Last Tuesday, Indonesian President Joko Widodo inaugurated the New Priok Container Terminal 1 (NPCT1) in Tanjung Priok, North Jakarta. Once fully operational, the new terminal will add 850 meters of quay length to the port, which equals a capacity of 1.5 million twenty foot equivalent units (TEUs) per year to the port’s current 7 million TEUs of annual capacity. The successful commissioning of NPCT1 is credit positive for Indonesia’s state-owned port operator, Pelabuhan Indonesia II (Persero) (P.T.) (Pelindo II, Baa3 stable), which operates the country’s largest and busiest container port in Tanjung Priok in Jakarta, because the associated start-up of rental fees will boost the company’s cash flow and liquidity.

The NPCT1 terminal is operated by a joint-venture between Pelindo II and a consortium composed of Mitsui & Co. Ltd. (A3 negative), PSA International Pte. Ltd. (Aa1 stable) and Nippon Yusen Kabushiki Kaisha (Baa2 review for downgrade).

Under the construction and operation agreement among the joint-venture parties, Pelindo II is entitled to three tranches of advance site rent payments totaling $100 million. The company received the first tranche of $30 million when construction of the terminal began and the second tranche of $40 million on 1 July 2016 after the handover of the first 450-meter quay length. Pelindo II will receive a final tranche of $30 million by 2018 at the latest.

Completing NPCT1 will also increase Pelindo II’s recurring income through the $14 million of quarterly rental income from the terminal. As the exhibit below shows, we project that Pelindo II’s ratio of funds from operations to debt will improve to around 16.0% in 2017 versus an estimated 14.9% in 2016, the latter of which does not include the full contribution of the recurring rental payments from NPCT1.

The higher contribution in fixed recurring income will also partially insulate Pelindo II from the container volume risks stemming from the challenging global macroeconomic and trade environment. Partial rental payments started in August 2016 and will ramp up to full payment in first-quarter 2017 after full delivery of the quay. Although NPCT1’s operations were delayed from the initial target date of 26 July 2016, underlying execution risks will decline with the completion of the 450-meter quay and expected completion of the remaining 400 meters by the end of the year.

Pelindo II is wholly owned by Indonesia’s Ministry of State Owned Enterprises and is regulated by the country’s Ministry of Transportation. The company handled 5.9 million TEUs, or about 45% of Indonesia’s total container throughput in 2015. Tanjung Priok, which Pelindo II operates, handled more than 5.1 million TEUs in 2015. The port is Indonesia’s main international container gateway.
Malaysia Airports Holdings' Weak Traffic Reflects Operating Challenges in Turkey, a Credit Negative

Last Tuesday, Malaysia Airports Holdings Berhad (MAHB, A3 negative) released monthly traffic statistics that showed overall passenger traffic across the company’s airports grew 2.0% in August and 4.2% for the first eight months of 2016. This growth was lower than the previous year, when passenger traffic grew 8.4% in August and 5.7% for the first eight months of 2015. The reduction in growth is the result of decreased traffic at MAHB-owned Sabiha Gokcen International Airport (SGIA, unrated) in Istanbul, Turkey. International passenger traffic growth at SGIA contracted 8.7% in August 2016 and 0.2% for the first eight months of the year, versus 19.7% growth in 2015 (see exhibit). Contracting passenger traffic at SGIA is credit negative for MAHB and reflects operating challenges in Turkey following the 28 June terrorist attack at the airport and a failed military coup on 15 July.

Year-over-Year Passenger Traffic Growth at MAHB’s Airports in Malaysia and Istanbul, Turkey

SGIA accounted for about 24% of MAHB’s consolidated revenues in 2015, so the weak passenger growth will have a material negative effect on MAHB’s credit quality. SGIA has yet to report net profits since its incorporation in May 2008, and we expect that MAHB will continue to provide it with financial support given the decline in passengers and MAHB’s corporate guarantee for SGIA’s €500 million loan to refinance €450 million of debt raised during the 2008-09 global financial crisis.

We expect SGIA’s weak performance will keep MAHB’s ratio of funds from operations to debt at a modest 7%-10% over the next three years. Such metrics are at the weaker end of the range for MAHB’s baseline credit assessment of baa3, and below our earlier expectation of 8%-14% before the terrorist attack and failed military coup.

We expect year-on-year traffic growth at SGIA to decline materially to the low single digits in 2016 as passengers defer travel to Turkey. Our base-case expectation for SGIA is for 2%-4% traffic growth in 2016, with international traffic more affected than domestic traffic. Although Russia ended its ban on charter flights into Turkey on August 28, we do not expect the benefit from the resumption of Russian charter flights to SGIA to significantly affect overall traffic growth this year. The negative effect on MAHB’s credit quality is exacerbated by higher passenger service fees for international passengers (€15 per departing passenger) than for domestic passengers (€3 per departing passenger), although domestic passenger traffic also declined by 3% in August.

MAHB is a near-monopoly airport operator in Malaysia. It operates five international, 16 domestic and 18 short take-off and landing airports in the country, as well as the airport in Turkey and an airport investment in India.
Banks

Deutsche Bank Looks to Settle US Mortgage Legal Exposure at a Reasonable Cost

On 15 September, Deutsche Bank AG (Baa2/A3, stable ba1) announced in a filing that it has commenced negotiations with the US Department of Justice (DoJ) aiming to settle civil claims in connection with the bank’s underwriting and issuance of residential mortgage-backed securities (RMBS) and related securitization activities between 2005 and 2007. Eliminating the claims’ litigation tail risk at a manageable cost would be credit positive for Deutsche Bank, but negotiations have just begun and the final cost of settlements of complex capital markets litigation remains very difficult to predict.

At the end of the second quarter of 2016, Deutsche Bank had €5.5 billion of litigation reserves, for a variety of legal matters, but the bank has not disclosed the size of reserves for any specific action. For the analysis below, we have assumed that at least half of the litigation reserve could be made available for a possible DoJ settlement. If Deutsche Bank can eliminate this tail risk and settle within or near the assumed reserve of €2.75 billion (or $3.1 billion), it would be positive for bondholders.

Deutsche Bank has indicated its willingness to consider settlements at a cost broadly in line with peers’ prior settlements. However, as Exhibit 1 indicates, peers’ settlements have varied widely, ranging from $1.7 million to $8.9 million per basis point of RMBS league table share. Based on Deutsche Bank’s 6.4% market share, a settlement in the low end ($1.7 million per basis point) or even at the mid-point ($3.6 million per basis point) of the settlement range would be well covered by our assumed DoJ settlement reserve. However, a DB settlement at the high end of announced peer settlements ($8.9 million per basis point) would total $5.7 billion. A settlement of $5.7 billion would require an addition to our assumed DoJ settlement reserve of €2.4 billion, which would dent 2016 profitability (pretax earnings for first-half 2016 totaled €1 billion), a credit negative. Basing litigation exposure solely on market share is a crude approximation, but it helps dimension the adequacy of reserves and potential income statement effect.

EXHIBIT 1
Selected RMBS Settlements, Market Share and Cost Per Basis Point

<table>
<thead>
<tr>
<th>Bank</th>
<th>RMBS Market Share</th>
<th>Date</th>
<th>Total $ Billion</th>
<th>$ Millions per Basis Points of Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>JPMorgan (and Washington Mutual)</td>
<td>17.98%</td>
<td>11/19/2013</td>
<td>$3.1</td>
<td>$1.7</td>
</tr>
<tr>
<td>Citibank</td>
<td>4.94%</td>
<td>7/14/2014</td>
<td>$4.3</td>
<td>$8.7</td>
</tr>
<tr>
<td>Bank of America</td>
<td>16.48%</td>
<td>8/21/2014</td>
<td>$5.9</td>
<td>$3.6</td>
</tr>
<tr>
<td>Morgan Stanley</td>
<td>3.11%</td>
<td>2/11/2016</td>
<td>$2.8</td>
<td>$8.9</td>
</tr>
<tr>
<td>Goldman Sachs</td>
<td>7.35%</td>
<td>4/11/2016</td>
<td>$2.6</td>
<td>$3.6</td>
</tr>
</tbody>
</table>

Sources: Asset Backed Alert and US Department of Justice

The commencement of these negotiations is not surprising since Deutsche Bank management set a strategic objective to resolve crisis-related litigation and remove uncertainty hanging over the bank. As the complex negotiations proceed, we also expect that management have strong incentives to resist a quick settlement with the DoJ that is more expensive than the prior settlements of peers. These incentives include preserving flexibility with respect to paying coupons on its additional Tier 1 (AT1) securities. Even a settlement requiring an additional $2.4 billion of reserve should still leave Deutsche Bank with sufficient

1 The ratings shown are Deutsche Bank’s deposit rating and senior unsecured debt rating, and its baseline credit assessment.
flexibility to pay its 2017 AT1 coupons.\(^2\) We expect this flexibility to increase given the EBA’s announced intention to bifurcate Pillar 2 capital requirements into required and guidance components, with only the required component factoring into the calculation of the Maximum Distributable Amount for AT1 coupon payments.

Finally, Deutsche bank’s current Baa2 rating and stable outlook already incorporates the possibility of a modest loss (and substantial litigation costs) in 2016 and the potential for limited profitability in 2017.

Basel III EU Bank Monitoring Results Show Stronger Loss Buffers, a Credit Positive

On 13 September, the European Banking Authority (EBA) published Basel III monitoring results for European Union (EU) banks as of year-end 2015. The results show progress toward meeting Basel III capital requirements and a higher capacity to absorb losses in adverse operating conditions, both in terms of quality and quantity of the available capital, a credit positive.

The results indicate that EU banks in 2015 were €5.3 billion short of meeting the Basel III fully phased-in minimum capital requirements due in 2019 for risk-based ratios such as common equity Tier 1 (CET 1), Tier 1 and total capital as well as the non-risk-based leverage ratio. The shortfall is substantially lower than the €29.2 billion gap in 2014.

The Basel III monitoring report for the EU covers 227 banks in the region and supports the EBA’s 29 July stress test findings that a significant sample of EU banks (51 institutions) has sufficient capacity to handle adverse conditions.3

For the aggregate sample of banks, the EBA reported a fully phased-in CET 1 ratio of 12.7% as of year-end 2015, which compares to 12.6% for the EBA stress test sample. Internationally active (Group 1) banks improved their results to 12.4% in 2015, from 11.4% in 2014, and more domestically focused (Group 2) banks improved to 13.6% in 2015 from 12.4% in 2014.

The report shows that the decline in CET 1 capital until the application of fully-phased-in definitions is larger for Group 1 banks at -4.7% than for large Group 2 banks (-3.5%) and small Group 2 banks (-1.8%). Similarly, Group 1 banks’ leverage ratios decline more after applying a fully phased-in definition than Group 2 banks’ leverage ratio. Nevertheless, all of the Group 1 banks are compliant with the targeted 3% leverage ratio and only nine Group 2 banks were non-compliant. However, Group 1 banks more frequently require additional Tier 1 capital to meet the 3% leverage ratio than they need to meet risk-based Tier 1 capital requirements. Consequently, Group 1 banks are more affected by the constraint imposed by the leverage ratio than Group 2 banks.

For our rated EU banks, we find that all systemwide leverage ratios (as measured by Tier 1 capital to total assets4) are above the EBA’s recommended level of 3%, as shown in the exhibit below, which highlights the ten lowest leverage ratios at country level. Therefore, at a systemwide level, the ratio does not directly constrain banks’ capital levels. However, in banking systems in France, Sweden, Germany, the United Kingdom and Denmark, institutions lag or just meet the EBA’s reported total average of 4.9%. In these five systems, low leverage ratios primarily reflect considerably lower levels of asset risk because of benign operating environments, high exposure to local governments and public sector entities (thus low risk weights) and extensive use of internal models to derive risk weights. Although this reduces their risk-based capital requirements, as reflected by the less than 40% risk density (risk-weighted assets to total assets), banks in these systems are at the same time more affected by the constraint imposed by the leverage ratio because they have to hold higher Tier 1 capital in absolute terms to meet the leverage ratio’s requirement. In contrast, banks in countries with higher levels of asset risk and thus higher risk-based capital requirements, for example, Italy and Spain, are comparatively less affected by the leverage ratio, which their higher leverage ratios and higher risk density reflect accordingly.

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3 See EBA Stress Test Shows Most EU Banks Are Resilient to Adverse Conditions, 1 August 2016.
4 The regulatory leverage ratio uses the variable “total exposure” as a denominator, which is a broader definition than on-balance total assets because it also includes off-balance sheet transactions. Therefore, because our denominator is generally smaller than the EBA’s and, the Tier 1 leverage ratios are biased upwards.
Ten Lowest Leverage Ratios Systemwide in the European Union

Source: Moody's Banking Financial Metrics
Israel Discount Bank’s Early Retirement Plan for Employees Is Credit Positive

Last Wednesday, Israel Discount Bank (IDB, Baa1 stable, ba1) announced that its board of directors had approved a plan to accelerate an employee headcount reduction that will complement the bank’s existing strategic plan. The headcount reduction is credit positive because it will further improve IDB’s comparatively weak efficiency metrics at a manageable cost of 14 basis points of the bank’s common equity Tier 1 capital (CET1).

The capital cost will be spread over five years, making use of incentives that the Bank of Israel offered to Israeli banks in December 2015 to improve their efficiency. With a CET 1 ratio of 9.5% as of June 2016, spreading the costs over five years will allow IDB to maintain its small buffer above the higher 9.2% regulatory CET 1 minimum ratio to which the bank must adhere starting 1 January 2017.

Although not as generous as an early-retirement plan that IDB offered in 2014, the new plan, if accepted by all employees to whom it is offered, will eliminate 500 highly paid employees, while an additional 500 employees will retire through natural attrition over the next five years. This plan would bring the total headcount reduction since January 2013 to around 2,000 by December 2021. The new early-retirement plan offers preferred terms to eligible employees, including increased severance pay of up to 265% of annual salary. The bank estimates that around 300 of these employees will choose to retire by the end of 2016.

With a reported cost-to-income ratio of 76% in second-quarter 2016, IDB has one of the weakest efficiency ratios relative to its Israeli peers, partly owing to its much larger staff base and larger branch network. IDB employed 9,068 workers as of December 2015, versus around 6,000 at Mizrahi Tefahot Bank (A2 stable, baa2), a similar size and more efficient bank with a reported cost-to-income ratio of 58% in second-quarter 2016 (see exhibit). A key driver of Israeli banks’ weak efficiency metrics is their high employee costs because of a strongly unionized labor force and automatic pay rises that banks agreed to in the past and are usually applicable to older employees. The weighted average ratio of personnel expenses to operating expenses for Israeli banks was 42% as of December 2015.

The new plan will cost IDB NIS510 million, of which NIS60 million has already been expensed in the bank’s first-half 2016 results and NIS200 million will be charged to net profit in the second half of the year. The remaining NIS250 million will be spread over the remaining duration of the liability, which the bank currently estimates will be 12 years.

The bank ratings shown in this report are the bank’s deposit rating and baseline credit assessment.
Singapore Banks Will Benefit from Improved Household Debt Metrics

Last Tuesday, the Monetary Authority of Singapore (MAS) released data showing that Singapore resident households’ debt-servicing ratio had improved since the June 2013 introduction of the total debt servicing ratio (TDSR) framework. Improved household debt metrics will support the asset quality of retail loans, a credit positive for Singapore banks.

Large Singapore banks with significant exposure to the household sector, including DBS Bank Ltd. (Aa1/Aa1 negative, aa3), Oversea-Chinese Banking Corp. Limited (OCBC, Aa1/Aa1 negative, aa3), United Overseas Bank Limited (UOB, Aa1/Aa1 negative, aa3) and Standard Chartered Bank (Singapore) Limited (SCBSL, Aa3/Aa3 negative, a2), will benefit the most from this improvement. At year-end 2015, around 20% of consolidated loans for DBS, OCBC and UOB were provided to domestic households. At SCBSL, that level was 92%.

The improved debt service ratios mean that borrowers have more headroom to withstand higher interest rates, which in turn protects banks from loan delinquencies if interest rates rise further. Exhibit 1 shows that the debt-servicing ratio for households in the 20th income percentile had improved to 17% in 2015 from 22% in 2013. The debt-servicing ratios for the median and 90th income percentile households also declined over the same time period.

<table>
<thead>
<tr>
<th>Income Percentile</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>20th Income Percentile</td>
<td>22</td>
<td>20</td>
<td>17</td>
</tr>
<tr>
<td>50th Income Percentile</td>
<td>35</td>
<td>34</td>
<td>34</td>
</tr>
<tr>
<td>90th Income Percentile</td>
<td>45</td>
<td>45</td>
<td>44</td>
</tr>
</tbody>
</table>

Note: Debt-servicing ratio is defined in MAS Notice 645 as monthly total debt obligations/gross monthly income.

Sources: Monetary Authority of Singapore (MAS) and Ministry of National Development estimates based on data from MAS, Housing Development Board and Department of Statistics.

In addition to improving debt-servicing ratios, other household credit metrics showed either a stable or improving trend. Exhibit 2 shows the nonperforming loan (NPL) ratio for housing loans, which constituted 71% of total household debt in Singapore, has remained low and stable, at around 0.4% as of the end of June 2016.

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6 The debt servicing ratio is defined in MAS Notice 645 as monthly total debt obligations/gross monthly income.

7 This income percentile refers to low-income households and means that 80% of households had a higher income and 20% had a lower income.
EXHIBIT 2

Singapore Banks’ Nonperforming Loan Ratio for Housing Loans

Source: Monetary Authority of Singapore

The decline in the rollover balances of Singapore’s credit card holders since 2012 and the shrinkage of these balances since the third quarter of 2015 (see Exhibit 3) point to a gradual reduction of riskier borrowing among Singapore households.

EXHIBIT 3

Singapore’s Credit Card Holders’ Year-over-Year Rollover Balance Growth

Source: Monetary Authority of Singapore

Nonetheless, slower growth in Singapore’s economy poses downside risks to employment and household income, which in turn would weigh on household debt service capability. Singapore’s resident unemployment rate rose to 3.0% in the June 2016 quarter from 2.7% in the previous quarter.

The MAS’ recent fine-tuning of refinancing rules to allow a select group of overleveraged borrowers (i.e., those exceeding the 60% TDSR limit imposed by MAS) to refinance their loans would provide these borrowers with an opportunity to deleverage, which would further improve household debt metrics.
Sovereigns

Renewed US Aid Package Bolsters Israel's Fiscal and Security Positions

On 14 September, Israel (A1 stable) and the US (Aaa stable) agreed to a new 10-year, $38 billion financial aid package providing Israel increased military assistance, beginning in 2019. The agreement grants Israel $3.8 billion annually for 2019-28, an increase above the annual $3.1 billion under the current program that expires next year. The credit-positive agreement provides considerable support for Israel's finances amid extensive security challenges, and ensures continued aid flow in 2018 and beyond.

The agreement caps a nearly year-long negotiation between the US and Israeli administrations and comes with harsher stipulations than under past agreements. In particular, the new aid agreement requires Israel to gradually increase to 100% the amount of the aid it spends on US-produced goods (and prohibits fuel purchases with the money) by the end of the 10-year deal; previously, Israel could spend roughly 26% of the funds on Israeli products. Additionally, Israel has pledged not to lobby the US Congress for additional financing during the first two years of the deal, unless a war breaks out. Separate US appropriations (at approximately $500 million per year) have historically funded Israel’s missile defense program, including the Iron Dome and David’s Sling and Arrow technologies. These separate appropriations are now rolled into the general agreement.

The American aid helps Israel address its manifold security challenges as a small country in a volatile and mainly hostile region. In 2015, 13.2% of Israel’s budget and 5.4% of GDP ($16.1 billion) was spent on defense, the largest single item in the government’s budget, which averaged 6.3% of GDP and 14.8% of expenditures in 2006-15. According to Stockholm International Peace Research Institute, Israel was globally the sixth-largest military spender as a share of GDP in 2015, behind other Middle Eastern countries including Oman (16.2% of GDP), Saudi Arabia (13.7%), Iraq (9.1%), and Algeria (6.2%).

Absent US support, Israel would be forced to make difficult budget choices: reduce its defense capabilities, thereby eroding its security buffers, or raise taxes, cut non-defense expenditures or reverse the decrease in government debt, which was 64.8% of GDP in 2015 after annual declines from 74.3% of GDP in 2009. Although military expenditures have decreased sharply (in relative terms) in the past 15 years, Israel’s high-tech missile security system costs have increased in the past three years. The new US military aid package will defray 20% or more of the total military expenses and allow Israel’s debt metrics to remain on a steady downward path.

We believe the new aid agreement shows dissipating strains in the relationship between the two longstanding allies, partly a reflection of the impending US election and the end of President Obama’s last term. President Obama and Israeli Prime Minister Benjamin Netanyahu have been at odds over some of the US’ key Middle East-related priorities in recent years, most notably over the continued expansion of Israeli settlements beyond its pre-1967 borders as well as the Iran nuclear accord.
IMF’s Decision to Disburse $1 Billion to Ukraine Supports Its International Reserves, a Credit Positive

On 14 September, the International Monetary Fund (IMF) completed the second review of Ukraine’s (Caa3 stable) $17.5 billion Extended Fund Facility (EFF), approving the disbursement of $1 billion, a credit positive. The disbursement, which was delayed for a year and was also cut nearly in half from the original $1.7 billion, will help bolster Ukraine’s international reserves.

The EFF, which was originally approved in March 2015, has been used primarily to replenish Ukraine’s foreign currency reserves, which fell to a low of $4.7 billion in February 2015 from $16.3 billion in May 2014 amid an expanding military conflict with pro-Russian separatists and the knock-on effects to the economy. Under the IMF’s EFF program, Ukraine has received a total of $7.6 billion since March 2015, which along with associated bilateral and multilateral lending and Ukraine’s restructuring of its Eurobond debt last November, has created substantial breathing room for the country’s external position.

IMF board members approved the review and voted in favor of the disbursement, averting Russian attempts to block the loan. Russia and Ukraine are locked in an ongoing legal battle over a $3 billion bond the Ukrainian government sold to Russia in 2013: the bond is currently in default, after Russia refused to agree to the debt’s restructure on terms that Ukraine’s other bondholders agreed to in November 2015.

The IMF’s hiatus after the last EFF disbursement in mid-2015, when the first review was completed, related largely to political infighting within the governing coalition over the key reforms the IMF required even after Ukraine resolved its drawn-out battle over the 2016 budget to the IMF’s liking. Those political tensions elicited fresh pressure on Ukraine’s currency, the hryvnia, during the IMF’s hiatus, decreasing foreign reserves (see exhibit) and eventually leading to the collapse of its technocratic government in early spring 2016.

Ukrainian Foreign Currency Reserves

![Graph showing Ukrainian Foreign Currency Reserves](attachment:image)

The new administration of Ukraine’s Prime Minister Volodymyr Groysman, which was formed in April 2016, was able to demonstrate sufficient progress in fulfilling the IMF’s reform requirements to warrant resumption of the program. The final sticking points surrounding anti-corruption reforms were resolved 1 September, with the initiation of e-invoicing. Still, in order to approve the disbursement, the IMF had to waive Ukraine’s non-compliance on several requirements such as international reserve targets, elimination of external payment arrears and new foreign exchange restrictions (even as others were removed).

The IMF’s resumption of the EFF program has buoyed market confidence and we expect that it will ease pressure on the hryvnia, allowing the National Bank of Ukraine (the central bank) to relax certain foreign...
exchange controls. The program’s resumption also paves the way for an additional $1 billion in US
guaranteed debt, a €600 million (approximately $675 million) loan from the European Union (subject to
the passage of specific legislation) and a $500 million World Bank-guaranteed loan to finance gas
purchases. In a press conference last Thursday, an IMF spokesman suggested that the IMF may also provide
an additional tranche of financing by the end of the year, although a precise timeline and list of criteria for
such a disbursement has not been disclosed. Receiving an additional tranche would be credit positive, since
it would put the troubled country in a stronger position to resist any new economic or political shocks.
**Sierra Leone Government’s Revenue Recovery Following Ebola Crisis Is Credit Positive**

Late last week, the Sierra Leone (unrated) Ministry of Finance reported on its website a surge in income tax revenues collected in July 2016. The report came shortly after the National Revenue Authority announced that the country’s fiscal revenues grew by 18% in the first half of 2016 versus a year earlier, exceeding government projections. These improvements are credit positive for Sierra Leone because improved revenue generation is a clear sign that the economy is recovering from the 2014-15 Ebola crisis.

In recent years, the outbreak of Ebola along with weak commodity prices led to a rapid deterioration of the government’s fiscal position. The fiscal deficit widened to 10% of GDP in 2015 from 4.9% in 2014, in part because of the sizable resource strains created by fighting the disease. Declines in iron ore prices – one of Sierra Leone’s key exports – in 2014-15 also contributed to weaker government revenues.

The revenue increase was driven by both a stronger operating environment as a result of the end of the Ebola crisis and a recovery in iron ore mining production (although prices still remain low). The revenue gains are likely to continue in the second half of the year, and will improve the government’s capacity to effectively deliver services to citizens, the failure of which contributed to the spread of Ebola.

Given that the increase in iron ore revenues has been modest and did not drive the overall tax increase, it is likely that the creation of the Extractive Industry Revenue Unit (EIRU) was responsible for the improved revenues. The EIRU is a new government agency focused on monitoring the mining industry to maximise tax income for the government. Its creation will benefit the sovereign’s long-term revenue prospects, and is in line with recommendations from the International Monetary Fund.

If Sierra Leone can sustain its increased revenue collection, it will gradually lift the sovereign’s ratio of revenue to GDP, bringing it closer to those of its regional peers (see exhibit). This will become particularly important as donor support is likely to decline now that the country’s public health crisis is over and more revenue collected domestically will be needed to offset falling external support.

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**Revenue as Percent of GDP in Sierra Leone and Moody’s-Rated Sub-Saharan African Countries in 2015**

![Chart showing revenue as percent of GDP for various countries.](chart.png)

Sources: International Monetary Fund and Moody’s Investors Service
US Public Finance

Court Okays Nassau County, New York’s Wage Freeze, a Credit Positive

Last Wednesday, a New York state appeals court ruled that the Nassau County Interim Finance Authority, NY (NIFA, Aa1 stable) was within its legal rights when it enacted a three-year wage freeze for employees of Nassau County, New York (A2 stable) beginning in March 2011. The court’s ruling is credit positive for Nassau County because it precludes the possibility that the county would have to return approximately $101 million in wage and benefit savings to the unions challenging the freeze. The $101 million sum is sizeable relative to the county’s available general fund balance of $75.5 million at year-end 2015. The ruling upheld a previous ruling by the state Supreme Court, effectively ending the unions’ appeals; the New York State Court of Appeals would have to give its permission for the unions to appeal further.

NIFA’s wage freeze was implemented to control county spending after years of budget imbalance that resulted in negative available fund balance and cash levels, net of cash flow borrowing. The freeze was lifted in 2014 after unions agreed to new contracts that included concessions. The county continues to struggle to maintain balanced operations, especially given its heavy reliance on economically sensitive sales tax revenue, although recent growth in its tax base (see exhibit) is a credit strength.

The presence of NIFA is a credit strength for the county, and maintaining its ability to implement policies such as the wage freeze is key to its ability to control future spending. The state-appointed fiscal watchdog reviews county budgets, approves debt issuance, and generally reviews all large contracts. Additionally, NIFA actively monitors budget performance alongside the county, requiring monthly spending reports and year-end projections, monthly and quarterly variance reports, and plans to mitigate any mismatch between revenues and expenditures.
Securitization

American Homes 4 Rent’s New Credit Facility Is Credit Positive for Its SFR Securitizations

On 9 September, American Homes 4 Rent (AH4R, unrated) paid off the $342 million loan backing its single-family rental (SFR) deal, American Residential Properties 2014-SFR1 Trust (ARP 2014-SFR1 Trust), using proceeds from a newly raised $1 billion credit facility, which is bigger and more flexible than the previous facility it replaces. Obtaining the new credit facility is credit positive for the other $2.5 billion of AH4R SFR securitizations we rate because it improves AH4R’s financial flexibility, credit quality and the likelihood that it will pay off the loans backing the remaining securitizations when they become due.

In addition to the $350 million term loan, a portion of which was used to repay the loan backing ARP 2014-SFR1, the $1 billion facility that matures in August 2019 includes a $650 million, interest-only revolving syndicated bank credit facility that is extendible for one year for an additional fee. The new facility is more flexible than the $800 million secured facility it replaces, and does not require pledging individual properties as collateral.8 Aside from boosting its liquidity, by moving a portion of its borrowing away from securitization financing, AH4R increases the amount of unencumbered assets on its books and diversifies its funding sources. Furthermore, a committed corporate facility does not require the appraisal of the properties backing a secured facility, is not tied to the performance of the assets and is less cumbersome to refinance and extend. The revolving facility’s interest rate is either LIBOR plus a 1.75%-2.30% margin, or a base rate pegged to a prime or federal funds rate plus a 0.75%-1.30% margin, depending on the company’s total-indebtedness-to-total-asset-value ratio at a given time. Comparatively, the loan backing ARP 2014-SFR1 Trust had an interest rate of 2.5% as of July 2016. Of the 48,000 properties AH4R owns, 21,628 now back securitizations.

AH4R’s improved capital structure better positions the company to pay down the loans backing its remaining SFR securitizations, namely if they have trouble refinancing in the future. SFR transactions might prove more difficult to refinance, relative to the similar but more established asset class of multifamily commercial mortgage-backed securities (CMBS), because of SFR deals’ higher leverage and lower debt yields. However, AH4R’s move exemplifies another available takeout strategy for SFR issuers in addition to refinancing. SFR securitizations are typically backed by a single loan collateralized by thousands of rental properties, cash flows from which the borrower (in this case AH4R) uses to make interest payments on the loan, which in turn flow to securitization note holders. If the borrower (in this case AH4R) cannot repay the loan at maturity, the properties revert to the securitization trust, which can sell the properties to pay down noteholders.

After paying down ARP 2014-SFR1 Trust9 and taking its 2,875 properties on balance sheet, AH4R now has five remaining SFR securitizations, all of which we rate, as the exhibit below shows.

---

8 There are, however, pledges of equity interests in certain entities in AH4R’s corporate family to secure repayment of the facility, which will get released if AH4R obtains an investment grade credit rating and meets certain other conditions.
### American Homes 4 Rent Remaining Securitizations

<table>
<thead>
<tr>
<th>Deal Name</th>
<th>Number of Properties Backing Deal</th>
<th>Remaining Par Amount at July 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>American Homes 4 Rent 2014-SFR1</td>
<td>3,852</td>
<td>$470,949,792</td>
</tr>
<tr>
<td>American Homes 4 Rent 2014-SFR2</td>
<td>4,487</td>
<td>$503,968,780</td>
</tr>
<tr>
<td>American Homes 4 Rent 2014-SFR3</td>
<td>4,503</td>
<td>$520,051,382</td>
</tr>
<tr>
<td>American Homes 4 Rent 2015-SFR1</td>
<td>4,661</td>
<td>$545,804,780</td>
</tr>
<tr>
<td>American Homes 4 Rent 2015-SFR2</td>
<td>4,125</td>
<td>$474,045,145</td>
</tr>
<tr>
<td>Total</td>
<td>21,628</td>
<td>$2,514,819,877</td>
</tr>
</tbody>
</table>

Source: Moody’s Investors Service, based on servicer data

Although the credit facility will be most useful for the American Homes 4 Rent 2014-SFR1, which matures in 2019, the other transactions, which are 10- to 30-year deals, will still benefit from AH4R’s generally improved credit quality.
UK’s Looming Pension Updates Are Credit Negative for Corporates

Last Monday, Associated British Foods plc (ABF, unrated) disclosed that a marked decline in UK long-term bond yields during the last quarter was largely responsible for an approximately £200 million deficit in the group’s UK pension scheme that previously had been in surplus. Deficits usually require more cash to be paid into the pension scheme, which is credit negative because it weakens the position of corporate bondholders and other creditors. Many rated corporates with exposure to UK pensions face a similar challenge from declining bond yields, an issue that has taken on greater importance given the Bank of England’s monetary policy easing after the UK’s June 2016 vote to leave the European Union.

ABF explained that the pension deficit would have no effect on cash flow until the completion of the next triennial valuation, due in 2017. The funding of pension plans in the UK is determined by a triennial funding valuation that forms the basis for a schedule of contributions to be agreed between the sponsoring employer and the plan’s trustees. The assumptions used for the triennial valuation differ from those used to calculate the pension liability reported on the balance sheet. A key difference is that the accounting valuation uses a discount rate derived from market yields on high-quality corporate bonds to calculate the pension scheme’s liabilities; the triennial valuation uses a rate that takes account of the expected return on the pension scheme’s specific assets.

ABF said in its annual report for the fiscal year that ended 12 September 2015 that the last triennial valuation for the UK pension scheme undertaken as of 5 April 2014 revealed a surplus of £79 million when the market value of the scheme’s assets was £3.085 billion. However, like the vast majority of companies with significant pension plans in the UK, the company did not disclose the investment return assumption that underpinned the calculation of the present value of the scheme’s liabilities at £3.006 billion. When ABF updates the 2014 valuation in 2017, it will have to assess whether the 2014 investment return assumption remains appropriate in the current low yield environment.

Lowering the investment return assumption increases the present value of the pension scheme’s liabilities. BT Group plc, the parent company of British Telecommunications Plc (Baa1 stable), lowered its return assumption on the plan’s investments when it updated the 30 June 2011 triennial valuation for its largest pension plan as of 30 June 2014. The result was that the pension deficit increased to £7 billion and the cash outflow committed under the multi-year recovery plan (excluding contingent payments) doubled to £9.596 billion from £4.715 billion.

Because companies are not required to disclose details of the triennial funding valuation in their annual accounts, it is difficult for investors to identify the firms affected by an impending funding valuation update, or the scale of the threat to their cash flow. Many companies voluntarily provide information that is helpful to investors, but, as the exhibit below shows, only half of them have quantified the outcome of the funding valuation (as ABF has done). Only two of the companies surveyed – AstraZeneca PLC (A3 stable) and BT Group plc – voluntarily provided fully comprehensive information, including the key investment return and inflation assumptions.
### Disclosure of Triennial Funding Valuations Varies by Company

<table>
<thead>
<tr>
<th>Company</th>
<th>Latest Available Annual Report</th>
<th>Date of Most Recent Triennial Valuation</th>
<th>Surplus (Deficit) at Most Recent Triennial Valuation, £ Millions</th>
<th>Funding at Most Recent Valuation, £ Millions</th>
<th>Disclosed Investment Return and Inflation Assumptions</th>
<th>Deficit Recovery Payments Explained</th>
</tr>
</thead>
<tbody>
<tr>
<td>Akzo Nobel N.V.</td>
<td>31-Dec-15</td>
<td>31-Mar-14 (ICIPF) 31-Mar-12 (CPS)</td>
<td>(£1,070)</td>
<td>No</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>AstraZeneca PLC</td>
<td>31-Dec-15</td>
<td>31-Mar-13</td>
<td>(£493)</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>BAE Systems plc</td>
<td>31-Dec-15</td>
<td>31-Mar-14</td>
<td>(£2,700)</td>
<td>No</td>
<td>Not completely¹</td>
<td></td>
</tr>
<tr>
<td>Bayerische Motoren Werke Aktiengesellschaft</td>
<td>31-Dec-15</td>
<td>NR</td>
<td>NR</td>
<td>NR</td>
<td>NR</td>
<td>NR</td>
</tr>
<tr>
<td>BP p.l.c.</td>
<td>31-Dec-15</td>
<td>31-Dec-14</td>
<td>Not quantified</td>
<td>No</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>British Airways Plc</td>
<td>31-Dec-15</td>
<td>31-Mar-12</td>
<td>(£3,340)</td>
<td>No</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>BT Group plc²</td>
<td>31-Mar-16</td>
<td>30-Jun-14</td>
<td>(£7,000)</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>Deutsche Post AG</td>
<td>31-Dec-15</td>
<td>1-Apr-15</td>
<td>Not quantified</td>
<td>No</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>Diageo plc</td>
<td>30-Jun-16</td>
<td>1-Jul-15</td>
<td>(£540)</td>
<td>No</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>GKN plc</td>
<td>31-Dec-15</td>
<td>5-Apr-13</td>
<td>Not quantified</td>
<td>No</td>
<td>Not completely³</td>
<td></td>
</tr>
<tr>
<td>GlaxoSmithKline plc</td>
<td>31-Dec-15</td>
<td>31-Dec-11</td>
<td>Not quantified</td>
<td>No</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>ITV plc</td>
<td>31-Dec-15</td>
<td>1-Jan-15</td>
<td>(£540)</td>
<td>No</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>Jaguar Land Rover Automotive plc</td>
<td>31-Mar-16</td>
<td>5-Apr-15</td>
<td>Not quantified</td>
<td>No</td>
<td>Not completely³</td>
<td></td>
</tr>
<tr>
<td>Marks and Spencer Group PLC</td>
<td>2-Apr-16</td>
<td>31-Mar-15</td>
<td>£204</td>
<td>No</td>
<td>N/A</td>
<td></td>
</tr>
<tr>
<td>Pearson plc</td>
<td>31-Dec-15</td>
<td>31-Jan-15</td>
<td>(£27)</td>
<td>No</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>Rolls-Royce Holdings plc</td>
<td>31-Dec-15</td>
<td>31-Mar-15 (RRPF) 31-Mar-13 (VCGPS)</td>
<td>Not quantified</td>
<td>No</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>Royal Dutch Shell plc</td>
<td>31-Dec-15</td>
<td>NR</td>
<td>NR</td>
<td>NR</td>
<td>NR</td>
<td>NR</td>
</tr>
<tr>
<td>Smiths Group plc¹</td>
<td>31-Jul-15</td>
<td>31-Mar-15 (SIPS) 31-Apr-15 (TIGPS)</td>
<td>(£301)</td>
<td>No</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>Tesco PLC</td>
<td>27-Feb-16</td>
<td>31-Mar-14</td>
<td>(£2,751)</td>
<td>No</td>
<td>Not completely³</td>
<td></td>
</tr>
<tr>
<td>Unilever Group</td>
<td>31-Dec-15</td>
<td>NR</td>
<td>NR</td>
<td>NR</td>
<td>NR</td>
<td>NR</td>
</tr>
</tbody>
</table>

**Notes:**

1. The cumulative amount of the annual deficit recovery payments agreed with the trustees is not entirely clear.
2. The disclosure relates to the main pension scheme.
3. The disclosure comes from news releases issued by the company on 17 November 2015 and 1 March 2016, after the publication of the annual report for the fiscal year that ended 31 July 2015.

**Key:** NR = There is no reference to the latest triennial funding valuation in the annual report. ICIPF = ICI Pension Fund; CPS = AkzoNobel (CPS) Pension Scheme; RRPF = Rolls-Royce Pension Fund; RRGPS = Rolls-Royce Group Pension Scheme; VGPS = Vickers Group Pension Scheme; SIPS = Smiths Industries Pension Scheme; TIGPS = Ti Group Pension Scheme.

**Sources:** The companies
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American Electric Power Company, Inc.

Electric Utility Holding Company

**Summary Rating Rationale**

American Electric Power Company’s (AEP) Baa1 rating is underpinned by the size and diversity of its regulatory jurisdictions and service territories. AEP’s ten retail utility subsidiaries operate under eleven different state regulatory bodies and with Federal Energy Regulatory Commission (FERC) regulation for its transmission subsidiaries. The rating reflects AEP’s stable earnings profile which over the past several years has yielded cash flow from operations pre-working capital (CFO pre-WC) to debt metrics in the high-teens to low twenty percent range. Cash flow stability is supported by AEP’s renewed corporate strategy of focusing on its core utility assets with more predictable earnings. These positive credit factors are balanced against weak demand growth associated with some of its larger service territories, namely the Appalachian economies, a prolonged period of material capital investments and an increasing amount of debt. The rating also incorporates a view that AEP will continue to evaluate strategic alternatives for its merchant generating fleet, including a sale or potential reregulation of its Ohio generating fleet, with a goal of maintaining cash flow predictability, a credit positive.
**Credit Strengths**

» Diversity of regulatory jurisdictions and service territories provide a strong foundation for current rating

» Continued regulatory support with timely and sufficient cost recovery

**Credit Challenges**

» Substantial investments in regulated transmission networks and for environmental mandates will increase debt burden

» Financial metrics are expected to move down from recent highs due to substantial capital expenditures - though primarily for lower risk transmission and distribution investments

**Rating Outlook**

AEP’s stable outlook reflects its diversified regulatory jurisdictions and service territories and our expectation that those jurisdictions will remain credit supportive and not prevent or materially delay the recovery of prudently incurred costs. The outlook also considers AEP’s prudent financial management and an expectation that credit metrics may weaken somewhat but that CFO pre-WC to debt will remain in the high-teens which is appropriate for the rating.

**Factors that Could Lead to an Upgrade**

» A successful sale or de-risking of AEP’s unregulated operations that also results in a stronger set of financial credit metrics, including interest coverage above 5.5x and CFO pre-WC to debt in the mid-twenties on a sustainable basis

» An upgrade of AEP’s largest utility subsidiaries

**Factors that Could Lead to a Downgrade**

» If a more contentious regulatory environment were to develop in any of its key jurisdiction

» If environmental and nuclear investments cannot be recovered on a timely basis

» If AEP’s financial metrics were to deteriorate on a sustained basis resulting in CFO pre-WC to debt in the low-teens

**Key Indicators**

<table>
<thead>
<tr>
<th>Exhibit 2</th>
</tr>
</thead>
</table>

**KEY INDICATORS [1]**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>CFO pre-WC / interest</td>
<td>4.6x</td>
<td>5.1x</td>
<td>6.0x</td>
<td>5.8x</td>
<td>5.8x</td>
</tr>
<tr>
<td>CFO pre-WC / Debt</td>
<td>19.8%</td>
<td>19.6%</td>
<td>21.4%</td>
<td>21.5%</td>
<td>21.0%</td>
</tr>
<tr>
<td>CFO pre-WC – Dividends / Debt</td>
<td>15.5%</td>
<td>15.0%</td>
<td>16.8%</td>
<td>16.6%</td>
<td>16.2%</td>
</tr>
<tr>
<td>Debt / Capitalization</td>
<td>46.5%</td>
<td>44.3%</td>
<td>44.1%</td>
<td>42.6%</td>
<td>42.8%</td>
</tr>
</tbody>
</table>


Source: Moody’s Investors Service

**Detailed Rating Considerations**

*Diversity of regulatory jurisdictions and service territories provide a strong foundation for current rating*

---

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.
AEP’s diversity in terms of regulatory jurisdictions and service territory economies is a meaningful credit strength as it provides AEP with a degree of insulation from any unexpected negative developments occurring at any one of its operating companies, state regulatory bodies or state economies. This diversity has been essential in helping AEP deal with an elevated capital expenditure program and weak demand growth in some of its service territories.

AEP’s primary regulated utilities and their regulatory jurisdictions are as follows: Ohio Power Company (OPCo: Baa1 positive) which accounted for 19% of AEP’s total 2015 revenues, operates under the Public Utility Commission of Ohio (PUCO); Appalachian Power Company (APCo: Baa1 stable), which accounted for 18% of AEP’s total 2015 revenues, operates under the Virginia State Corporation Commission (VSCC), (covering a little over half of APCo’s customers) and the more challenging Public Service Commission of West Virginia (PSC WV); Indiana Michigan Power Company (I&M: Baa1 stable), 13% of AEP’s total 2015 revenues, is regulated by the Indiana Utility Regulatory Commission (IURC), (about ¾ of I&M’s customers) and the Michigan Public Service Commission (MPSC); Southwestern Electric Power Company (SWEPCo: Baa2 stable), 11% of AEP’s total 2015 revenues, operates under the Louisiana Public Service Commission (LPSC) (about 43% of SWEPCo customers), the Arkansas Public Service Commission (APRSC) (22% of SWEPCo customers) and the Public Utility Commission of Texas (PUCT) (35% of SWEPCo customers); Public Service Company of Oklahoma (PSO: A3 stable), 8% of AEP’s total 2015 revenues, is regulated by the Oklahoma Corporation Commission (OCC); AEP Texas Central (TCC: Baa1 stable) and AEP Texas North Company (TNC: Baa1 stable), 7% and 2% of AEP’s total 2015 revenues, respectively, both under the Public Utility Commission of Texas (PUCT); and Kentucky Power Company (KPCo: Baa2 stable), 4% of AEP’s total 2015 revenues, is under the Kentucky Public Service Commission (KPSC).

For further information on these service territories please refer to each utility’s credit opinion on Moodys.com.

*Continued regulatory support with timely and sufficient cost recovery important to credit quality*

Given the significant amount of capital expenditures AEP has planned across its regulated business segments it is essential that AEP maintain a supportive relationship with its regulators to sustain credit quality. The utility subsidiary ratings and outlooks reflect our view that AEP will continue to receive timely and consistent long-term regulatory support across the majority of its jurisdictions. Recent regulatory filings, orders and updates for AEP are as follows:

OPCo - In December 2015, a non-unanimous stipulation agreement related to OPCo’s application for approval of a power purchase agreement (PPA) with its affiliate AEP Generation Resources (AGR: unrated) was filed with PUCO, and on March 31, 2016 it was unanimously approved with minor changes. In April 2016, in response to filed complaints, the Federal Electric Regulatory Commission (FERC) rescinded AEP’s affiliate waivers and determined the PPA between OPCo and AGR was subject to its review. AEP and OPCo are currently reviewing strategic options, which may include divestiture and/or the pursuit of state legislation that would allow the transfer of the AGR Ohio assets back to OPCo, or the deregulation of generation in the State. In addition, OPCo has filed for re-hearing of the PUCO’s March 31st order to reflect its inability to implement the AGR PPA as of June 1, 2016 as originally intended, and to clarify/modify the remaining provisions of the settlement accordingly. As required under the settlement, OPCo also filed to extend its current Electric Security Plan, (which is in effect through May 2018) through May 2024.

The affiliate OPCo/AGR PPA was under fire as it was viewed by many as subsidizing the company’s merchant generating operations by way of non-bypassable surcharges that potentially transferred benefits from utility ratepayers to shareholders. Although we estimate the near-term revenues AEP would have received under the PPA to be greater than the revenues we expect will be generated from the sale of energy and capacity on a merchant basis, we anticipate the impact on AEP’s consolidated credit metrics will be modest and that they will remain appropriate for the rating. AEP management remains focused on their goal of becoming a premium regulated utility, and plans to implement a de-risking strategy that includes either the divestiture or deregulation of the AGR assets, by the end of 2017.

The December 2015 settlement approved by the PUCO included other OPCo commitments such as: implementation of a by-passable competition incentive rider (CIR); filing a carbon emission reduction plan with PUCO; supporting the future conversion or retirement of Conesville coal-fired units (owned by AGR); and exploring grid modernization initiatives. OPCo also committed to develop and implement, subject to cost recovery, solar energy projects of at least 400 MW and wind energy projects of at least 500 MW by 2021, with 100% of all output to be received by OPCo. An OPCo affiliate could own up to 50% of these solar and wind projects with cost recovery in the proposed PPA rider. Assuming a successful rehearing of the PUCO’s March order, these commitments will remain in place.
APCo (Virginia) - In February 2015, Virginia enacted legislation temporarily suspending its required biennial review of investor-owned utility earnings, effectively freezing rates for APCo through the 2017 test year. Biennial reviews are to begin again in 2020 addressing results for the 2018 and 2019 test years. This is positive for APCo considering its last biennial review decision (issued November 2014) found that for the 2012 and 2013 test years APCo had on average earned an 11.86% ROE, which was above the upper end of the 10.4%-11.4% allowed range established for those years. APCo was required to make refunds totaling $5.8 million, and the commission set a baseline ROE of 9.7% for the biennial review for 2014 and 2015 which is significantly below the prior 10.9% baseline (although the allowable range was widened so the upper boundary would have been 10.4%). As the biennial reviews have been suspended, no refunds will be required in the event of over earning until the next review in 2020.

In February 2016, some APCo industrial customers filed a petition with the VSCC requesting a declaratory order finding the amendments to Virginia law suspending biennial reviews unconstitutional and directs APCo to make biennial review filings beginning in 2016. Oral arguments at the VSCC were held in March 2016 and the industrial petition was denied. The customers have filed an appeal to the Virginia Supreme Court, where a similar case was filed related to another utility. A reinstatement of the biennial review process in advance of March of 2020 would likely reduce future cash flows and coverage metrics. For example, based on the between earned and allowed ROE noted above, we estimate reinstatement of the biennial process could cause APCo’s ratio of cash from operations excluding changes in working capital (CFO Pre-WC) to debt to be 0.5 – 1.0 percentage points lower.

APCo (West Virginia) - In May 2015, the WVPSJC issued an order in APCo’s pending base rate case authorizing a $99 million rate increase based on a 9.75% return on equity. The initial case was filed almost a year prior in June 2014 requesting a $226 million increase in annual revenues based on a 10.62% return on equity. The WVPSJC’s order also included the delayed billing of $25 million of the rate increase to residential customers until July 2016. On a positive note, the order included approval of an annual vegetation rider of $45 million, revised depreciation rates and recovery of $89 million in previously recorded regulatory assets over five years. The May 2015 order also resolved an ongoing ratemaking issue concerning the WVPSJC’s approach to consolidated tax adjustments (CTA). The order, which was upheld on reconsideration in July of 2015, resolved that losses used in the CTA would be limited to those generated by APCo’s parent company, AEP, rather than including the losses at non-parent affiliated subsidiaries. This resolution should allow more opportunity for APCo to earn its allowed return in West Virginia.

PSO - In July 2015, PSO filed a request with the OCC to increase annual revenues by $137 million to recover costs associated with its environmental compliance plan and other rate base additions. The rate increase included a 10.5% return on equity. In October 2015, the OCC staff filed testimony recommending that annual revenues increase by $10 million to $31 million based on returns on equity ranging from 8.75% to 9.3%. In January 2016, PSO implemented an interim rate increase of $75 million which is subject to refund. An order from the OCC is anticipated by the end of the third quarter of 2016. The ability to implement interim increases, and the existence of rider mechanisms for significant distribution investments such as AMI contribute to the stability and predictability of PSO’s cash flow. In 2016, management anticipates PSO should be able to earn an ROE of about 9%.

For more details regarding any of AEP’s subsidiaries regulatory updates please refer to their pages on Moodys.com.

Substantial investments in regulated transmission networks and environmental mandates

AEP has been investing heavily to meet stringent environmental compliance requirements and to assure reliability throughout its service territories. High capital investment levels are expected to continue and the company has announced a program of approximately $15 billion for 2016 through 2018. Of the total $15 billion, about 95% will be spent in regulated businesses as follows: transmission about 48%, distribution 26%, regulated generation 16%, and corporate 5%. AEP’s average projected capital investments of $5.0 billion per year through 2018 is a modest increase when compared to $4.5 billion spent in 2015, but a substantial increase from the $3.1 billion invested in 2012 and $2.7 billion in 2011. Transmission and distribution (T&D) investments are expected to be recovered largely either through the transmission formula based rates or rider recovery, a credit positive. Generation investment is primarily recovered in base rates and more susceptible to lags in recovery. Given the sheer magnitude of the investment program, we anticipate intermediate term credit metrics could deteriorate somewhat. An offset to this is the multi-year extension of bonus depreciation benefits, which will add to cash flow over the near-to-medium term and help to maintain coverage metrics that are appropriate for the rating.
Additional debt financing for capex spend will put downward pressure on financial metrics - though offset to a large degree by the extension of bonus depreciation.

AEP’s key financial credit metrics remain appropriate its rating category. As of the last twelve months ending (LTM) Q1 2016, AEP’s adjusted three year average interest coverage ratio was 5.7 times and CFO pre-W/C to debt of 21%, both strong for the Baa rating category. Total adjusted consolidated debt has increased to $22.6 billion at March 31, 2016 from around $21 billion in 2013, a trend we expect to continue going forward mainly due to the required funding of capital expenditures. For the following 18-24 months we expect AEP’s financial metrics to deteriorate slightly but remain within its rating category, including an interest coverage ratio in the 4.5x-5.5x range and CFO pre-W/C to debt in the high teens.

As of December 31, 2015, AEP had long-term parent level debt obligations of about $1.4 billion, or 7% of AEP’s total debt. These parent level obligations are made up of about $830 million of holding company debt and $590 million in debt guaranteed by the parent for its competitive business AGR. AEP is also dedicated to growing its transmission footprint through AEP Transmission Company (AEP TransCo: not rated) and several joint ventures (JVs). AEP Transco is fully regulated by the FERC and had debt of about $1.7 billion, or about 8% of AEP’s total debt.

Historically, we have not applied any structural subordination notching to AEP’s Baa1 rating relative to the average credit quality of its rated subsidiaries due to the diversity and the stability of AEP’s operating subsidiaries cash flows. It is our view that the modest 8% level of parent holding company debt and debt guaranteed by the parent relative to total consolidated debt does not merit any structural subordination notching for AEP at this time. However, if material increases in the parent company debt occur, or if there were to be a material increase in the financial or operating risk profile of AEP’s other unrated subsidiaries, we could reconsider the level of structural subordination notching.

Liquidity Analysis

AEP’s liquidity is considered adequate. Although we anticipate its significant investment program will result in negative free cash flow for the foreseeable future, the company has demonstrated capital markets access and its credit facilities currently provide adequate protection. For the twelve months ending 3/31/2016, AEP generated approximately $4.3 billion of cash from operations (CFO), invested $4.7 billion in capital expenditures and paid $1.1 billion in dividends resulting in a negative free cash flow (FCF) of approximately $1.5 billion.

AEP has two syndicated credit facilities totaling $3.5 billion, a $1.75 billion facility expiring in June 2017 and another $1.75 billion facility expiring in July 2018. Both permit same-day borrowing and have a combined letter of credit sub-limit of $1.2 billion. At March 31, 2016, AEP had $502 million of commercial paper outstanding and $1.8 million of letters of credit issued leaving about $3.0 billion of availability on its credit facilities.

AEP is not required to make a representation with respect to either material adverse change or material litigation in order to borrow under the facilities. Default provisions exclude non-significant subsidiaries (including AGR) cross-default and insolvency/bankruptcy provisions. The facilities contain a covenant requiring that AEP’s consolidated debt to capitalization (as defined) not to exceed 67.5%. AEP states the contractually defined ratio was 51% at March 31, 2016.

Including securitization bonds, put bonds and other amortizations, AEP has debt maturities of about $1.8 billion in 2016 and $2.7 billion in 2017. AEP has a receivables securitization agreement of $750 million that expires in June 2017.

Profile

American Electric Power Company, Inc. (AEP: Baa1 stable), headquartered in Columbus, Ohio, is a large electric utility holding company with ten vertically integrated or retail transmission and distribution utility subsidiaries operating in eleven states. The company also operates transmission companies within the eastern and southwestern regions of the United States and owns a predominately Ohio based competitive generation and marketing business for which it is currently evaluating strategic alternatives. AEP has a regulated rate base of approximately $29 billion and serves about 5.4 million customers. In 2016, the company’s total generation capacity of about 35,000 MW (including power purchase agreements, approximately 6,752 MW of competitive generating assets, and reflecting about 750 MW of coal to gas conversions expected to be completed in 2016), is about 52% coal/lignite fired. For 2015, AEP’s regulated retail revenue composition by customer class was about 41% residential, 24% commercial, 19% industrial, 13% wholesale and 3% other.
## Rating Methodology and Scorecard Factors

**Exhibit 3**

<table>
<thead>
<tr>
<th>Factor 1: Regulatory Framework (25%)</th>
<th>Measure</th>
<th>Score</th>
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</thead>
<tbody>
<tr>
<td>a) Legislative and Judicial Underpinnings of the Regulatory Framework</td>
<td>A</td>
<td>A</td>
</tr>
<tr>
<td>b) Consistency and Predictability of Regulation</td>
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<table>
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<tr>
<th>Factor 2: Ability to Recover Costs and Earn Returns (25%)</th>
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<tr>
<td>a) Timeliness of Recovery of Operating and Capital Costs</td>
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<td>Baa</td>
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<td>b) Sufficiency of Rates and Returns</td>
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<th>Factor 3: Diversification (10%)</th>
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<td>a) Market Position</td>
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<td>b) Generation and Fuel Diversity</td>
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<tr>
<th>Factor 4: Financial Strength (40%)</th>
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<tr>
<td>a) CFO pre-WC + Interest / Interest (3 Year Avg)</td>
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<td>b) CFO pre-WC / Debt (3 Year Avg)</td>
<td>17% - 22%</td>
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<tr>
<td>c) CFO pre-WC - Dividends / Debt (3 Year Avg)</td>
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<tr>
<td>d) Debt / Capitalization (3 Year Avg)</td>
<td>40% - 45%</td>
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**Rating:**

| Grid-Indicated Rating Before Notching Adjustment | Baa1 |
| HoldCo Structural Subordination Notching      | Baa1 |
| a) Indicated Rating from Grid                  | Baa1 |
| b) Actual Rating Assigned                      | Baa1 |

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[3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures. Source: Moody's Investors Service
# Ratings

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*Source: Moody's Investors Service*
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American Electric Power Company, Inc.

No impact to AEP from FERC rescission of affiliate waiver

On April 27, 2016, the Federal Energy Regulatory Commission (FERC) rescinded the affiliate waivers granted to American Electric Power Company, Inc. (AEP, Baa1 stable) and First Energy Corp. (First Energy, Baa3 negative) and required them to submit recently authorized power purchase agreements (PPAs) between their merchant generating and utility subsidiaries to FERC for approval prior to implementation. As such, the Public Utilities Commission of Ohio (PUCO) approved PPA between AEP subsidiaries Ohio Power Company (OPCo, Baa1 stable) and AEP Generation Resources (AGR not rated) cannot go into effect on June 1, 2016 as planned. Although we viewed the PPA as positive for AEP, as it would have allowed the company to earn a regulated return on approximately 2,700 MW of merchant capacity and was consistent with the company’s strategy of focusing strictly on its core regulated businesses, the impact on financial metrics is modest and there has been no change in the company’s de-risking strategy.

The affiliate PPAs were under fire as they were viewed by many as subsidizing the companies’ merchant generating operations by way of non-bypassable surcharges that potentially transferred benefits from utility ratepayers to shareholders. Although the revenues AEP would have received under the PPA are greater than the revenues the assets are expected to generate from the sale of energy and capacity on a merchant basis, we anticipate AEP’s consolidated financial metrics will remain robust. For example, we estimate, based on current market prices, on an annualized basis, the ratio of cash flow from operations excluding changes in working capital to debt may be about 1% lower. However, we anticipate the ratio will remain appropriate for the rating in the high-teens range.

AEP management has stated they are not interested in a protracted FERC proceeding and are instead focused on their goal of becoming a premium regulated utility. The company is planning to move forward on two simultaneous alternatives. First, the PPA assets will be included in the strategic review (divestiture) process that is currently in progress for the other approximately 5,200 MW of generating assets AGR holds in Ohio; this process would be expected to conclude by mid-2017. Second, AEP will push for re-regulation in Ohio, or the potential ability to transfer the PPA assets back to OPCo; either of these alternatives would require legislative involvement. Given the level of understanding of the issues surrounding generation in Ohio, AEP feels the legislature could also move quickly along this path. In either case, AEP will have ultimately removed its merchant exposure.
Headquartered in Columbus Ohio, AEP is a large electric utility holding company with ten vertically integrated or retail transmission and distribution utility subsidiaries operating in eleven states. The company also operates transmission companies within the eastern and southwestern regions of the United States and owns a predominately Ohio based competitive generation and marketing business for which it is currently evaluating strategic alternatives.
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Credit Opinion: **American Electric Power Company, Inc.**

Global Credit Research - 30 Nov 2015

*Columbus, Ohio, United States*

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### Contacts

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<th>Analyst</th>
<th>Phone</th>
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<tr>
<td>Laura Schumacher/New York City</td>
<td>212.553.3853</td>
</tr>
<tr>
<td>William L. Hess/New York City</td>
<td>212.553.3837</td>
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### Key Indicators

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<td>CFO pre-WC + Interest / Interest</td>
<td>6.3x</td>
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<td>5.1x</td>
<td>4.6x</td>
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<td>22.9%</td>
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<td>19.6%</td>
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<td>18.2%</td>
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<td>15.0%</td>
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<td>Debt / Capitalization</td>
<td>43.2%</td>
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<td>46.5%</td>
<td>47.6%</td>
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*Note: For definitions of Moody's most common ratio terms please see the accompanying [User's Guide](#).*

### Opinion
Rating Drivers

Diversity of regulatory jurisdictions and service territories provide a strong foundation for current rating

Continued regulatory support with timely and sufficient cost recovery is credit positive

Substantial investments in regulated transmission networks and for environmental mandates

Financial metrics are expected to move lower due to substantial capital expenditures - though primarily for lower risk transmission and distribution investments

Corporate Profile

American Electric Power Company, Inc. (AEP: Baa1 stable), headquartered in Columbus, Ohio, is a large electric utility holding company with ten vertically integrated or retail transmission and distribution utility subsidiaries operating in eleven states. The company also operates transmission companies within the eastern and southwestern regions of the United States and owns a predominately Ohio based competitive generation and marketing business for which it is currently evaluating strategic alternatives. AEP has a regulated rate base of approximately $29 billion and serves about 5.4 million customers. In 2015, the company’s total generation capacity of about 37,303 MW (including power purchase agreements, approximately 7,225 MW of competitive generating assets, and reflecting about 750 MW of coal to gas conversions expected to be completed in 2016), is about 52% coal/lignite fired. For 2014, AEP’s retail revenue composition by customer class was 42% residential, 24% commercial, 19% industrial and 15% wholesale.

SUMMARY RATING RATIONALE

AEP’s Baa1 rating is underpinned by the size and diversity of its regulatory jurisdictions and service territories. AEP’s ten retail utility subsidiaries operate under eleven different state regulatory bodies and with Federal Energy Regulatory Commission (FERC) regulation for its transmission subsidiaries. The rating reflects AEP’s stable earnings profile which over the past several years has yielded cash flow from operations pre-working capital (CFO pre-WC) to debt metrics in the high-teens. Cash flow stability is supported by AEP’s renewed corporate strategy of focusing on its core utility assets with more predictable earnings. These positive credit factors are balanced against weak demand growth associated with some of its larger service territories, namely the Appalachian economies, a prolonged period of material capital investments and an increasing amount of debt. The rating also incorporates a view that AEP will continue to evaluate strategic alternatives for its merchant generating fleet, including a sale or long-term PPA with a regulated affiliate, with a goal of maintaining cash flow predictability, a credit positive.

RECENT EVENTS

Sale of AEP River Operations LLC

AEP recently sold its river barge business, AEP Operations LLC (unrated), for $550 million to American Commercial Lines (ACL, unrated) as operating a commercial barge business no longer fits into AEP’s strategy. AEP River Operations was not a large part of AEP’s overall business with earned income of $50 million or 3% of AEP’s 2014 consolidated net income of $1.6 billion. Its earnings have also been volatile over the last few years, with earned income of $15 million in 2012 and $12 million in 2013.

AEP netted approximately $400 million in cash after taxes, debt retirements and transaction fees from this sale and expects to record a net gain of about $125 million. AEP plans to reinvest these proceeds into its transmission business regulated by the FERC, a credit positive. FERC-regulated transmission assets earn equity returns through a formulaic rate-making structure.

DETAILED RATING CONSIDERATIONS

Diversity of regulatory jurisdictions and service territories provide a strong foundation for current rating

AEP’s diversity in terms of regulatory jurisdictions and service territory economies is a meaningful credit strength as it provides AEP with a degree of insulation from any unexpected negative developments occurring at any one of its operating companies, state regulatory bodies or state economies. This diversity has been essential in helping AEP deal with an elevated capital expenditure program and weak demand growth in some of its service territories.

AEP’s primary regulated utilities and their regulatory jurisdictions are as follows: Ohio Power Company (OPCo:
In May 2015, the WVPSC issued an order in APCo’s pending base rate case authorizing a

For further information on these service territories please refer to each utility’s credit opinion on Moodys.com.

Continued regulatory support with timely and sufficient cost recovery important to credit quality

Given the significant amount of capital expenditures AEP has planned across its regulated business segments it is essential that AEP maintain a supportive relationship with its regulators to maintain credit quality. The utility subsidiary ratings and stable outlooks reflect our view that AEP will continue to receive timely and consistent long-term regulatory support across the majority of its jurisdictions. Recent regulatory filings, orders and updates for AEP are as follows:

OPCo - In February 2015, the PUCO approved the implementation of a new Electric Security Plan (ESP) III for OPCo covering the period June 1, 2015 through May 31, 2018 with a return on common equity (ROE) of 10.2% on capital costs for certain riders including a distribution investment rider. OPCo's initial request included authorization of a purchased power agreement (PPA) rider that would allow retail customers to receive a rate stabilizing charge or credit by hedging market based prices with a cost based PPA with AEP Generation Resources Inc. (AGR not rated) AEP's competitive generating subsidiary. The PUCO authorized the establishment of a PPA rider, but at a rate of zero.

The PUCO order provided the opportunity for OPCo to reapply in the future with a more detailed PPA proposal pending the outcome of a separate proceeding to evaluate the requested PPA. OPCo has proposed an extended PPA with AGR for 2,671 MW and also included OPCo's 953 MW Ohio Valley Electric Cooperative (OVEC) purchase commitment in the PPA rider. In October 2015, the PUCO staff submitted testimony that opposed the new PPA application as currently proposed, but concluded that with changes such a PPA could be in the public interest. AEP anticipates resolution of this issue in the first quarter of 2016.

In the event a PPA with AGR and the associated riders are not ultimately established, OPCo will continue to obtain energy for its customers via a PUCO approved competitive bidding process and to recover these costs through its Generation Energy Rider. A PPA with OPCo would provide cash flow stability for its customers and about a third of AGR's generating capacity. In the event a PPA is not established, AEP would likely seek to divest or otherwise reduce their exposure to these assets along with the remaining AGR and OVEC interests.

APCo (Virginia) - In February 2015, Virginia enacted legislation temporarily suspending its required biennial review of investor-owned utility earnings, effectively freezing rates for APCo through the 2017 test year. Biennial reviews are to begin again in 2020 addressing results for the 2018 and 2019 test years. This is positive for APCo considering its last biennial review decision (issued November 2014) found that for the 2012 and 2013 test years APCo had on average earned an 11.86% ROE, which was above the upper end of the 10.4%-11.4% allowed range established for those years. APCo was required to make refunds totaling $5.8 million, and the commission set a baseline ROE of 9.7% for the biennial review for 2014 and 2015 which is significantly below the prior 10.9% baseline (although the allowable range was widened so the upper boundary would have been 10.4%). As the biennial reviews have been suspended, no refunds will be required in the event of over earning until the next review in 2020. We note however that the legislation also requires APCo to absorb any incremental expenses incurred through 2017 as a result of severe weather events or costs associated with impairments due to new carbon emissions guidelines issued by the Federal EPA, a credit negative. Rider recovery of various other expenses and investments will continue and biennial proceedings will continue to set the appropriate ROE to be used in the calculations.

APCo (West Virginia) - In May 2015 the WWPSC issued an order in APCo's pending base rate case authorizing a
$99 million rate increase based on a 9.75% return on equity. The initial case was filed almost a year prior in June 2014 requesting a $226 million increase in annual revenues based on a 10.62% return on equity. The WVPSC's order also included the delayed billing of $25 million of the rate increase to residential customers until July 2016. On a positive note, the order also included approval of an annual vegetation rider of $45 million, revised depreciation rates and recovery of $89 million in previously recorded regulatory assets over five years.

PSO - In July 2015 PSO filed a request with the OCC to increase annual revenues by $137 million to recover costs associated with its environmental compliance plan and other rate base additions. The rate increase included a 10.5% return on equity. In October 2015 the OCC filed testimony recommending that annual revenues increase by $10 million to $31 million based on returns on equity ranging from 8.75% to 9.3%. Hearings are scheduled for December 2015.

Transfer of Mitchell Plant to Wheeling Power Company (WPCo unrated) and KPCo:

WPCo is a distribution utility serving approximately 41,000 customers in northern West Virginia. In January 2015, AEP completed the transfer, at net book value, of AGR's one half (780 MW) ownership of the Mitchell Plant to WPCo. As discussed below, the other 50% was transferred to KPCo. The transfer is credit positive for AEP because it brings the majority of the generating asset immediately into the regulated rate base. The rate impact for WPCo’s customers is mitigated by a provision in the approved settlement agreement which excludes 17.5% of WPCo’s Mitchell ownership from rate base until no later than 2020.

In June 2015, the KPSC issued an order approving a modified stipulation agreement in KPCo's December 2014 filed rate case that included a net revenue increase of $45 million. The increase consisted of a $68 million increase in rider rates offset by a $23 million decrease in annual base rates. The approved agreement was positive in that the increase reflects KPCo's ownership interest in the Mitchell Plant and riders to recover costs associated with the planned shut down and coal-to-gas conversion at the Big Sandy plant. In 2016, AEP expects KPCo will be able to earn a return on equity of about 8.6%, which is a significant improvement over the negative returns exhibited for the twelve months ending September 2015.

For more details regarding any of AEP's subsidiaries regulatory updates please refer to their pages on Moodys.com.

Substantial investments in regulated transmission networks and environmental mandates

AEP has been investing heavily to meet stringent environmental compliance requirements and to assure reliability throughout its service territories. High capital investment levels are expected to continue and the company has announced a program of approximately $13 billion for 2016 through 2018. Of the total $13 billion, about 96% will be spent in regulated businesses as follows: transmission about 44%, distribution 28% and generation 18%. AEP’s average projected capital investments of $4.3 billion per year through 2018 is a slight increase when compared to $4.1 billion in 2014, but a substantial increase from the $3.1 billion in 2012 and $2.7 billion in 2011. Transmission and distribution (T&D) investments are expected to be recovered largely either through the transmission formula based rates or rider recovery, a credit positive. Generation investment is primarily recovered in base rates and more susceptible to lags in recovery. Given the sheer magnitude of the investment program, we anticipate intermediate term credit metrics could deteriorate somewhat.

Included in the above capital plan are numerous nuclear generation projects underway at I&M to extend the life of the 2,191 MW Cook nuclear plant. This project amounts to approximately $1.2 billion through 2018, excluding AFUDC. As of December 31, 2014 I&M had incurred costs of $550 million, including AFUDC. All approved costs will be recovered through a nuclear life cycle management (LCM) rider which will be determined in semi-annual proceedings and were implemented in January 2014.

Financial metrics will be pressured going forward due to substantial capex spend - though primarily for lower risk transmission and distribution investments

AEP’s key financial credit metrics remain appropriate its rating category. As of LTM Q3 2015 the adjusted three year average interest coverage ratio was 5.5 times and CFO pre-W/C to debt of 21%, both strong for the Baa rating category. Total adjusted consolidated debt has increased to $22.2 billion at September 30, 2015 from around $21 billion in 2013, a trend we expect to continue going forward mainly due to the funding of capital expenditures. For the following 18-24 months we expect AEP's financial metrics to deteriorate slightly but remain within its rating category, including an interest coverage ratio in the 4.5x-5.5x range and CFO pre-W/C to debt in the mid-to-high teens.
As of September 30, 2015, AEP had parent level debt obligations of about $1.7 billion, or 8% of AEP’s total debt. These parent level obligations are made up of about $850 million of holding company debt and $845 million in debt guaranteed by the parent for its competitive business AGR. AEP is also dedicated to growing its transmission footprint through AEP Transmission Company (AEP TransCo: not rated) and several joint ventures (JVs). AEP Transco is fully regulated by the FERC and had debt of about $1.3 billion, or 7% of AEP’s total debt.

Historically we have not applied any structural subordination notching to AEP’s Baa1 rating relative to the credit quality and ratings of its subsidiaries due to the diversity and the stability of AEP’s operating subsidiaries cash flows. It is our view that the modest 8% level of parent holding company debt and debt guaranteed by the parent relative to total consolidated debt does not merit any structural subordination notching for AEP at this time. However, if material increases in the parent company debt occur or if AGR’s divestiture looks uncertain, or if there were to be an increase in the financial or operating risk profile of AEP’s other unrated subsidiaries, we could reconsider the level of structural subordination notching.

**Liquidity**

AEP’s liquidity is adequate. AEP has two syndicated credit facilities totaling $3.5 billion, a $1.75 billion facility expiring in June 2017 and another $1.75 billion facility expiring in July 2018. Both permit same-day borrowing and have a combined letter of credit sub-limit of $1.2 billion. At September 30, 2015 AEP had $32 million of commercial paper outstanding and $33 million of letters of credit issued leaving over $3.4 billion of availability on its credit facilities.

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 non-significant subsidiaries’ (including AGR) cross-default and insolvency/bankruptcy provisions. The facilities contain a covenant requiring that AEP’s consolidated debt to capitalization (as defined) not to exceed 67.5%. AEP states the contractually defined ratio was 50.6% at September 30, 2015.

Including securitization bonds, put bonds and other amortizations, AEP has debt maturities of about $1.2 billion in 2016 and $2.6 billion in 2017. In June 2014 AEP increased its $700 million receivables securitization agreement to $750 million with an expiration of June 2017.

At LTM 9/30/2015, AEP generated approximately $4.8 billion of cash from operations (CFO), invested $4.3 billion in capital expenditures and paid $1 billion in dividends resulting in a negative free cash flow (FCF) of approximately $500 million.

**Rating Outlook**

AEP’s stable outlook reflects its diversified regulatory jurisdictions and service territories and our expectation that those jurisdictions will remain credit supportive and not prevent or materially delay the recovery of prudently incurred costs. The outlook also considers AEP’s prudent financial management and an expectation that credit metrics may weaken somewhat but that CFO pre-WC to debt will remain in the high-teens which is appropriate for the rating.

**What Could Change the Rating - Up**

A rating upgrade for AEP could occur if AEP were successful in selling its unregulated operations and produces a stronger set of financial credit metrics including interest coverage above 5.5x and CFO pre-WC to debt in the mid-twenties on a sustainable basis.

**What Could Change the Rating - Down**

AEP’s rating could be downgraded if a more contentious regulatory environment were to develop in any key jurisdiction, if environmental and nuclear investments cannot be recovered on a reasonably timely basis, or if AEP’s financial metrics were to deteriorate on a sustained basis resulting in CFO pre-WC to debt in the low-teens.

**Rating Factors**

American Electric Power Company, Inc.

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<td>21.0%</td>
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<td>c) CFO pre-WC - Dividends / Debt (3 Year Avg)</td>
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<td>d) Debt / Capitalization (3 Year Avg)</td>
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[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] As of 9/30/2015(L); Source: Moody's Financial Metrics [3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.

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AEP Casts Away Its Barge Business, a Credit Positive

From Credit Outlook

Last Thursday, American Electric Power Company, Inc. (AEP, Baa1 stable) announced that it had sold its river barge business, AEP River Operations LLC (unrated), for $550 million to American Commercial Lines (ACL, unrated). The transaction is credit positive for AEP because it reduces the company's exposure to non-utility businesses and allows it to focus on its core regulated utility assets. The company expects to close the sale in the fourth quarter of this year, pending regulatory approval.

AEP River Operations is a commercial inland barge company delivering about 45 million tons of products annually, including 10 million tons of coal. Competition within the bargeing business is intense and demand can be seasonal. Cold winters, water levels and inefficient older river locks can also limit operations, which cause earnings volatility. AEP River Operations was not a large part of AEP’s overall business with earned income of $50 million or 3% of AEP’s consolidated $1.65 billion for 2014. Its earnings have also been volatile over the last few years, with earned income of $15 million in 2012 and $12 million in 2013. Operating a commercial barge business no longer fits into AEP’s strategy, which is focused on its core utility assets with much more predictable earnings.

AEP expects to net approximately $400 million in cash after taxes, debt retirements and transaction fees from this sale and to record a net gain of about $125 million. AEP plans to reinvest these proceeds into its transmission business regulated by the US Federal Energy Regulatory Commission (FERC), a credit positive. FERC-regulated transmission assets earn equity returns through a formulaic rate-making structure.

AEP will not completely exit the barge business because it retains ownership of its captive barge fleet, which delivers approximately 19 million tons of coal to the company’s regulated coal-fueled power plants owned by AEP subsidiaries Appalachian Power Company (Baa1 stable), Kentucky Power Company (Baa2 stable) and Indiana Michigan Power Company (Baa1 stable).

Global Credit Research - 18 May 2015

Columbus, Ohio, United States

Ratings

| Category                        | Moody's Rating | Outlook | Stable | Baa1 | (P)Baa2 | P-2
|---------------------------------|----------------|---------|--------|------|--------|-----
| Senior Unsecured                | Baa1           |         |        |      |        |     |
| Jr Subordinate Shelf            | (P)Baa2        |         |        |      |        |     |
| Commercial Paper                | P-2            |         |        |      |        |     |
| AEP Texas North Company         |                |         |        |      |        |     |
| Outlook                         | Stable         |         |        |      |        |     |
| Issuer Rating                   | Baa1           |         |        |      |        |     |
| Appalachian Power Company       |                |         |        |      |        |     |
| Outlook                         | Stable         |         |        |      |        |     |
| Issuer Rating                   | Baa1           |         |        |      |        |     |
| Southwestern Electric Power Company |            |         |        |      |        |     |
| Outlook                         | Stable         |         |        |      |        |     |
| Issuer Rating                   | Baa2           |         |        |      |        |     |
| Senior Unsecured                | Baa2           |         |        |      |        |     |
| Indiana Michigan Power Company  |                |         |        |      |        |     |
| Outlook                         | Stable         |         |        |      |        |     |
| Issuer Rating                   | Baa1           |         |        |      |        |     |
| Senior Unsecured                | Baa1           |         |        |      |        |     |

Contacts

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<tr>
<th>Analyst</th>
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<tbody>
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Key Indicators

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<td>5.8x</td>
<td>5.7x</td>
<td>5.0x</td>
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<td>21.2%</td>
<td>19.2%</td>
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<td>Debt / Capitalization</td>
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Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.
Rating Drivers

Diversity of regulatory jurisdictions and service territories provides strong foundation for current rating

Continued regulatory support, timely and sufficient costs recoveries is credit positive

Substantial investments in regulated transmission networks and environmental mandates

Financial metrics look pressured due to weak demand growth in eastern service territories and higher parent debt

Corporate Profile

American Electric Power Company, Inc. (AEP: Baa1 stable), headquartered in Columbus, Ohio, is a large electric utility holding company with nine utility subsidiaries operating in eleven states representing approximately $27 billion of rate base and serving about 5.3 million customers. AEP's 2014 total generation capacity by fuel diversity, including power purchase agreements, based on MW is 60% coal/lignite fired, without considering around of 16% announced retirements. The breakdown of Kilowatt hour (kWh) sales in 2014 was approximately 29% residential, 24% commercial, 28% industrial, 18% wholesale and 1% other.

SUMMARY RATING RATIONALE

AEP's Baa1 rating reflects the size and diversity of its regulatory jurisdictions and service territories, and steady cash flow metrics which produced a ratio of cash flow pre-working capital (CFO pre-WC) to debt in the high-teens over the past several years. These positive credit factors are balanced against weak demand growth associated with some its larger service territories (Appalachian economies), a prolonged period of material capital investments, and an increasing amount of parent holding company debt. The rating also incorporates a view that AEP will, over the next 12 - 24 months, divest its unregulated merchant generating assets and river barge operations, a credit positive.

DETAILED RATING CONSIDERATIONS

DIVERSITY OF REGULATORY JURISDICTIONS AND SERVICE TERRITORIES PROVIDES STRONG FOUNDATION FOR CURRENT RATING

From a credit perspective, AEP's diversity in terms of regulatory jurisdictions and service territory economies are meaningful credit strengths as they provide the parent company with a degree of insulation from any unexpected negative developments occurring at one of its companies, state regulators or state economy's. The largest states ranked by rate base are Virginia, West Virginia, Ohio, Indiana, Oklahoma and Texas.

AEP's regulated utilities operate under the following regulatory jurisdictions; Appalachian Power Company (APCo: Baa1 stable) under the Virginia State Corporation Commission (VSCC) and the more challenging Public Service Commission of West Virginia (PSC WV); Kentucky Power Company (KEPCo: Baa2 stable) under the Kentucky Public Service Commission (KPSC); Ohio Power Company (OPCo: Baa1 stable) under the Public Utility Commission of Ohio (PUCO); Indiana Michigan Power Company (I&M: Baa1 stable) under the Indiana Utility Regulatory Commission (IURC) and the Michigan Public Service Commission (MPSC); Public Service Company of Oklahoma (PSO: A3 stable) under the Oklahoma Corporation Commission (OCC); Southwestern Electric Power Company (SWEPCo: Baa2 stable) under the Louisiana Public Service Commission (LPSC); the Arkansas Public Service Commission (ARPC) under the Public Utility Commission of Texas (PUCT); and AEP Texas North Company (TNC: Baa1 stable) and AEP Texas Central (TCC: Baa1 stable) both under the PUCT. For further information on these service territories please refer to each utilities credit opinion on Moodys.com.

AEP's western service territories with their greater leverage to the energy economy have registered a much stronger recovery than those in the east (more challenged due to Federal budget cuts, waning coal exports and slow industrial growth that is straining the Appalachian economies). Overall, 2014 sale volumes were positive for AEP on a consolidated basis, with retail sales increasing by 1.1% and industrial sales increasing by 0.4% when compared to 2013.

CONTINUED REGULATORY SUPPORT, TIMELY AND SUFFICIENT COST RECOVERIES NEEDED

We think AEP will continue to receive timely and consistent long-term regulatory support across all of its jurisdictions because of plant retirements, recovery of capital expenditures associated to transmission and distribution (T&D) and other investments in the regulated business segment.
For example, in November 2014, the VSCC issued an order concluding that APCo had earned an average 11.86% ROE versus its 11.4% baseline ROE for 2012 and 2013. These returns are above the national average. The order included, among others, a $6 million refund to customers and a 9.7% ROE as the baseline for APCO's biennial earnings review for 2014 and 2015.

In January 2015, AEP completed the transfer, at net book value, of one-half interest of AEP Generating Resources’ (AGR, not rated) ownership of Mitchell Plant to WPCo. The transfer is credit positive because it moves the majority of the generating asset into the regulated rate base. WPCO and APCo's (WV) customers rates would be impacted by addition of rate base to WPCo; however in the settlement, 17.5% of Mitchell is excluded from rate base until no later than 2020.

In June 2014, APCo filed a request with the WVpsc to increase annual rate bases by $226 million, based upon a 10.62% ROE to be effective in the second quarter of 2015. The filing included a request to increase generation and depreciation rates, requested recovery of $89 million over five years related to storm costs and the implementation of a rider of approximately $45 million to recover total vegetation management costs. A resolution is expected before end of Q2 2015.

In January 2015 the KPSC issued an order disallowing certain fuel adjustment costs, and directing KPCo to refund about $13 million to customers by the end of the Q2 2015. This order stemmed from the transfer approval of the 50% ownership in Mitchell plant which has led to a surplus of capacity at KPCo and additional costs to the rate payers. The impact of this order on cash flow metrics are credit negative. In December 2014, the utility filed for an increase of $70 million in rates and a $75 million increase in rider rates offset by a $5 million decrease in annual base rates to be effective July 2015. The increase also reflects the inclusion of Mitchell's environmental plan, and recovery of Big Sandy plant's retirement and operational costs and deferred storm costs riders.

In April 2014 PSO agreed, via settlement with OCC, to reduce its electric base rates by $4.8 million and adopt a 9.85% ROE. The settlement benefits PSO with an advanced metering investments (AMI) rider which will provide additional revenues of $17 million and $27 million in revenues in 2015, 2016 and 2017 respectively. The settlement also allows PSO's Southwest Power Pool Transmission Cost Tariff rider and its off-system sales margin-sharing provisions to remain unchanged. A credit positive.

In 2014 SWEPCo reversed $114 million of previous regulatory disallowances that excluded AFUDC from the Turk plant in Texas resulting in a base rate increase of about $52 million, a credit positive.

In February 25, the PUCO approved the implementation of a new ESP III covering the period June 1, 2015 through May 31, 2018. For more details regarding OPCo's regulatory outcomes during 2014, please refer to OPCo's credit opinion.

SUBSTANTIAL INVESTMENTS IN REGUALTED TRANSMISSION NETWORKS AND ENVIRONMENTAL MANDATES

AEP is still exposed to stringent environmental compliance requirements and has announced a capital investment program for 2015 through 2017 of approximately $12 billion, of which 96% will be spent in the regulated businesses as follows: transmission about 40%, distribution 30% and generation 22%. Transmission and distribution (T&D) investments are expected to be recovered either through the transmission formula base rates or rate case activity, a credit positive.

AEP's average projected capital investments of $4.0 billion per year through 2017 is a slight decrease compared to $4.4 billion in 2014, but a substantial increase from the $3.1 billion in 2012 and $2.7 billion in 2011. We expect AEP will successfully obtain state-level and even federal-level extensions for Mercury and Air Toxics Standard (MATS) compliance, however if not successful the investment schedule may be accelerated and could stress intermediate term financial metrics.

AEP also has an important nuclear generation project underway at I&M to extend the life of the Cook nuclear plant. This project amounts to approximately $1.2 billion through 2018, excluding AFUDC. As of December 31, 2014 I&M has incurred costs of $550 million, including AFUDC. All approved costs will be recovered through an LCM rider which will be determined in semi-annual proceedings and were implemented in January 2014.

FINANCIAL METRICS LOOK PRESSURED DUE TO WEAK DEMAND GROWTH IN EASTERN SERVICE TERRITORIES AND HIGHER PARENT DEBT

AEP's key financial credit metrics remain appropriate for the grid-indicated rating category and well positioned compared to peers in the region. For 2014 and LTM Q1 2015, the interest coverage ratio was 5.7x and 5.8x, CFO
pre-WC to debt (Leverage ratio) 21% and 21.7%, CFO pre-WC minus dividends to debt (RCF ratio) 16.7% and 17%, and debt to capitalization was 44% for both periods. From 2012 to 2014, AEP generated on approximately $4.5 billion in CFO pre-WC and invested about $4 billion in capital expenditures per year. Total adjusted consolidated debt has increased to $22 billion in 2014 from around $21 billion in 2012. For the following 18-24 months we expect AEP’s financial metrics to deteriorate slightly but remain within its rating category, such as an interest coverage ratio in the 4.0x-5.0x range, leverage ratio in the mid- to high teens range, RCF ratio in the mid-teens range and debt to book capitalization in high forties range.

AEP’s non-utility debt has grown from approximately 9% in 2012 to 20% ($4.0 billion) in 2014, of which 10% is a combination of direct parent holding company debt and debt guaranteed by the parent for its competitive business, approximately $1.9 billion. The competitive business includes AEP Generating Resources (AGR: not rated) and AEP’s barge business, representing about $1.1 billion debt guaranteed by the parent. AEP is also dedicated to growing its transmission footprint through AEP Transmission Company (AEP TransCo) and several joint ventures (JVs), representing approximately $1.1 billion in debt at the parent. The remaining debt consolidated at the AEP parent level is $250 million for AEP Generating (under FERC and IURC), $750 million in receivable securitization fully recovered in retail rates along with other monies for general corporate purposes.

Historically we have not applied any structural subordination notching to AEP’s Baa1 rating relative to the credit ratings of its subsidiaries due to the diversity and the stability of AEP’s operating subsidiaries cash flows. It is our view that the 10% ratio of parent holding company debt and debt guaranteed by the parent relative to total consolidated debt (excluding the transmission debt) does not merit any structural subordination notching for AEP at this time. However, increases in the parent company debt, or if AGR’s divestiture looks uncertain, where the company is financed by AEP (or based on parent support) on a permanent or quasi-permanent basis, would be viewed as a material credit negative. As such, AEP would receive additional scrutiny with respect to the level of structural subordination notching.

**Liquidity**

AEP’s liquidity is adequate. AEP has two syndicated credit facilities totaling $3.5 billion, a $1.75 billion facility expiring in June 2017 and another $1.75 billion facility expiring in July 2018. Both permit same-day borrowing and have a combined letter of credit sub-limit of $1.2 billion. At year-end 2014 AEP had $602 million of commercial paper outstanding and $63 million of letters of credit issued leaving over $2.3 billion of availability on its credit facilities.

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 non-significant subsidiaries’ cross-default and insolvency/bankruptcy provisions; however the 2013 amendment excludes AGR as a significant subsidiary. The facilities contain a covenant requiring that AEP’s consolidated debt to capitalization (as defined) not to exceed 67.5%. AEP states the actual ratio was 51% at year-end 2014.

Including securitization bonds, put bonds and other amortizations, AEP has debt maturities of about $2.5 billion in 2015 and $1.3 billion in 2016, including $300 million in senior notes due in May of 2015 and $150 million in senior notes due in July of 2015. In June 2014 AEP increased its $700 million receivables securitization agreement to $750 million with an expiration of June 2016.

In 2014, AEP generated approximately $4.6 billion of cash from operations (CFO), invested $4.3 billion in capital expenditures and paid $1 billion in dividends resulting in a negative free cash flow (FCF) of approximately $700 million.

**Rating Outlook**

AEP’s stable outlook reflects its diversified regulatory jurisdictions and service territories and the expectation that those jurisdictions will remain supportive and not prevent recovery of prudently incurred costs. The outlook also considers AEP’s prudent financial management going forward, maintaining a CFO pre-WC to debt in the high-teens, which is appropriate for the rating category. For the following 18-24 months we expect AEP’s financial metrics to deteriorate slightly but remain within its rating category, such as an interest coverage ratio in the 4.0x-5.0x range, leverage ratio in the mid- to high teens range, RCF ratio in the mid-teens range and debt to book capitalization in high forties range.

**What Could Change the Rating - Up**

A rating upgrade for AEP could occur if AEP were successful in selling its unregulated operations and producing a
stronger set of financial credit metrics including interest coverage above 4.5x, CFO pre-WC to debt in the twenties, and debt to capitalization ratio below 45% on a sustainable basis.

What Could Change the Rating - Down

AEP’s rating could be downgraded if a more contentious regulatory environment were to develop in any key jurisdiction, such as Ohio or the Appalachian region, which negatively impact material subsidiaries such as OPCo and/or APCo, or if environmental and nuclear investments cannot be recovered on a reasonably timely basis, which produces unexpected financial stress. Any weakness or volatility in the consolidated financial profile through 2016, including a ratio of CFO pre-WC to debt in the mid-teens and debt to book capitalization in the high forties on a sustainable basis, could trigger a rating downgrade.

Rating Factors

American Electric Power Company, Inc.

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<td>Factor 1 : Regulatory Framework (25%)</td>
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<td>a) Legislative and Judicial Underpinnings of the Regulatory Framework</td>
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<td>b) Consistency and Predictability of Regulation</td>
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<tr>
<td>a) Timeliness of Recovery of Operating and Capital Costs</td>
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<td>b) Sufficiency of Rates and Returns</td>
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<td>a) Market Position</td>
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<td>b) Generation and Fuel Diversity</td>
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<td>a) CFO pre-WC + Interest / Interest (3 Year Avg)</td>
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<td>b) CFO pre-WC / Debt (3 Year Avg)</td>
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<td>c) CFO pre-WC - Dividends / Debt (3 Year Avg)</td>
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<td>d) Debt / Capitalization (3 Year Avg)</td>
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Rating:

Grid-Indicated Rating Before Notching Adjustment
HoldCo Structural Subordination Notching
a) Indicated Rating from Grid
b) Actual Rating Assigned

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody’s Global Standard Adjustments for Non-Financial Corporations. [2] As of 3/31/2015(L); Source: Moody’s Financial Metrics [3] This represents Moody’s forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.

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ISSUER COMMENT
4 MARCH 2015

RATINGS

American Electric Power Company, Inc.
Issuer Rating: Baa1
Outlook: Stable

Ohio Power Company
Issuer Rating: Baa1
Outlook: Stable

KEY METRICS:

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<th></th>
<th>American Electric Power Company, Inc.</th>
<th>Ohio Power Company</th>
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<td>(CFO Pre-WC + Interest) / Interest Expense</td>
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<td>(CFO Pre-WC) / Debt</td>
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<td>(CFO Pre-WC - Div)/Debt</td>
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<tr>
<td>Debt / Capitalization</td>
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Moody’s Financial Model

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US Utilities
Ohio regulators approve Ohio Power Company’s Electricity Security Plan, a credit positive

Ohio regulators approve Ohio Power Company’s Electricity Security Plan, a credit positive


Over the past few years, Ohio’s ESP structures have provided OPCo with a reasonable suite of recovery mechanism and cash flow stability, a credit positive, during the state’s market transition into a competitive generation framework, which is expected to be reached in June 2015. Since March 2009, OPCo has operated under the ESP framework, with the first ESP (ESP I) expiring in May 2011, and the second (ESP II) expiring in May 2015. The latest ESP (ESP III) will cover the period June 1 2015 to May 31 2018.

In our opinion, the approval of the new ESP III continues a policy where the PUCO provides a more prescriptive and efficient ESP framework, a catalyst for continued support for infrastructure investments.

The ESP III is credit positive for OPCo; though the authorization of the PPA rider and future filings creates some uncertainty for the T&D utility. In the event future PPA riders are approved, they would be credit positive for OVEC as the unregulated power generation entity is currently challenged by the volatile power markets and stringent EPA mandates. The PUCO’s opinion and order acknowledged the uncertainty and speculation inherent in the process of projecting the impact of the proposed power purchase agreement (PPA) and likely net cost to customers during the life of the ESP III. Thus, the PUCO reserves the right to require a study by an independent third party of reliability and pricing issues. Also OPCo must provide for the PUCO’s rigorous oversight of the PPA rider. In addition, the PUCO directed OPCo to continue to pursue transfer of the Ohio Valley Energy Corporation (OVEC, Baa3 stable) contractual entitlements to AEP Resources, Inc. (AGR, not rated) or otherwise divest its OVEC investment. We expect OPCo to file a status report regarding the transfer of its OVEC assets by June 30.
Electricity Security Plan: A catalyst for predictable cash flows

ESP III includes full transition to auction based generation pricing beginning in June 2015, conducting six auctions to procure 100% of its standard service offer (SSO) requirements, a 10.20% ROE for certain riders. All in OPCo estimates an average decrease in rates of 9% over a three-year term for customers who received the Reliability Pricing Model (RPM) and energy-auction based generation through OPCo. Also, the ESP III includes a cost recovery path related to distribution investments and vegetation program, representing a $543 million distribution rider for the period 2015 through May 2018. While an Enhanced Service Reliability Rider (ESRR), based on prudently incurred costs, is subject to review and reconciliation on an annual basis.

By way of comparison, OPCo’s ESP I addressed three major areas: generation (including but not limited to fuel adjustment clause, capacity charges, market purchases, off-system sales (OSS), alternate energy portfolio standards (REC), incremental carrying cost for environmental investments); distribution (riders such as enhanced service reliability (ESRP), gridSmart, provider of last resort (POLR), line extensions); and transmission.

OPCo’s ESP II aimed to fine tune the suite of recovery riders, among the most relevant ones, creation of a non-by passable retail stability rider (RSR) to address base generation rates, excessive earnings test (SEET) at 12% return on equity (ROE), adjusted PJM auction based rate paid by competitive retail electric suppliers (CRES). ESP II 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) for approximately $300 million in aggregate through May 31 2015.

Ohio Power Company, a wholly owned subsidiary of American Electric Power Company is engaged in the transmission and distribution of power to nearly 1.5 million customers in Ohio.American Electric Power is one of the largest electric utilities in the United States, delivering electricity to more than 5 million customers in 11 states.

AEP ranks among the nation’s largest generators of electricity, owning nearly 38,000 megawatts of generating capacity in the U.S. AEP also owns the nation’s largest electricity transmission system, a 40,000-mile network that includes more 765 kilovolt extra-high voltage transmission lines than all other U.S. transmission systems combined.
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# Moody’s

**INVESTORS SERVICE**


Global Credit Research - 03 Nov 2014  
*Columbus, Ohio, United States*

### Ratings

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### Contacts

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<tr>
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<td>212.553.4694</td>
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<td>William L. Hess/New York City</td>
<td>212.553.3837</td>
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### Key Indicators

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*Note: For definitions of Moody’s most common ratio terms please see the accompanying [User’s Guide.]*
Rating Drivers

Diversity of regulatory jurisdictions and service territories provides strong credit foundation

Continued regulatory support, with timely and sufficient costs recoveries is credit positive

Substantial investments due to environmental mandates and regulated investments in transmission and distribution, despite weak demand growth is a risk

Financial metrics look pressured due to higher parent debt

Corporate Profile

American Electric Power Company, Inc. (AEP, Baa1 stable), headquartered in Columbus Ohio, is a large electric utility holding company with nine retail utility subsidiaries operating in eleven states representing approximately $27 billion rate base and serving about 5.3 million customers. The breakdown of megawatt hour (MWh) sales in 2013 was approximately 30% residential, 25% commercial, 28% industrial, 16% wholesale and 2% other. AEP owns or leases 37,600 megawatts (MW) of generating assets, 63% of which is coal/lignite fired.

SUMMARY RATING RATIONALE

AEP's Baa1 rating reflects the size and diversity of its regulatory jurisdictions and service territories, consolidated financial profile that includes a moderate amount of parent holding company debt and adequate liquidity and financial metrics that over the past several years have averaged high-teens CFO pre WC to debt. These positive factors are balanced against risks associated with a material increase in capital expenditures for mandated environmental requirements, an expectation for higher levels of parent holding company debt and residual execution risk in Ohio.

DETAILED RATING CONSIDERATIONS

DIVERSITY OF REGULATORY JURISDICTIONS AND SERVICE TERRITORIES PROVIDES STRONG FOUNDATION FOR CURRENT RATING

AEP’s electric utility operations are diversified in terms of regulatory jurisdictions (eleven states) and service territory economies. The largest states ranked by rate base are Ohio, Virginia, West Virginia, Texas, Indiana and Oklahoma. These jurisdictions translate into diversity in revenues (by state and operating utility), cash flows, assets and customers. From a credit perspective, AEP’s size and diversity are meaningful credit strengths as they provide the parent company with a degree of insulation from any unexpected negative developments occurring at one of its companies, state regulators or state economy’s.

The benefit from AEP's service territory diversity has been seen 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 due to Federal budget cuts, waning coal exports and slow industrial growth that is straining the Appalachian economies. Overall, AEP’s retail sales volume in 2013 declined 1.6% across the board and industrial sales declined 4.5%.

CONTINUED REGULATORY SUPPORT, TIMELY AND SUFFICIENT COST RECOVERIES NEEDED

AEP will need timely and consistent long-term regulatory support because it will be in front of several commissions in the next 12-18 months regarding, among them, plant retirements, recovery of significant capital expenditures and other related costs.

For example, in January 2014 Public Service Company of Oklahoma (PSO, A3 stable) filed a request with the Corporation Commission of the State of Oklahoma (OCC) to increase annual base rated by $38 million, based upon a 10.5% return on common equity. In June 2014 a stipulation agreement was filed between PSO and the OCC. The stipulation recommended no overall change to the transmission rider or annual revenues, other than additional revenues through a advanced metering investments (AMI) rider which would provide PSO $7 million, $17 million and $27 million in revenues in 2015, 2016 and 2017 respectively. New depreciation rates are also recommended for advanced metering investments and existing meters and the stipulation recommends recovery of regulatory assets for 2013 storms and regulatory rate case expenses. An order is anticipated in the fourth quarter of 2014.

In March 2014, Appalachian Power Company (APCo, Baa1 stable) filed its biennial rate case with the Virginia
State Corporation Commission (Virginia SCC). APCo did not request an increase in base rates as its Virginia retail combined rate of return on common equity for 2012 and 2013 was within the statutory range (10.9%). The filing also included a request to decrease generation depreciation rates effective February 2015 and a request to amortize $7 million annually for two years beginning February 2015 related to IGCC and other deferred costs.

In August 2014, the Virginia SCC staff and intervenors filed testimony concluding that APCo’s adjusted earned rate of return on common equity for 2012 and 2013 was above the allowed threshold. Staff recommendations included refunds to customers ranging from $15 million to $22 million, the write-off of certain APCo assets, including IGCC pre-construction costs and previously approved 2009 storm costs, totaling $27 million and $38 million in increased depreciation expense annually, retroactive to January 1, 2014, primarily related to accelerating depreciation on APCo generation assets to be retired in the second quarter of 2015. Hearings at the Virginia SCC were held in September 2014 and a decision is expected in November 2014.

Also in March 2014, APCo and Wheeling Power (WPCo, not rated) filed a request with the West Virginia Public Service Commission (WVPSC) for approval to transfer at net book value AGR’s ownership of Mitchell Plant to WPCo. WPCO and APCo’s (WV) customers rates would be impacted by addition of rate base to WPCo. On June 2, 2014 the Federal Energy Regulatory Commission (FERC) issued an order approving this request and an agreement was also reached in the West Virginia with a hearing held on October 21st. In the agreement 18% of Mitchell is excluded from rate base until no later than 2020. The transfer is expected by year end 2014.

Then, in June 2014, APCo filed a request with the WVPSC to increase annual rate bases by $226 million, based upon a 10.62% ROE to be effective in the second quarter of 2015. The filing included a request to increase generation and depreciation rates, requested recovery of $89 million over five years related to storm costs and the implementation of a rider of approximately $45 million to recover total vegetation management costs. Hearings are the WVPSC are scheduled for January 2015.

In August 2014, the Kentucky Public Service Commission (KPSC) issued an order initiating a review of Kentucky Power Company’s (KPCo, Baa2 stable) fuel adjustment clause from November 2013 through April 2014. In October 2014, intervenors filed testimony that recommended the KPSC direct KPCo to modify its fuel allocation methodology and order a refund to customers of approximately $13 million, plus carrying charges at a weighted average cost of capital, related to the period January 1, 2014 through April 30, 2014. A hearing at the KPSC is scheduled for November 2014.

Ohio Power Company (OPCo, Baa1 stable) operated under an Electric Security Plan (ESP I) (March 2009 to 2011) and currently ESP II (June 2012 to May 2015), which provide a reasonable suit of recovery mechanism and cash flow stability through the Ohio transition into a full competitive generation market by June 2015. Under the ESPs, as of September 30, 2014, OPCo’s net deferred fuel balance was $395 million, excluding unrecognized equity carrying costs and capacity deferral estimated at $463 million by the end of May 2015. OPCo also obtained approval from Public Utility Commission of Ohio (PUCO) to securitize $298 million of approved deferred distribution asset recovery rider costs.

In December 2013, OPCo filed an application with the PUCO to approve a new ESP III from June 2015 to May 2018. Full transition to auction based generation pricing will begin in June 2015. The proposal also includes a recommended auction schedule, an ROE of 10.65% on capital costs, the continuation and modification of certain existing riders, including the Distribution Investment Rider (DIR) and a purchased power agreement rider (PPA) for their 19.3% share of the Ohio Valley corporation (OVEC, Baa3 stable). In October 2014, OPCo filed a separate application with the PUCO to propose a new PPA for inclusion in the PPA rider, known as the expanded PPA which would include an additional 2,671 MW to be purchased from AEP Generation Resources (AGR, not rated) over the life of the respective generating units.

SUBSTANTIAL INVESTMENTS DUE TO ENVIRONMENTAL MANDATES AND REGUALTED INVESTMENTS IN T&D

AEP is still exposed to stringent environmental compliance requirements and has announced a capital investment program for 2014 through 2016 of approximately $11.7 billion. Approximately 96% of that amount will be spent in the regulated businesses as follows: generation $2.9 billion (25%), distribution $3.1 billion (27%), and transmission $5.2 billion (44%). Transmission and distribution (T&D) investments are expected to be recovered either through the transmission formula base rates or rate case activity, a credit positive.

AEP also has an important nuclear generation project underway at Indiana Michigan Power Company (I&M, Baa1, stable) to extend the life of the Cook nuclear plant. This project amounts to approximately $1.2 billion through 2018, excluding AFUDC. As of September 30, 2014, I&M has incurred costs of $492 million, including AFUDC. In July
2013 the Indiana Utility Regulatory Commission (IURC) approved recovery of all costs associated with this project with the exception of $23 million which I&M could seek recovery for in a subsequent base rate case. All approved costs will be recovered through an LCM rider which will be determined in semi-annual proceedings.

We estimate AEP’s average projected total capital investments of $4.1 billion per year through 2016 is a slight increase compared to $3.7 billion in 2013, but a substantial increase from the $3.1 billion in 2012 and $2.7 billion in 2011. In the near term, environmental retrofits and transmission investments will be the largest drivers of the capital investments. We expect AEP will successfully obtain state-level and even federal-level extensions for Mercury and Air Toxics Standard (MATS) compliance, however if not successful the investment schedule may be accelerated and could stress intermediate term financial metrics.

FINANCIAL METRICS LOOK PRESSURED DUE TO HIGHER PARENT DEBT

AEP’s cash flow financial metrics have been appropriate for the rating category. In 2012, the utility recorded a three-year average interest coverage ratio of 4.2x, CFO pre WC to debt of 18.3%, and total debt to capitalization of 48.2%; for 2013 key financial metrics were 4.6x, 19% and 46.3%, respectively; and for LTM Q3 2014 key financial metrics exhibited values of 4.8x, 19.5%, and 45.3%, respectively which are strong ratios compared to peers.

CFO pre WC has improved slightly to $4.13 billion for LTM Q3 2014, from approximately $4.08 billion in 2013, and $4.16 billion in 2012. Total adjusted debt has also increased slightly to $21.4 billion in LTM Q3 2014, from $21.2 billion in 2013, resulting in debt to book capitalization ratio of 43.9% as of LTM Q3 2014. We understand that the increase in parent debt will be refinanced at the utility affiliate levels in the near future, thus causing the percentage of parent debt to revert to historical levels (approximately 5%).

If it is indeed transitional, the increase in AEP holding company debt is not expected to have any implications for downward notching of AEP debt relative to its subsidiary ratings. However, if the parent company debt is higher than expected or it becomes evident that AGR's debt will be financed at the parent level (or based on parent support) on a permanent or quasi-permanent basis, AEP’s ratings could become pressured. Especially given the increased share of unregulated generation and retail sales within AEP's overall business mix, which we currently see rising to around 25% of AEP's consolidated financial profile from historical of 11%.

Despite AEP's structural subordination relative to the debt of its subsidiaries, we do not notch AEP's rating down below the Baa1 senior unsecured rating that is assigned to the majority of its operating subsidiaries, based on the diversity and stability of subsidiaries’ cash flows, in addition to the relatively acceptable debt level at the parent company of about 8% (around $1.3 billion) at year-end 2013.

AEP will likely continue to exhibit financial metrics within its rating category, such as an interest coverage ratio in the 4.5x-5.0x range, CFO pre WC to debt in the 15%-20% range, and debt to book capitalization in the 42%-47% range. Post-transition, AEP will need to produce financial metrics towards the higher end of its rating category range; however factors that could challenge AEP during this period include longer than anticipated regulatory lag to recover environmental and nuclear capex and on the unregulated side 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).

Liquidity

AEP’s liquidity is adequate. AEP has two syndicated credit facilities totaling $3.5 billion that were renewed and extended in February 2013. One is a $1.75 billion facility expiring June 2016, and the other is also a $1.75 billion facility expiring in July 2017 and both permit same-day borrowing and have a combined letter of credit sub-limit of $1.2 billion. 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, however, based on the 2013 amendment AGR is effectively excluded as a significant subsidiary. The facilities contain a covenant requiring that AEP’s consolidated debt to capitalization (as defined) not to exceed 67.5%. AEP states the actual ratio was 49.9% at 9/30/2014, indicating substantial headroom. In early November 2014, AEP will close a renewal and extension of both facilities for one year, with maturities of June 2017 and July 2018.

As of September 30, 2014, AEP had $194 million of cash on hand and approximately $2.9 billion of availability under its two syndicated revolving credit facilities after giving effect to $532 million of commercial paper outstanding and $76 million of issued letters of credit.

Including securitization bonds, put bonds and other amortizations, AEP has no debt maturities remaining in 2014.
and about $1.8 billion in 2015. In June 2014 AEP increased its $700 million receivables securitization agreement to $750 million with an expiration of June 2016.

Over the next 24-months, Moody's estimates that AEP will generate roughly $4.0 billion annually in CFO Pre-WC, spend about $4.4 billion annually in capital investments, and pay about 1.1 billion in annual dividends. This will yield negative average free cash flow of average $1.5 billion per year, a credit negative that we think is unsustainable over the longer term horizon.

Rating Outlook

AEP's outlook is stable, reflecting its diversified regulatory jurisdictions and service territories, including expectations that those jurisdictions will remain supportive and not materially preventing recovery of prudently incurred costs. Also that AEP will exercise prudent financial management, leading to CFO pre WC to debt position close to the twenties appropriate for its regulated 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 impact the metrics threshold for maintaining its Baa1 unsecured rating. Nevertheless, ratings could be up for review, if AEP were successful in selling their unregulated operations and producing a stronger set of financial credit metrics on a sustainable basis, including interest coverage ratio above 4.5x and a ratio of CFO pre WC to debt above 22%.

What Could Change the Rating - Down

AEP's rating could be downgraded if a more contentious regulatory environment were to materialize in any key jurisdictions such as Ohio or the Appalachian region, impacting negatively material subsidiaries such as OPCo and/or APCo, or environmental and nuclear investments would not be recovered on a reasonably timely basis. All of which could result in weaker financial metrics or more volatile than expected through 2016, including a ratio CFO pre WC to debt in the mid-teens range and debt to book capitalization higher than 50%, on a sustainable 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.

Rating Factors

American Electric Power Company, Inc.

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<tr>
<td>Factor 1 : Regulatory Framework (25%)</td>
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<td>a) Legislative and Judicial Underpinnings of the Regulatory Framework</td>
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<td>b) Consistency and Predictability of Regulation</td>
<td>Baa Baa</td>
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<td>Factor 2 : Ability to Recover Costs and Earn Returns (25%)</td>
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<td>a) Timeliness of Recovery of Operating and Capital Costs</td>
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<td>b) Sufficiency of Rates and Returns</td>
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<td>Factor 3 : Diversification (10%)</td>
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<td>a) Market Position</td>
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<td>b) Generation and Fuel Diversity</td>
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<td>Factor 4 : Financial Strength (40%)</td>
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<td>a) CFO pre-WC + Interest / Interest (3 Year Avg)</td>
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<td>b) CFO pre-WC / Debt (3 Year Avg)</td>
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<td>c) CFO pre-WC - Dividends / Debt (3 Year</td>
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<td>d) Debt / Capitalization (3 Year Avg)</td>
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[1] All ratios are based on 'Adjusted' financial data and incorporate Moody’s Global Standard Adjustments for Non-Financial Corporations. [2] As of 9/30/2014 (LTM); Source: Moody’s Financial Metrics [3] This represents Moody’s forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on http://www.moodys.com for the most updated credit rating action information and rating history.

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Ohio Power Company

PPA filing would be credit positive for AEP, but regulators might alter proposal

On 3 October 2014, Ohio Power Company (OPCo, Baa1 stable) a transmission and distribution utility subsidiary of American Electric Power Company (AEP, Baa1 stable), filed an expanded Power Purchase Agreement (PPA) with the Public Utilities Commission of Ohio (PUCO). The PPA is designed to provide OPCo’s customers with more stable electricity prices during periods of market volatility and enhance reliability ahead of any early coal-fired generating retirements. The companies also assert that the PPA will help save jobs at the threatened generating plants and enhance the value of the generating fleet, which if approved, would be credit positive for AEP.

The PPA filing needs to be approved by the PUCO. We think approval is likely, but not before there are some significant adjustments to the PPA, as filed. We think the PUCO will consider both rate stability for OPCo and affordable rates for its customers, but also compliance with pending EPA rules (including plant retirements) and fair market competition for all retail customers and competitive electric suppliers. Thus we assume that PUCO and its staff could propose a template with certain modifications for the PPA proposals not only filed by AEP but also for the ones already done by First Energy (FE, Baa3 stable) and its Ohio operating utility companies.

We see Ohio as a relatively supportive regulatory jurisdiction, and the slow but steady transition to a competitive market has allowed different utilities in the state to emphasize different aspects of their transition plans. We think the PUCO is keenly focused on the risks and unintended consequences of any market intervention.

Still, if approved by the PUCO, the PPA would be credit positive for AEP because it would decrease its exposure to competitive power markets and make these assets more attractive to a potential buyer. OPCo will be insulated from power price volatility because the PPA acts as a pass-through vehicle of capacity and energy costs, which is positive for liquidity, and protects customers from higher power prices.

The expanded PPA would not affect the Standard Service Offer (SSO) load because OPCo will bid 100% of the plants’ capacity and energy into the PJM. Also, as the PPA rider is non-bypassable, it should have no effect on competitive retail electric suppliers (CRES providers) to compete for customers.

The Electricity Security Plan (ESP) III, filed in December 2013, is proposed for the term June 1, 2015 to May 31, 2018 when market transition would be considered completed,
and projects an average 9% decrease in rates over the three-year term for customers who receive their generation through OPCo. Its structure supports needed distribution infrastructure investment (through a Basic Transmission Costs rider) for continued and increased reliability, assumes that the Retail Stability rider (RSR) currently in place will remain at $4 per MWh until the balance of capacity deferrals have been collected in early 2018, and provides customers two auctions per year each synchronized to PJM planning year (through Auction Cost Reconciliation rider), and seeks to collect capacity and energy costs for non-shopping customers through related riders.

The key credit components of the expanded PPA are:

The PPA would provide OPCo’s customers price transparency and stability, which is credit positive because regulators are keen on stable rates. Under the agreement, OPCo would be entitled to the capacity, energy and ancillary service output of AEP Generation Resources (AGR, not rated) ownership share of Cardinal unit 1, Conesville units 4-6, Stuart units 1-4 and Zimmer unit 1 for the remaining life of the facilities. The PPA envisions a special vehicle within the AGR structure in order to bundle about 2,700 MW installed capacity and will start on June 1, 2015. Today, there are no planned environmental upgrades for the generating units, unless any investments will be able to clear in the market.

OPCo will be insulated from power price volatility because the PPA acts as a pass-through vehicle, which is positive for liquidity. OPCo will bid 100% of the output into the PJM RTO, and pass the benefits (or costs) to its customers through a non-bypassable PPA recovery rider included under the proposed ESP III, and expected to be approved by year-end 2014. The PPA is under FERC jurisdiction because it is a wholesale contract; however the PPA rider is under PUCO’s for approval. AEP has proposed an adjusted return on equity (ROE) based on interest rates, similar to other AEP’s third party wholesale contracts.

The agreement would benefit AEP and its non-core generation business because it would improve the economic viability of its Ohio generation assets. According to the company, the coal-fired plants included in the PPA provide significant employment benefits, directly or indirectly, to approximately 1,700 employees either working in the plants or in coal mines, and the annual property tax benefit to the state of Ohio is about $9 million.

Ohio ratepayers will be partially shielded from market volatility, price shocks, if the market prices were to increase, the PPA rider will be a benefit to customers which AEP has estimated of about $224 million over a 10-year period. In addition the PPA would preserve service reliability, Ohio could become an importer of power because of the early plant retirements.

» Ohio Power Company, a wholly owned subsidiary of American Electric Power Company is engaged in the transmission and distribution of power to nearly 1.5 million customers in Ohio.

» American Electric Power is one of the largest electric utilities in the United States, delivering electricity to more than 5 million customers in 11 states. AEP ranks among the nation’s largest generators of electricity, owning nearly 38,000 megawatts of generating capacity in the U.S. AEP also owns the nation’s largest electricity transmission system, a 40,000-mile network that includes more 765 kilovolt extra-high voltage transmission lines than all other U.S. transmission systems combined.
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Global Credit Research - 14 Apr 2014

Columbus, Ohio, United States

Ratings

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<td>Jr Subordinate Shelf</td>
<td>(P)Baa2</td>
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<td>Commercial Paper</td>
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AEP Texas North Company

Outlook                           | Stable         |
Issuer Rating                     | Baa1           |

Appalachian Power Company

Outlook                           | Stable         |
Issuer Rating                     | Baa1           |
Senior Unsecured                  | Baa1           |

Indiana Michigan Power Company

Outlook                           | Stable         |
Issuer Rating                     | Baa1           |
Senior Unsecured                  | Baa1           |

Southwestern Electric Power Company

Outlook                           | Stable         |
Issuer Rating                     | Baa2           |
Senior Unsecured                  | Baa2           |

Contacts

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<td>Susana Vivares/New York City</td>
<td>212.553.4694</td>
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<tr>
<td>William L. Hess/New York City</td>
<td>212.553.3837</td>
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Key Indicators

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

Opinion
Rating Drivers

Diversity of regulatory jurisdictions and service territories provides strong foundation for current rating

Ohio Power’s corporate separation completed

Substantial capex due to environmental mandates and regulated investments in transmission and distribution

Financial metrics look pressured due to higher parent debt and deregulated revenues

Corporate Profile

American Electric Power Company, Inc. (AEP, Baa1 stable), headquartered in Columbus, Ohio, is a large electric utility holding company with nine retail utility subsidiaries operating in eleven states representing approximately $24 billion rate base and serving about 5.3 million customers. The breakdown of megawatt hour (MWh) sales in 2013 was approximately 30% residential, 25% commercial, 28% industrial, 16% wholesale and 2% other. AEP owns or leases 37,600 megawatts (MW) of generating assets, 63% of which is coal/lignite fired.

SUMMARY RATING RATIONALE

AEP’s Baa1 rating reflects the size and diversity of its regulatory jurisdictions and service territories, financial metrics that over the past several years have supported the rating, a consolidated financial profile that includes a moderate amount of parent holding company debt, and adequate liquidity. These positive factors are balanced against risks associated with the transition of Ohio’s market into full competition by June 2015, an expectation for higher levels of parent debt, and a material increase in capital expenditures for mandated environmental requirements, including investments to extend the life of Cook nuclear plant, and regulated investments in transmission and distribution.

DETAILED RATING CONSIDERATIONS

DIVERSITY OF REGULATED CASH FLOWS AND SERVICE TERRITORY

AEP’s electric utility operations are diversified in terms of regulatory jurisdictions (eleven states) and service territory economies. The largest states ranked by base rates are Ohio, Virginia, West Virginia, Texas, Indiana, and Oklahoma. These jurisdictions translate into 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, its state regulators or in one state’s economy.

One benefit from the service territory diversity has been seen 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 due to Federal budget cuts, waning coal exports, and slow industrial growth that are placing strains on the Appalachian economies. Overall, AEP’s retail sales volume in 2013 declined 1.6% across the board, and industrial sales declined 4.5%.

CONTINUED REGULATORY SUPPORT, TIMELY AND SUFFICIENT COST RECOVERIES NEEDED

AEP will need timely and consistent long-term credit regulatory support because it will be in front of several commissions in the next 12-18 months regarding, among them, the pending resolution of the transfer of Mitchell Plant to Wheeling Power Company (WPCo, not rated), plant retirements, recovery of significant capital expenditures and other related costs. AEP has secured some formula based rate cases during 2014 but more are needed.

In Oklahoma, a rate case was filed in January, requesting a $45 million increase in base rates based on a 10.5% ROE, and including riders for advanced metering costs and for transmission investments. In addition, AEP will be filing for rate increases in West Virginia and Kentucky in 2014. A significant component of those filings reflects the transfer of the Amos and Mitchell assets. In West Virginia, the filing is the result of a prior settlement on the expanded net energy charge (ENEC), and is expected to include Amos and potentially Mitchell in base rates filings. In Kentucky, rates can be implemented subject to a refund six-months after filing the case, expected no later than December 2014. In March, Appalachian Power Company (APCo, Baa1 stable) filed its biennial rate case in Virginia which included no increase in rates since APCO’s rates are within the current earnings band.
We view the Ohio regulatory environment as reasonably supportive to credit quality. It has historically been AEP's most important jurisdiction. Ohio Power Company (OPCo Baa1, stable) is operating under ESP I (March 2009 to 2011) and ESP II (June 2012 to May 2015) which provide a reasonable suit of recovery mechanism and cash flow stability through the Ohio transition into a full competitive generation market by June 2015. Under the ESPs, there would be fuel deferral accrued balances of $445 million, and capacity deferral estimated at $463 million by the end of May 2015. OPCo also obtained approval from Public Utility Commission of Ohio (PUCO) to securitize $298 million of approved deferred distribution asset recovery rider costs. Some of the fuel and capacity deferrals related to these orders may also be securitized, since Ohio enacted securitization legislation in December 2011, a sign of positive political intervention. In December 2013, OPCo filed an application with the PUCO to approve a new ESP (ESP III) from June 2015 until May 2018 seeking a more prescriptive, transparent, and efficient ESP that includes full transition to auction based generation pricing beginning in June 2015.

OHIO POWER'S CORPORATE SEPARATION COMPLETED

On December 31, 2013, based on Federal Energy Regulatory Commission (FERC) and PUCO orders, OPCo transferred 11,650 MW of its generation assets and related liabilities, including pollution control bonds (PCRBs), at net book value to affiliate AEP Generation Resources Inc (AGR, not rated), thus becoming a fully regulated transmission and distribution utility (T&D).

As a result of the corporate separation, OPCo's net property plant and equipment (NPP&E) decreased from approximately $10 billion to $4.5 billion. OPCo redeemed approximately $1.6 billion of debt (in conjunction with the asset transfer), or roughly 40% of its total debt. Today, OPCO has about $2.7 billion of debt.

The corporate separation qualifies as a tax free acquisition of business under common control.

In 2013, OPCo also issued about $1.6 billion of debt to fund debt maturities, redeem PCRBs, and securitize distribution regulatory assets. As part of that issuance OPCo drew down a term loan facility of $1.0 billion due in May 2015 to execute the corporate separation. Subsequently OPCo assigned to affiliates AGR, APCo and Kentucky Power Company (KEPCo, Baa2 stable) intercompany notes related to that issuance.

The generation assets were transferred with the associated PCRBs which have also been allocated to the individual affiliates as follows: $86 million to APCo, $65 million to KEPCo, and AGR assumed the obligations and rights to $721.2 million, of this amount $395.4 million are held in trust so when re-issued AGR will receive the proceeds.

In the case of APCo due to the transfer of 867 MW of Amos plant, NPP&E increased by $800 million, assumption of debt estimated at about $386 million, including assigned $300 million from AGR and $86 million PCRBs, at year-end 2013. There is also related deferred income taxes and other liabilities associated with the transfer. The difference between the assets and liabilities transferred is recorded as paid-in-capital of around $240 million.

The impact of the transfer of 780 MW Mitchell to KEPCo shows NPP&E increase of about $675 million, plus the assumption of debt estimated at about $265 million, which includes $200 million assigned from AGR and $65MM PCRB -Mitchell note currently held in a trust, at year-end 2013. There is also related deferred income taxes and other liabilities associated with the transfer. The difference between the assets and liabilities transferred is recorded as paid-in-capital of around $375 million.

As of December 31, 2013, as part of the transfer AGR received NPP&E of approximately $5.6 billion, assumption of debt estimated at about $1.1 billion, including $211 million PCRBs and short-term debt of about $240 million. As in the case of APCo and KEPCo, it also received associated non-current liabilities (about $1.7 billion) and assets. AGR' fleet is now around 11,191 MW of which 2,523 MW will be retired by June 2015. AEP has announced that AGR would be capitalized with a combination of about 65%-70% equity and 35%-30% debt that is either borrowed by AEP and on-lent to AGR, or guaranteed by AEP.

AGR is housed by AEP Energy Supply LLC (not rated) the unregulated business arm of AEP, and operates within the PJM system and is required to offer all of its available generation to the PJM Reliability Pricing Model auction. Through May 2015, AGR will provide generation capacity to OPCo for switched and non-switched generation customers.

SUBSTANTIAL CAPEX DUE TO ENVIRONMENTAL MANDATES AND REGULATED INVESTMENTS IN T&D

AEP is still exposed to stringent environmental compliance requirements. It has announced a capital investment program for 2014 through 2016 of approximately $10.6 billion, of which approximately 95% of that amount will be spent in the regulated businesses as follows: generation $2.8 billion (26.5%), distribution $3.3 billion (31.1%), and
transmission $4.5 billion (42.4%). Transmission and distribution (T&D) investments are expected to be recovered either through the transmission formula base rates or rate case activity, a credit positive.

AEP's average projected total capex of $3.8 billion per year through 2016 is essentially flat compared to $3.7 billion in 2013, but a substantial increase from the $3.1 billion in 2012, and $2.7 billion in 2011. In the near term, environmental retrofits and transmission investments will be the largest drivers of the capital investments. We expect AEP will successfully obtain state-level and even federal-level extensions for Mercury and Air Toxics Standard (MATS) compliance. But if AEP is not successful, the investment schedule may be accelerated, which could stress intermediate term metrics.

AEP's 2014 environmental capex is expected to be allocated to regulated T&D around $2.65 billion and about $600 million in environmental mandates. Another important capex investment is at Indiana Michigan Power Company (I&M, Baa1, stable) to extend the life of the Cook nuclear plant. This amounts to approximately $1.2 billion through 2018, excluding AFUDC. As of December 2013, I&M has incurred costs of $380 million, including AFUDC. We expect that AEP's subsidiaries will be successful in obtaining reasonably timely recovery of capital and operating expenditures associated with environmental compliance and plant upgrades.

FINANCIAL METRICS LOOK PRESSURED DUE TO HIGHER PARENT DEBT AND DEREGUALTED REVENUES

As of year-end 2013, on a consolidated basis AEP reported long-term debt of $16.8 billion compared to $15.6 billion as of year-end 2012, before adjusting for unfunded pensions and operating leases. We understand that the increase in parent debt will be refinanced at the utility affiliate levels in the near future, thus causing the percentage of parent debt to revert to historical levels (approximately 5%). If it is indeed transitional, the increase in AEP holding company debt is not expected to have any implications for downward notching of AEP debt relative to its subsidiary ratings. However, if the parent company debt is higher than expected or it became evident that AGR's debt will be financed at the parent level (or based on parent support) on a permanent or quasi-permanent basis, AEP's ratings could become pressured. Especially given the increased share of unregulated generation and retail sales within AEP's overall business mix, which we currently see rising to around 25% of AEP's consolidated financial profile from historical of 11%.

As of year-end 2013, AEP's financial metrics, including the ratio of CFO Pre-WC plus interest / interest and the ratio of CFO Pre-WC to debt were 5.0x and 19% respectively compared to year-end 2012 of 4.5x and 19.5%. Adjusted Debt to book capitalization decreased by year-end to 44.6% compared to 46.6% at year-end 2012. AEP has announced capital investments and equity contribution through 2016 of around $3.8 billion a year and plan to maintain a dividend payout ratio at 60-70% to be in line with peers in the market. On a consolidated basis as of December 31, 2013, AEP generated approximately $4.3 billion in CFO pre-WC, made approximately $3.8 billion in capital investments, and paid $954 million in dividends, resulting in about $454 million of negative free cash flow.

Prospectively, AEP's metrics are likely to weaken between 2014 through 2018, as the interest coverage, CFO Pre-WC, and RFC to debt ratios average 4.5x, 16%, and 12.5% respectively. Still, these ratios are towards the lower end of the mid-Baa range.

Post-transition, AEP will need to produce financial metrics towards the higher end of its rating category range given the higher risk nature of its unregulated operations. Factors that could challenge AEP during this period include, among others, longer than anticipated regulatory lag to recover environmental and nuclear capex, adverse rulings from the Ohio Supreme Court on ESP's elements currently being reviewed and West Virginia's regulators concerning remaining 50% transfer of Mitchell to WPCo, and on the unregulated side 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).

Despite AEP's structural subordination relative to the debt of its subsidiaries, we do not notch AEP's rating down below the Baa1 senior unsecured rating that is assigned to the majority of its operating subsidiaries, based on the diversity and stability of subsidiaries' cash flows, in addition to the relatively acceptable debt level at the parent company of about 8% (around $1.3 billion) at year-end 2013.

Liquidity

AEP's liquidity is adequate. AEP has two syndicated credit facilities totaling $3.5 billion that were renewed and extended in mid-2011. One is a $1.75 billion facility expiring June 2016, and the other is also a $1.75 billion facility (upsize from $1.5 billion) expiring in July 2017, permit same-day borrowing and have a combined letter of credit sub-limit of $1.2 billion. 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, however, base on the new amendment AGR is effectively excluded as a significant subsidiary. The facilities contain a covenant requiring that AEP's consolidated debt to capitalization (as defined) not to exceed 67.5%. AEP states the actual ratio was 50.4% at 12/31/2013, indicating substantial headroom.

Including securitization bonds, put bonds and other amortizations, AEP has debt maturities of $1.4 billion in 2014, and about $2.7 billion in 2015. AEP amended its $700 million receivable securitization agreement to extend $385 million amount through June 2014, and remaining $315 million through June 2015.

As of 12/31/2013, AEP had $118 million of cash on hand and approximately $3.4 billion of availability under its two syndicated revolving credit facilities after giving effect to $57 million of commercial paper outstanding and $170 million of issued letters of credit.

Over the next two years, Moody's estimates that AEP will generate roughly $4 billion annually in CFO Pre-WC, spend about $3.9 billion annually in capital investments, and pay about 1 billion in annual dividends. This will yield negative average free cash flow of average $900 million per year, a credit negative that we think is unsustainable over the longer term horizon.

Rating Outlook

The credit rating and stable outlook reflects AEP's diversified regulatory jurisdictions and service territory of its portfolio of utility subsidiaries. We believe AEP will continue to demonstrate a reasonable approach towards its financial policies through this period, particularly with respect to the transition in Ohio and expected environmental and nuclear spending, leading to CFO Pre-WC 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 impact the metrics threshold for maintaining its Baa1 unsecured rating. Nevertheless, ratings could be upgraded, if AEP were successful in producing a stronger set of financial credit metrics on a sustainable basis, including a ratio of CFO Pre-WC plus interest of at least 5.0x, a ratio of CFO Pre-WC to debt above 22% average and debt to capitalization below 45%.

What Could Change the Rating - Down

AEP's rating could be downgraded if a more contentious regulatory environment were to materialize in any key jurisdictions; for instance, if regulatory decisions impacting 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 Baa1 rating) were downgraded. In addition, ratings could be downgraded if AEP’s financial metrics were weaker or more volatile than expected through 2016, including a ratio CFO Pre-WC to debt in the mid-teens range and debt to book capitalization higher than 50%.

Rating Factors

American Electric Power Company, Inc.

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<tr>
<td>Factor 1 : Regulatory Framework (25%)</td>
<td>Measure</td>
<td>Score</td>
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<td>a) Legislative and Judicial Underpinnings of the Regulatory Framework</td>
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<td>A</td>
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<td>b) Consistency and Predictability of Regulation</td>
<td>Baa</td>
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<tr>
<td>Factor 2 : Ability to Recover Costs and Earn Returns (25%)</td>
<td>Measure</td>
<td>Score</td>
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<td>a) Timeliness of Recovery of Operating and Capital Costs</td>
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<td>Factor 3 : Diversification (10%)</td>
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<tr>
<td>a) Market Position</td>
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<td>b) Generation and Fuel Diversity</td>
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<td>Factor 4 : Financial Strength (40%)</td>
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<td>a) CFO pre-WC + Interest / Interest (3 Year Avg)</td>
<td>4.6x A</td>
<td>4.7x - 5x</td>
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<td>b) CFO pre-WC / Debt (3 Year Avg)</td>
<td>19.0% Baa</td>
<td>14% - 18% Baa</td>
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<td>c) CFO pre-WC - Dividends / Debt (3 Year Avg)</td>
<td>14.7% Baa</td>
<td>10% - 12% Baa</td>
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<td>d) Debt / Capitalization (3 Year Avg)</td>
<td>46.3% Baa</td>
<td>42% - 45% Baa</td>
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<td>Grid-Indicated Rating Before Notching Adjustment</td>
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<td>HoldCo Structural Subordination Notching</td>
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<td>a) Indicated Rating from Grid</td>
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<td>b) Actual Rating assigned</td>
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[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] As of 12/30/2013(L); Source: Moody's Financial Metrics [3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.

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Moody’s
INVESTORS SERVICE

Rating Action: Moody’s upgrades American Electric Power and certain utility subsidiaries.

Global Credit Research - 31 Jan 2014

Approximately $22 Billion of Debt Affected

New York, January 31, 2014 -- Moody’s Investors Service upgraded the long-term ratings of American Electric Power (AEP), senior unsecured rating to Baa1 from Baa2, and certain of its utility subsidiaries. At the same time, Moody’s confirmed the ratings of Kentucky Power Company. The actions conclude the reviews for upgrade of AEP and the six subsidiaries, Moody’s initiated on November 8, 2013. All the ratings have a stable outlook.

In the actions, Moody’s upgraded the ratings of AEP Texas Central Company (AEP TCC), senior unsecured and Issuer Rating to Baa1 from Baa2; AEP Texas North Company (AEP TNC), Issuer Rating to Baa1 from Baa2; Appalachian Power Company (APCO), senior unsecured and Issuer Rating to Baa1 from Baa2; Public Service of Oklahoma (PSO) senior unsecured and Issuer Rating to A3 from Baa1; Indiana Michigan Power Company (I&M) senior unsecured and Issuer Rating to Baa1 from Baa2; and Southwestern Electric Power Company (SWEPCO), senior unsecured and Issuer Rating to Baa2 from Baa3.

RATINGS RATIONALE

Moody’s had placed the ratings on review for upgrade in response to Moody’s more favorable view of the relative credit supportiveness of the US regulatory environment, as detailed in the September 2013 Request for Comment titled “Proposed Refinements to the Regulated Utilities Rating Methodology and our Evolving View of US Utility Regulation.” Critical factors supporting this view include better cost recovery provisions, reduced regulatory lag, and generally fair and open relationships between utilities and regulators. The US utility sector’s low number of defaults, high recovery rates, and generally strong financial metrics from a global perspective provide additional corroboration for these upgrades.

Moody’s upgraded the ratings of AEP based on its diversity of utility subsidiaries cash flows, a supportive regulatory environment, a successfully executed corporate restructuring, and growing rate base. This is offset by weaker financial metrics, high leverage and certain execution challenges and regulatory risks as Ohio Power completes its business restructuring. These challenges include the completion of assets transfers and/or plant retirements, a smooth transition into a competitive market in Ohio -- in addition to the lag in recovery costs associated to the several riders and trackers under the Energy Security Plans (ESPs) I & II, regulators’ concern regarding Transcos’ reliability, regulatory oversight, and an impact on base rate increases. A prolonged period of recovering costs associated with any of the riders and trackers under Ohio Power (OPCO)’s Energy Security Plans would be credit negative, as the associated securitization burden would remain in its balance sheet longer, with a negative credit impact on the parent AEP. On December 2013, OPCO filed a new ESP III seeking a more prescriptive, transparent, and efficient ESP for operations after June 2015.

Moody’s upgraded the ratings at APCO after regulatory decisions regarding the transfer of assets, specifically the Amos Plant, went smoothly. There is still need, however, for more supportive regulatory decisions to address the completion of plant transfers such as the Mitchell Plant, as well as the merger between WPCO and APCO. However, Moody’s believes APCO’s regulatory environment will continue to be supportive and outweighs the slight weakness in key financial metrics. APCO shows three-year average financial metrics within the Baa3 rating category while operating in a service territory that is still economically challenged relative to the rest of the country. In LTM third-quarter 2013, CFO pre-WC to debt and CFO pre WC -- Div to debt were 15% and 11.9% respectively.

Moody’s upgraded the ratings of AEP TCC and TNC because of the supportive and constructive regulatory environment for T&Ds in Texas with a relatively transparent regulatory process. The financial profile of both AEP TCC and TNC is strong, and rate base (combined for the two utilities) should grow to roughly $1.0 billion over the next three years. Assuming AEP TCC and TNC can keep their total debt outstanding near $3.4 billion, the ratio of CFO pre-WC to debt should remain in the mid to high-teens range over the next three years. Their Baa1 ratings also reflect a low business risk and operating profile.
The upgrade of PSO's rating to A3 reflects a reasonable credit-supportive regulatory framework, along with historically robust financial performance. PSO operates in an economically vibrant service territory, shows credit metrics that are strong for the rating, balanced against a sizeable, but manageable environmental capital expenditure program of estimated around $1.0 billion through 2016. We expect reasonable recovery of the environmental costs in future proceedings. Assuming continuous regulatory support, CFO pre-WC -- Div to debt should remain in the mid -teen's range over the next three years.

The upgrade of I&M's rating to Baa1 incorporates Moody's expectation that regulatory support in both Michigan and Indiana will continue to be strong and include timely recovery of a sizeable, multi-year environmental and nuclear capital expenditure program. Financial metrics have also historically been adequate for the Baa1 rating. The LTM third-quarter 2013 key financial indicators show no significant deterioration considering the sizable environmental costs of Cook and Rockport plants. Moody's expects the financial profile to remain appropriate for the ratings category, with CFO pre-WC to debt averaging in the high teens range and CFO pre WC -- Div to debt averaging in the mid teens range.

The upgrade of SWEPCO's to Baa2 encompasses the company's diversified territory, with Moody's expecting regulatory support to continue in jurisdictions such as Louisiana and Arkansas. The treatment of the inclusion of the Turk Plant is a credit positive for the company. Texas remains a challenging regulatory jurisdiction for vertically integrated utilities. Financial key metrics for LTM third-quarter 2013, CFO pre-WC to debt of 16.5%, and CFO pre WC -- Div to debt of 12.5% show deterioration compared to the levels of 2011 and 2010. Moody's expects no major improvements in financial metrics for the period 2014-16, with CFO pre-WC to debt averaging between 13-15%, and CFO pre WC -- Div to debt averaging between 11-13%.

Moody's confirmed the ratings of Kentucky Power Company because of a regulatory environment that has been relatively supportive offset by high leverage, a large capital expenditure program and weak financial metrics. The settlement outcome of last October clears the path to complete the transfer of the Mitchell Plant (including addressing potential greenhouse initiatives), authorization to record the FGD costs as a regulatory asset, and the conversion of the Big Sandy Unit 1 to natural gas. KEPCO'S financial metrics for LTM third-quarter 2013, are reasonably within the range for the rating category. However on a forward looking basis, a large capital expenditure program and increased leverage will contribute to weaker financial metrics such as CFO pre-WC to debt will average between 12-14% and CFO pre WC -- Div to debt will average between 9-11%.

RATING OUTLOOK

The outlook on all ratings is stable. Over the next few years, AEP's regulated subsidiaries (vertically integrated and T&D subsidiaries) will produce predictable and stable cash flows and financial metrics. According to AEP, 95% of capital allocation will be deployed into the regulated business to fuel a base rate growth of approximately 6% CAGR.

On the unregulated business side, Moody's views AEP Generation Resources (AGR, Not Rated) as bringing unpredictable financial metrics and a volatile business edge to AEP's regulated and low risk business and operating strategy. However, Moody's considers AGR to be a non-core business, likely to be divested over the next 3-5 years, although the rating agency also regards AEP as an experienced operator of generation assets.

AEP' metrics will remain weak for the rating category on a forward-looking basis. Moody's expects key financial metrics such as CFO pre-WC to debt and CFO pre WC -- Div to debt to average between 14-16% and 10-12% respectively.

WHAT COULD CHANGE RATING -- UP

AEP's ratings are unlikely to be upgraded in the near term, however, ratings could be upgraded if APCO's performance metrics were to be robust and sustained through 2017, showing CFO pre-WC to debt in the high teens and CFO pre-WC -- Div to debt in the mid to high teens on a sustainable basis. There would also have to be clarity on pending decisions for the several riders' and trackers' recovery costs in Ohio under the Electricity Security Plans during the transition, as well as pending approval of ESP III filed last December 2013.

AEP TCC and TNC could both be considered for upgrade if their financial metrics improved over a sustained period of time, with CFO pre-WC to debt close to 20%, and CFO pre WC -- Div to debt in the high-teens.

Any upgrade among KEPCO, PSO, SWEPCO, and I&M is unlikely near term primarily because of the size of environmental costs, the level of capital expenditures, and a nuclear management program, all of which will likely challenge the historically stable financial metrics through 2016. In order for them to be upgraded, there would need
to be robust and sustained financial metrics over time for factors such as CFO pre-WC to debt, and CFO pre WC -- Div to debt.

APCO’s rating could be upgraded if sufficient clarity materialized on pending decisions regarding the plan transfers, along with sustainable and robust financial credit metrics. Specifically, on a three-year projected basis CFO pre-WC to debt to average between 18-20% and CFO pre-WC --Div to debt averaging between 15-17% on sustainable basis

WHAT COULD CHANGE RATING -- DOWN

Ratings of the AEP subsidiaries could be downgraded if, in Moody’s view, the regulatory environment and proceedings in jurisdictions in which the AEP subsidiary operates were to take a dramatically negative turn, leading to steady and prolonged period of deterioration in regulatory proceedings and subsidiaries financial performance. In addition, significant deterioration in the regulatory frameworks across territories where APCO and OPCO operate (Virginia, West Virginia and Ohio) could have a more pronounced negative impact on AEP overall financial performance due to sizable cash flow contribution to their parent.

The principal methodology used in this rating was Regulated Electric and Gas Utilities published in December 2013. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

Rating's Upgrades and Confirmations:

American Electric Power:
Senior Unsecured Rating to Baa1 from Baa2
Senior Unsecured Shelf to (P)Baa1 from (P)Baa2
Junior Subordinate Shelf to (P)Baa2 from (P)Baa3
Commercial Paper Affirmed at to P-2

AEP Texas Central:
LT Issuer Rating to Baa1 from Baa2
Senior Unsecured Rating to Baa1 from Baa2
Backed Senior Unsecured to A3 from Baa1

AEP Texas North:
LT Issuer Rating to Baa1 from Baa2

Indiana Michigan Power Company:
LT Issuer Rating to Baa1 from Baa2
Senior Unsecured Rating to Baa1 from Baa2
Senior Unsecured MTN to (P)Baa1 from (P)Baa2

Public Service Company of Oklahoma
LT Issuer Rating to A3 from Baa1
Senior Unsecured Rating to A3 from Baa1
Backed Senior Unsecured to A3 from Baa1
Southwestern Electric Power Company
LT Issuer Rating to Baa2 from Baa3
Senior Unsecured Rating to Baa3 from Baa3
Underlying Senior Unsecured to Baa2 from Baa3
Appalachian Power Company
LT Issuer Rating to Baa1 from Baa2
Senior Unsecured Rating to Baa1 from Baa2
Senior Unsecured MTN to (P)Baa1 from (P)Baa2
Backed Senior Unsecured to Baa1 from Baa2
Underlying Senior Unsecured to Baa1 from Baa2
Senior Unsecured Shelf to (P)Baa1 from (P)Baa2
Kentucky Power Company
LT Issuer Rating Confirmed at Baa2
Senior Unsecured Rating Confirmed at Baa2
RGS (I&M) Funding Corporation
Senior Secured to Baa1 from Baa2

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American Electric Power Company, Inc.

Full Rating Report

Key Rating Drivers

Balanced Regulatory Construct: Fitch Ratings views the state regulatory constructs within American Electric Power Company, Inc.'s (AEP) service territories as balanced. Authorized returns on equity (ROEs) are close to the industry average in most jurisdictions and include provisions to mitigate commodity and environmental regulation risks. Fitch expects consolidated earned ROE, which was 9.8% for LTM as of June 30, 2016, to edge slightly higher over 2016–2018 as higher-earning transmission assets gain relative importance.

Exiting Competitive Power Business: AEP's efforts to reduce its exposure to the volatile merchant generation sector are supportive of its credit profile. The planned sale of 5.2 GW of merchant capacity will improve the business risk profile, while the impact on credit protection measures will depend on management's allocation of proceeds between growth initiatives, shareholder rewards and debt reduction. Divestment or regulatory support for the remaining Ohio-based merchant capacity would also be credit positive.

Large Capex Spending: Fitch's model includes management's forecasted capex spending of about $5 billion annually in 2016–2018, almost exclusively geared to growing the regulated rate base. About $7.3 billion of capex spending through 2018 targets transmission assets regulated by the Federal Energy Regulatory Commission (FERC) that earn attractive and contemporaneous returns on investment. The extension of bonus depreciation reduces the strain of the elevated capex plan on AEP's credit metrics.

Consistent Credit Protection Measures: AEP's FFO-based leverage and coverage metrics are strong for the current ratings at 4.0x and 4.7x, respectively, at June 30, 2016. Fitch expects adjusted debt/EBITDAR to remain around 4.0x over the rating horizon due to the elevated capex plan and a modest regulatory lag.

Diversified Business Profile: AEP's ownership of nine regulated electric utilities operating in 11 states and its growing investments in FERC-regulated transmission projects provide regulatory, geographic and cash flow diversity. Fitch forecasts substantially all of AEP's consolidated EBITDA will come from regulated businesses in 2017 and beyond.

Rating Sensitivities

Positive Rating Action: Future developments that may, individually or collectively, lead to a positive rating action include an upward migration in ratings of its regulated subsidiaries and/or adjusted debt/EBITDAR below 3.8x on a sustainable basis.

Negative Rating Action: Ratings could be downgraded if management were to pursue a more aggressive growth or financial strategy such that adjusted debt/EBITDAR and FFO-adjusted leverage ratios materially exceed 4.0x and 5.5x, respectively, on a sustainable basis.
Financial Overview

Liquidity and Debt Structure

AEP’s liquidity position was adequate at June 30, 2016, with approximately $2.3 billion of total liquidity available, including $2.1 billion available under two equal-sized revolving credit facilities totaling $3.5 billion. On July 1, 2016, the credit facilities were amended, with one facility increased to $3 billion and extended to June 2021, while the second facility was reduced to $500 million with the maturity remaining in June 2018.

The credit facilities also serve as a backstop for AEP’s commercial paper program and letters of credit. Subsidiaries’ excess cash balances and short-term borrowing needs are centralized into two money pools, segregating regulated and nonregulated activities. Operating subsidiaries rely on AEP for their cash and treasury management, but access the capital markets independently for their long-term borrowing needs. Utility money pool borrowings and long-term financing may be limited by regulatory orders for individual subsidiaries.

AEP and its subsidiaries regularly access the debt markets to fund capex and refinance maturing obligations. The debt maturities over the 2016–2018 rating horizon are manageable, and Fitch expects them to be refinanced at competitive rates. Borrowings under the revolving credit facilities ($2.1 billion at June 30, 2016) are included in the 2016 maturities listed below.

AEP must maintain a ratio of debt to total capitalization that does not exceed 67.5%, per the covenants to its credit agreement. AEP stood comfortably within this guideline at 51.5% as of June 30, 2016.

Cash Flow Analysis

Fitch expects modest growth in EBITDAR generation in 2016–2018 supported primarily by investments in regulated assets subject to contemporaneous recovery mechanisms. Implementation of recent general rate case (GRC) decisions and modest load growth in AEP’s service territories should also contribute to the EBITDAR growth.

Under its base case scenario, Fitch expects cash flow from operations to approximate management’s planned $15 billion capex investments during 2016–2018. Investments are focused on growing the regulated rate base, including about $7.3 billion for regulated transmission businesses, $3.9 billion for regulated distribution operations and $2.5 billion for regulated generation assets. Transmission investments are likely to be revised upward for 2017–2018, as AEP seeks to reinvest some of the proceeds from its sale of merchant assets.
AEP targets a dividend payout ratio of 60%–70% of its operating earnings, representing about $1.1 billion annually. Fitch expects any cash shortfall to be funded through incremental debt, resulting in relatively stable credit protection measures in 2016–2018.

**CFO and Cash Use**

![CFO and Cash Use Chart]

Source: Company data, Fitch.

### Peer and Sector Analysis

**Peer Group Analysis**

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<td>Operating EBITDA/(Gross Interest Expense + Rents)</td>
<td>4.4</td>
<td>6.2</td>
<td>4.4</td>
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<td>FFO Fixed-Charge Coverage</td>
<td>4.7</td>
<td>6.0</td>
<td>3.8</td>
<td>6.0</td>
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<td>Total Adjusted Debt/Operating EBITDA</td>
<td>4.3</td>
<td>5.8</td>
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<td>4.4</td>
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<td>FFO/Total Adjusted Debt (%)</td>
<td>24.7</td>
<td>17.6</td>
<td>18.7</td>
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<td>FFO-Adjusted Leverage</td>
<td>4.0</td>
<td>5.7</td>
<td>5.4</td>
<td>4.0</td>
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<tr>
<td>Common Dividend Payout (%)</td>
<td>54.7</td>
<td>84.7</td>
<td>65.7</td>
<td>83.3</td>
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<tr>
<td>Internal Cash/Capex (%)</td>
<td>68.6</td>
<td>65.8</td>
<td>63.5</td>
<td>76.9</td>
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<tr>
<td>Capex/Depreciation (%)</td>
<td>281.0</td>
<td>257.5</td>
<td>200.1</td>
<td>202.9</td>
</tr>
<tr>
<td>Return on Equity (%)</td>
<td>10.8</td>
<td>10.9</td>
<td>6.8</td>
<td>5.8</td>
</tr>
</tbody>
</table>

**Financial Information**

| Revenue | 15,318 | 17,393 | 23,017 | 28,673 |
| Revenue Growth (%) | (7.4) | (2.7) | 0.0 | (0.7) |
| EBITDA | 4,747 | 6,886 | 9,242 | 7,629 |
| Operating EBITDA Margin (%) | 31.0 | 39.5 | 40.2 | 26.6 |
| FFO | (1,733) | (2,225) | (2,700) | (2,031) |
| Total Adjusted Debt with Equity Credit | 21,839 | 40,280 | 44,310 | 34,099 |
| Readily Available Cash | 247 | 1,897 | 676 | 1,647 |
| Funds Flow from Operations | 4,253 | 5,939 | 6,107 | 7,194 |
| Capex | (4,612) | (6,514) | (7,398) | (8,782) |

IDR – Issuer Default Rating.
Source: Company data, Fitch.
Key Rating Issues

Focus on Transmission Assets

Fitch views AEP’s emphasis on transmission assets as its primary growth platform positively, as these projects generally present modest execution risk, enjoy stable earning profiles without volume or commodity risk, and benefit from relatively high authorized ROEs at around 11.0%–11.5%, inclusive of a 50 basis point adder for belonging to a regional transmission organization. Furthermore, the rate structure allows for regulatory preapproval of projects and contemporaneous returns on investments, which lessens the pressure from the elevated investments on the balance sheet. Fitch considers challenges to the FERC-authorized ROEs to be a moderate concern.

AEP has identified more than $7 billion of FERC-regulated transmission investment opportunities over the rating horizon, with the projects split roughly equally between its vertically integrated utilities and its transmission-only subsidiaries.

Balanced and Diversified Regulatory Constructs

AEP’s regulated revenues are diversified across 11 regulatory jurisdictions, with FERC, Ohio, Texas, Virginia, West Virginia, Oklahoma and Indiana generating the largest shares of revenues. The company has been generally successful in recent years in obtaining satisfactory GRC conclusions, which is improving earned ROEs. Ohio Power Co.’s earned ROE in 2016 benefited from the approval of a rider allowing the recovery of accumulated deferred fuel costs in Ohio and a favorable true-up of transmission revenues.

Earned ROE per Regulated Subsidiary
(LTM Ended June 30)

Fitch assumes a satisfactory outcome to the GRC filed by Public Service Company of Oklahoma (PSO) in July 2015. PSO requested a rate increase of $172 million, of which $96 million would be primarily due to the cost of compliance with the EPA’s Regional Haze Rule, based on an ROE of 10.5% and a rate base of $2.1 billion.

Fitch’s base-case scenario assumes the extension of Ohio Power’s three-year electric security plan, allowing the pass-through of purchased power costs set by a competitive bid process, beyond its current May 31, 2018 maturity under similar terms. The pending request for income guarantee for Ohio Power’s share of two Ohio Valley Electric Corp. coal-fired facilities (19.9% of 2,390 MW of generation capacity) is not a material credit concern, given the relatively small financial impact of the merchant exposure.
Divestment of Merchant Assets

AEP's announced sale of 5.2 GW of merchant capacity will improve the company's business risk profile by significantly reducing its exposure to the volatile merchant power sector. The Stable Rating Outlook assumes a balanced allocation of the $1.2 billion in net proceeds between incremental investments in regulated assets, shareholder rewards and debt reduction such that credit protection measures remain relatively unchanged over the medium term. The sale, expected to close in the first quarter of 2017, remains subject to regulatory approvals.

AEP's remaining fleet of merchant assets is primarily comprised of coal-fired plants located in the western portion of the PJM Interconnection LLC (PJM) region. The economic viability of these assets is under pressure given their proximity to low-cost Marcellus shale gas and transmission constraints that limit exports to higher-priced regions in eastern PJM. Management is evaluating strategic options for its remaining merchant assets, including divestment and/or market restructuring in Ohio. Our ratings assume a status quo for AEP's merchant generation assets. All other things remaining equal, the divestment of these generation assets and/or their transfer to a quasi-regulated status would be credit positive.

Fitch views management's interest in renewable projects as neutral to its credit profile. These projects usually benefit from long-term power purchase agreements (PPAs) with creditworthy off-takers. Fitch views the technological, completion and operational risks of the solar and wind projects as manageable.

Investment in Renewables

The importance of coal-fired assets in AEP’s regulated generation portfolio is a source of long-term concern, given the momentum toward greater carbon and pollutant regulations. The concern is heightened by the lack of environmental riders in most jurisdictions making timely capital cost recovery more challenging. Adding to the challenge is the significant overlap between AEP’s integrated utilities service territories and coal-driven counties.

AEP’s service territories have modest renewable portfolio standards to date, with a mandatory target of 10% in Michigan and voluntary targets of 15% in Indiana, Oklahoma and Virginia. There are currently no targets in Arkansas, Kentucky, Tennessee or West Virginia. While most of AEP’s regulatory jurisdictions have approved recovery mechanisms for investments in energy efficiency, capital investments in renewables generally do not qualify for accelerated recovery mechanisms. To date, AEP has primarily relied on PPAs to add renewables to its generation mix. Commitments under PPAs are recoverable under power purchase or fuel adjustment clauses in all jurisdictions, thus supportive of earnings stability. After numerous asset retirements and conversions to natural gas, coal-fired capacity declined to 46% of AEP’s regulated generation fleet in 2015, from about 70% a decade earlier, while carbon-free generation, including nuclear and renewables under long-term PPAs, rose to 25% of the regulated capacity. Fitch also notes that all planned generation additions until 2020 are renewables, potentially adding 3 GW of wind and solar capacity to the mix.
Organizational Structure

American Electric Power, Inc.  
BBB/Stable  
Total Adjusted Debt 21,839

Public Service Company of Oklahoma  
BBB/Stable  
Total Adjusted Debt 3,992

Indiana Michigan Power Company  
BBB+/Stable  
Total Adjusted Debt 3,162

Kentucky Power Company  
BBB+/Stable  
Total Adjusted Debt 915

Ohio Power Company  
BBB+/Stable  
Total Adjusted Debt 2,027

Public Service Company of Oklahoma  
BBB/Stable  
Total Adjusted Debt 3,992

Southwestern Electric Power Company  
BBB+/Stable  
Total Adjusted Debt 2,586

AEP Texas Central Company  
BBB+/Stable  
Total Adjusted Debt 1,436

AEP Texas North Company  
BBB+/Stable  
Total Adjusted Debt 614

Other Subsidiaries — Not Rated  
Include  
AEP Generating Co.  
AEP Transmission Holding Co.

IDR – Issuer Default Rating.  
Source: Company filings, Fitch analysis.
Key Metrics

Definitions

- Total Adjusted Debt/Op. EBITDAR: Total balance sheet adjusted for equity credit and off-balance-sheet debt divided by operating EBITDAR.
- FFO Fixed-Charge Coverage: FFO plus gross interest minus interest received plus preferred dividends plus rental payments divided by gross interest plus preferred dividends plus rental payments.
- FFO-Adjusted 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.

**Total Adjusted Debt/Op. EBITDAR**

- **American Electric Power Company, Inc.**
- **UPC Median**

![Graph](image1)

**FFO Fixed-Charge Coverage**

- **American Electric Power Company, Inc.**
- **UPC Median**

![Graph](image2)

**FFO-Adjusted Leverage**

- **American Electric Power Company, Inc.**
- **UPC Median**

![Graph](image3)

**Capex/Depreciation**

- **American Electric Power Company, Inc.**
- **UPC Median**

![Graph](image4)
Company Profile

AEP is a public utility holding company providing generation, transmission and distribution services across 11 states stretching from Texas to Michigan. The major business segments include vertically integrated utilities, transmission and distribution utilities, and transmission networks. AEP is in the process of divesting most of its merchant generation assets to focus on its regulated activities.

Vertically Integrated Utilities

This segment includes five state-regulated integrated utilities operating in Arkansas, Indiana, Kentucky, Louisiana, Michigan, Oklahoma, Texas, Virginia and West Virginia. This is the largest business segment, contributing about half of consolidated earnings in recent years.

Distribution and Transmission Utilities

The wires-only segment consists of three companies operating in Ohio and Texas, and represented about 23% of earnings in first-half 2016. The planned merger of AEP Texas Central and AEP Texas North will not impact their credit profiles, as Fitch already considered them on a consolidated basis and equalized their credit ratings.

AEP Transmission

AEP’s management is focused on investing in transmission infrastructure regulated by FERC for growth. The transmission business is the fastest-growing segment, generating almost 15% of earnings during first-half 2016 compared with 10% during first-half 2015. About 25% of the planned capex for 2016–2018 is earmarked to expand the transmission rate base.

Competitive Generation and Marketing

AEP is actively shrinking its merchant activities, composed of 8 GW of competitive generating capacity located in the PJM wholesale market as well as 842 MW located in ERCOT as of June 30, 2016. Four power plants, representing 5.2 GW of the PJM-based capacity, are to be divested effective first-quarter 2017 while the company is considering the sale of its remaining PJM-based generation assets. This segment provided about 10% of earnings in first-half 2016.

Business Trends

Revenue Dynamics

EBITDA Dynamics

Source: Company data, Fitch.
# Financial Summary — American Electric Power Company, Inc.

($ Mil., As of June 30, 2016, IDR — BBB/Rating Outlook Stable)

<table>
<thead>
<tr>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>LTM 6/30/16</th>
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<tr>
<td><strong>Fundamental Ratios (x)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Operating EBITDAR/(Gross Interest Expense + Rents)</td>
<td>3.7</td>
<td>4.0</td>
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<tr>
<td>FFO Fixed-Charge Coverage</td>
<td>3.9</td>
<td>4.0</td>
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<tr>
<td>Total Adjusted Debt/Operating EBITDAR</td>
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<td>3.9</td>
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<tr>
<td>FFO/Total Adjusted Debt (%)</td>
<td>25.6</td>
<td>25.6</td>
<td>26.9</td>
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<tr>
<td>FFO-Adjusted Leverage</td>
<td>3.9</td>
<td>3.9</td>
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<tr>
<td>Common Dividend Payout (%)</td>
<td>72.8</td>
<td>64.5</td>
<td>61.1</td>
<td>51.7</td>
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<tr>
<td>Internal Cash/Capex (%)</td>
<td>90.5</td>
<td>80.0</td>
<td>80.0</td>
<td>74.4</td>
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<tr>
<td>Capex/Depreciation (%)</td>
<td>188.4</td>
<td>242.9</td>
<td>254.7</td>
<td>269.5</td>
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<tr>
<td>Return on Equity (%)</td>
<td>8.3</td>
<td>9.2</td>
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**Profitability**

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<td>Revenues</td>
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<td>15,015</td>
<td>16,614</td>
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<td>Revenue Growth (%)</td>
<td>(1.5)</td>
<td>2.6</td>
<td>10.6</td>
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<td>Net Revenues</td>
<td>9,358</td>
<td>9,456</td>
<td>10,256</td>
<td>9,929</td>
<td>9,640</td>
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<td>Operating and Maintenance Expense</td>
<td>(4,077)</td>
<td>(4,083)</td>
<td>(4,586)</td>
<td>(4,029)</td>
<td>(3,909)</td>
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<td>Operating EBITDA</td>
<td>4,431</td>
<td>4,482</td>
<td>4,755</td>
<td>4,927</td>
<td>4,747</td>
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<td>Operating EBITDAR</td>
<td>4,777</td>
<td>4,809</td>
<td>5,059</td>
<td>5,220</td>
<td>5,040</td>
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<td>Depreciation and Amortization Expense</td>
<td>(1,569)</td>
<td>(1,492)</td>
<td>(1,623)</td>
<td>(1,673)</td>
<td>(1,641)</td>
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<td>Operating EBIT</td>
<td>2,862</td>
<td>2,990</td>
<td>3,132</td>
<td>3,254</td>
<td>3,106</td>
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<td>Gross Interest Expense</td>
<td>(931)</td>
<td>(882)</td>
<td>(838)</td>
<td>(857)</td>
<td>(851)</td>
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<td>Net income for common</td>
<td>1,259</td>
<td>1,480</td>
<td>1,634</td>
<td>2,047</td>
<td>1,991</td>
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<td>Operating Maintenance Expense % of Net Revenues</td>
<td>(43.6)</td>
<td>(43.2)</td>
<td>(44.7)</td>
<td>(40.6)</td>
<td>(40.5)</td>
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<td>Operating EBIT % of Net Revenues</td>
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<td>31.6</td>
<td>30.5</td>
<td>32.8</td>
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**Cash Flow**

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<tr>
<td>Cash Flow from Operations</td>
<td>3,591</td>
<td>3,855</td>
<td>4,307</td>
<td>4,411</td>
<td>3,902</td>
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<td>Change in Working Capital</td>
<td>(49)</td>
<td>246</td>
<td>128</td>
<td>249</td>
<td>(351)</td>
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<td>Funds from Operations</td>
<td>3,640</td>
<td>3,609</td>
<td>4,179</td>
<td>4,162</td>
<td>4,253</td>
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<tr>
<td>Dividends</td>
<td>(916)</td>
<td>(954)</td>
<td>(998)</td>
<td>(1,059)</td>
<td>(1,090)</td>
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<td>Capex</td>
<td>(2,956)</td>
<td>(3,624)</td>
<td>(4,134)</td>
<td>(4,508)</td>
<td>(4,612)</td>
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<td>FCF</td>
<td>(281)</td>
<td>(723)</td>
<td>(825)</td>
<td>(1,086)</td>
<td>(1,733)</td>
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<td>Net Change in Debt</td>
<td>35</td>
<td>340</td>
<td>216</td>
<td>808</td>
<td>861</td>
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<tr>
<td>Net Other Investment Cash Flow</td>
<td>473</td>
<td>303</td>
<td>756</td>
<td>301</td>
<td>984</td>
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<td>Net Equity Proceeds</td>
<td>83</td>
<td>84</td>
<td>73</td>
<td>82</td>
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**Capital Structure**

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<td>Short-Term Debt</td>
<td>981</td>
<td>757</td>
<td>1,346</td>
<td>800</td>
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<td>Total Long-Term Debt</td>
<td>15,476</td>
<td>15,426</td>
<td>16,039</td>
<td>17,283</td>
<td>17,443</td>
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<td>Total Debt with Equity Credit</td>
<td>15,476</td>
<td>15,426</td>
<td>16,039</td>
<td>17,283</td>
<td>17,443</td>
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<tr>
<td>Total Adjusted Debt with Equity Credit</td>
<td>19,225</td>
<td>18,799</td>
<td>19,817</td>
<td>20,427</td>
<td>21,839</td>
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<tr>
<td>Total Common Shareholders' Equity</td>
<td>15,237</td>
<td>16,085</td>
<td>16,820</td>
<td>17,892</td>
<td>18,386</td>
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<td>Total Capital</td>
<td>31,694</td>
<td>32,269</td>
<td>34,209</td>
<td>35,988</td>
<td>37,908</td>
</tr>
<tr>
<td>Total Debt/Total Capital (%)</td>
<td>52</td>
<td>50</td>
<td>51</td>
<td>50</td>
<td>51</td>
</tr>
<tr>
<td>Common Equity/Total Capital (%)</td>
<td>48</td>
<td>50</td>
<td>49</td>
<td>50</td>
<td>49</td>
</tr>
</tbody>
</table>

IDR — Issuer Default Rating.
Source: Company data, Fitch.
The ratings above were unsolicited and have been provided by Fitch as a service to investors.

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American Electric Power Company, Inc.

Full Rating Report

Ratings

<table>
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<tr>
<th>Rating Type</th>
<th>Rating</th>
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<tr>
<td>Short-Term IDR</td>
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<td>Senior Unsecured</td>
<td>BBB</td>
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IDR – Issuer Default Rating.

Rating Outlook

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<th>Outlook</th>
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<tbody>
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<td>Stable</td>
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</tbody>
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Financial Data

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<tr>
<th>Company</th>
<th>Adjusted Revenue ($ Mil.)</th>
<th>Operating EBITDAR ($ Mil.)</th>
<th>Capex/Depreciation (%)</th>
<th>FFO Fixed-Charge Coverage (x)</th>
<th>FFO-Adjusted Leverage (x)</th>
<th>Total Adjusted Debt/EBITDAR (x)</th>
</tr>
</thead>
<tbody>
<tr>
<td>American Electric Power Company, Inc.</td>
<td>LTM 2015 16,584</td>
<td>2014 16,614</td>
<td>260%</td>
<td>4.8</td>
<td>3.6</td>
<td>3.8</td>
</tr>
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</table>

Key Rating Drivers

**Diversified Business Profile:** American Electric Power Company, Inc.'s (AEP's) ownership of nine regulated electric utilities operating in 11 states and its growing investments in Federal Energy Regulatory Commission (FERC)-regulated transmission projects provide regulatory, geographic and cash flow diversity. Fitch Ratings forecasts almost 90% of AEP's consolidated EBITDA will come from its regulated businesses over the rating horizon, supporting a low business risk profile.

**Balanced Regulatory Construct:** Fitch views the state regulatory constructs as balanced within AEP’s service territories. ROEs are close to the industry average and include provisions to mitigate commodity and environmental regulation risks. Recent favorable outcomes to general rate cases (GRCs) and incremental rider mechanisms should result in modestly higher earned ROE in 2015–2017.

**Large Capex Spending:** Fitch’s model includes management’s forecast capex spending of about $4.4 billion in 2015, $3.8 billion in 2016 and $3.9 billion in 2017, significantly higher than average annual expenditures of about $2.3 billion during 2011–2014. At least $1 billion of annual capex spending through 2017 targets FERC-regulated transmission assets, which earn attractive and contemporaneous returns on investment.

**Resilient Credit Metrics:** AEP’s credit metrics are adequate for its ratings, including adjusted debt to EBITDAR of 3.8x and FFO-adjusted leverage of 3.6x for LTM ending June 30, 2015. Fitch forecasts credit metrics to weaken slightly in 2016–2017, given the elevated capex plan and regulatory lag, but to remain commensurate with the rating category.

**Challenging Merchant Environment:** Low electricity demand and a weak pricing environment will persist over the forecast period, in Fitch’s opinion, depressing margins in the merchant business. Management is currently engaged with Ohio regulators to seek long-term contracts for some of its in-state power plants to provide a stable rate of return. Management is simultaneously exploring the divestment of its merchant power business. These endeavors, if successful, would further strengthen AEP’s credit profile.

**Stable Rating Outlook:** The Outlook reflects the solid liquidity, growing but manageable capex and supportive regulatory environment. The Stable Outlook also reflects Fitch’s expectation that regulated subsidiaries’ capex will be funded in a manner that preserves regulatory capital structures commensurate with their current credit profiles.

Rating Sensitivities

**Positive Rating Action:** A positive rating action may be considered if AEP strengthens its balance sheet, such that adjusted debt to EBITDAR improved to 3.6x on a sustainable basis, or if it improves its business risk profile by curtailing its exposure to volatile merchant activities.

**Negative Rating Action:** Future developments that may, individually or collectively, lead to negative rating action include adjusted debt to EBITDAR and FFO-adjusted leverage ratios rising higher than 4.0x and 5.5x, respectively, on a sustainable basis.

Related Research

American Electric Power Company, Inc. - Ratings Navigator (March 2015)
2015 Outlook: U.S. Utilities, Power and Gas (Slow and Steady) (December 2014)

Analysts

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Financial Overview

Liquidity and Debt Structure

AEP had approximately $3.2 billion of total liquidity available at the end of second-quarter 2015, including $3 billion available under two equal revolving credit facilities maturing in June 2017 and July 2018. The credit facilities also serve as a backstop for AEP’s commercial paper program and letters of credit.

Subsidiaries’ excess cash balances and short-term borrowing needs are centralized into two money pools, segregating regulated and nonregulated activities. Operating subsidiaries rely on AEP for their cash and treasury management, but access the capital markets independently for their long-term borrowings needs. Utility money pool borrowings and long-term financing may be limited by regulatory orders for individual subsidiaries. AEP and its subsidiaries regularly access the debt markets to fund capex and refinance maturing obligations. The debt maturities over the 2015–2018 rating horizon are modest, and Fitch expects them to be refinanced at competitive rates.

AEP must maintain a ratio of debt to total capitalization that does not exceed 67.5%, per the covenants to its credit agreement. AEP stood comfortably within this guideline at 51.4% at the end of second-quarter 2015.

<table>
<thead>
<tr>
<th>Debt Maturities and Liquidity ($ Mil., As of June 30, 2015)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>73</td>
</tr>
<tr>
<td>2016</td>
<td>181</td>
</tr>
<tr>
<td>2017</td>
<td>201</td>
</tr>
<tr>
<td>2018</td>
<td>1</td>
</tr>
<tr>
<td>Thereafter</td>
<td>2,351</td>
</tr>
<tr>
<td>Cash and Cash Equivalents</td>
<td>195</td>
</tr>
<tr>
<td>Undrawn Committed Facilities</td>
<td>3,042</td>
</tr>
</tbody>
</table>

Source: Company data, Fitch.

Cash Flow Analysis

Fitch expects modest growth in cash flow from operations, with improved economic activity in AEP’s service territories leading to modest volume growth, favorable settlement of new GRCs and contemporaneous return on FERC-regulated transmission investments.

Fitch also expects capex to remain elevated, at least over the rating horizon, with $12.3 billion planned in 2015–2017. Investments are focused on growing the regulated rate base, including about $5.2 billion for regulated transmission businesses, $3.5 billion for regulated distribution operations and $2.6 billion for regulated generation assets. Management plans a relatively modest $525 million investment into its competitive operations, focused on maintenance and environmental upgrades.
Cash flow from operations has been sufficient to permit a modest decrease in leverage and increase the dividend payout during 2012–2014. AEP currently targets a dividend payout ratio of 60%–70% of its operating earnings, mostly supported by cash flows from its regulated operating subsidiaries.

Peer and Sector Analysis

**Peer and Sector Analysis**

**Peer Group Analysis**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>As of</td>
<td>6/30/15</td>
<td>6/30/15</td>
<td>6/30/15</td>
<td>6/30/15</td>
</tr>
<tr>
<td>IDR</td>
<td>BBB</td>
<td>A</td>
<td>BBB+</td>
<td>BBB</td>
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<tr>
<td>Rating Outlook</td>
<td>Stable</td>
<td>RWN</td>
<td>Stable</td>
<td>RWN</td>
</tr>
</tbody>
</table>

**Fundamental Ratios (x)**
- Operating EBITDAR/(Gross Interest Expense + Rents) 4.62 5.31 4.34 4.05
- FFO Fixed-Charge Coverage (x) 4.80 5.76 5.83 6.55
- Total Adjusted Debt/Operating EBITDAR 3.77 4.96 4.36 3.15
- FFO/Total Adjusted Debt (%) 27.5 23.3 22.3 34.5
- FFO-Adjusted Leverage (x) 3.63 4.29 4.48 2.90
- Common Dividend Payout (%) 59.1 89.7 101.0 45.6
- Internal Cash/Capex (%) 74.2 65.1 74.3 75.8
- Capex/Depreciation (%) 259.5 307.5 196.2 317.3
- ROE (%) 10.2 10.8 6.9 10.1

**Revenue**
- 16,584 17,876 23,006 30,013

**Revenue Growth (%)**
- 1.9 (1.0) (9.4) 16.2

**Operating EBITDA (%)**
- 4,969 5,454 8,525 7,672

**Operating EBITDA Margin (%)**
- 33.4 36.8 36.2 26.5

**FCF**
- (1,142) (2,073) (1,440) (1,768)

**Total Adjusted Debt with Equity Credit**
- 19,851 27,647 38,527 24,519

**Cash and Cash Equivalents**
- 195 813 960 6,014

**FFO**
- 4,326 5,323 7,179 7,171

**Capex**
- (4,433) (5,937) (6,046) (7,295)

IDR – Issuer Default Rating. RWN – Rating Watch Negative.
Source: Company data, Fitch.
Key Rating Issues

Regulated Rate Cases

AEP’s regulated subsidiaries operate in 11 jurisdictions, which provides regulatory diversity. The company has been successful in recent years in obtaining positive GRC conclusions, which is improving earned ROEs. Kentucky Power Co.’s (KPCO’s) earned ROE was exceptionally low during the LTM ended June 30, 2015 due to one-off charges for fuel costs related to the Mitchell Power Plant acquisition in 2014. Fitch expects KPCO to earn close to 9% going forward.

Earned ROE per Regulated Subsidiary
(LTM Ended June 30, 2015)

Fitch assumes a satisfactory outcome to the GRC filed by Public Service Company of Oklahoma (PSO) in July 2015. PSO requested a rate increase of $172 million, of which $96 million would be primarily due to the cost of compliance with the EPA’s Regional Haze Rule, based on an ROE of 10.5% and a rate base of $2.1 billion.

Fitch’s base-case scenario does not incorporate the approval of the pending request by Ohio Power Co. to enter into a long-term power purchase agreement (PPA) with four AEP-owned, Ohio-based merchant plants and its share of two Ohio Valley Electric Corp. coal facilities. The PPA would strengthen AEP’s credit profile if approved under supportive terms, in Fitch’s opinion, by providing a stable rate of return on assets currently exposed to volatile PJM Interconnection LLC (PJM) power prices.

Focus on Transmission Assets

AEP is emphasizing transmission investments as its primary growth platform, aiming to grow the rate base to about $7 billion in 2018 from $2.7 billion in 2014. Fitch views the emphasis on transmission assets positively, as these generally enjoy stable earning profiles without volume or commodity risk and relatively high authorized ROEs, at around 11.0%–11.5%.

The company has identified investments worth $4 billion–$6 billion over the rating horizon in the FERC-regulated transmission assets, which will provide a cash return on investment during construction, mitigating pressure on credit protection measures during the construction phase. Under FERC regulations, these assets will enter the company’s rate base once the work is complete. FERC regulations also provide for an annual true-up for the over-and-under recoveries.
Competitive Energy Business

The operating environment for AEP’s merchant business, primarily 7.9 gigawatts (GW) of capacity located in the PJM region, is expected to remain challenging, as sluggish demand and abundant natural gas supply constrain power prices. About 5.3 GW of the merchant fleet consists of coal-fired plants located in western PJM, where dark spreads are squeezed by the proximity to the Marcellus shale gas play and transmission constraints toward the higher load regions in eastern PJM.

AEP derives additional revenues by participating in PJM’s capacity market. Following elevated outages during winter 2014, PJM introduced a capacity performance (CP) mechanism, with enhanced incentives for performance during emergency conditions and significant penalties for nonperformance. Results from the 2018–2019 delivery year auction, the first to include CP, were positive, with average clearing prices rebounding to $165/MW-day from $120/MW-day for 2017–2018, and AEP clearing all its capacity bid into the auction. Incremental transition auctions for delivery years 2016–2017 and 2017–2018 were also positive, each generating about $120 million in extra revenues. AEP expects to earn almost $400 million annually in 2016–2018 from capacity payments.

All generation assets are compliant with existing environmental regulations following the retirement of 2.5 GW in first-half 2015. Capex is forecast to be about $150 million annually in 2015–2017, but the Clean Power Plan may result in incremental environmental spending over the medium term. It is uncertain if future power prices would properly compensate for these investments.

Management is evaluating strategic options for its merchant fleet, including divestment and/or entering into a long-term PPA with its regulated subsidiary Ohio Power Co. Our ratings assume status quo status for AEP’s merchant generation assets. All other things remaining equal, the divestment of the generation assets and/or the transfer of a portion of the merchant asset to a quasi-regulated status would be credit positive.

Organizational Structure

Organizational and Debt Structure — American Electric Power Company, Inc.
($ Mil., As of June 30, 2015)

<table>
<thead>
<tr>
<th>Company</th>
<th>LT IDR</th>
<th>Total Adjusted Debt</th>
</tr>
</thead>
<tbody>
<tr>
<td>American Electric Power Company, Inc.</td>
<td>BBB/Stable</td>
<td>19,851</td>
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<tr>
<td>Appalachian Power Co.</td>
<td>BBB-/Stable</td>
<td>3,701</td>
</tr>
<tr>
<td>Indiana Michigan Power Co.</td>
<td>BBB-/Stable</td>
<td>2,534</td>
</tr>
<tr>
<td>Kentucky Power Co.</td>
<td>BBB-/Stable</td>
<td>872</td>
</tr>
<tr>
<td>Ohio Power Co.</td>
<td>BBB+/Stable</td>
<td>2,037</td>
</tr>
<tr>
<td>Public Service Co. of Oklahoma</td>
<td>BBB/Stable</td>
<td>1,306</td>
</tr>
<tr>
<td>Southwestern Electric Power Co.</td>
<td>BBB-/Stable</td>
<td>2,567</td>
</tr>
<tr>
<td>AEP Texas Central Co.</td>
<td>BBB+/Stable</td>
<td>1,267</td>
</tr>
<tr>
<td>AEP Texas North Co.</td>
<td>BBB+/Stable</td>
<td>525</td>
</tr>
<tr>
<td>AEP Texas North Co.</td>
<td>BBB+/Stable</td>
<td>525</td>
</tr>
<tr>
<td>Other Subsidiaries including: AEP Generating Co.</td>
<td>NR</td>
<td></td>
</tr>
<tr>
<td>AEP Transmission</td>
<td>NR</td>
<td></td>
</tr>
</tbody>
</table>

Source: Company reports, Fitch analysis.
Key Metrics

Definitions

- **Total Adjusted Debt/Op. EBITDAR**: Total balance sheet adjusted for equity credit and off-balance sheet debt divided by operating EBITDAR.
- **FFO Fixed-Charge Coverage**: FFO plus gross interest minus interest received plus preferred dividends plus rental payments divided by gross interest plus preferred dividends plus rental payments.
- **FFO-Adjusted 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.

---

**Total Adjusted Debt/Operating EBITDAR**

(x)

2011 2012 2013 2014 LTM 2015

AEP UPC Median

UPC – Utility parent company.
Source: Company data, Fitch.

**FFO Fixed-Charge Coverage**

(x)

2011 2012 2013 2014 LTM 2015

AEP UPC Median

UPC – Utility parent company.
Source: Company data, Fitch.

**FFO-Adjusted Leverage**

(x)

2011 2012 2013 2014 LTM 2015

AEP UPC Median

UPC – Utility parent company.
Source: Company data, Fitch.

**Capex/Depreciation**

(%) 300

250 200 150 100 50 0

2011 2012 2013 2014 LTM 2015

AEP UPC Median

UPC – Utility parent company.
Source: Company data, Fitch.
Company Profile

AEP is a public utility holding company providing generation, transmission and distribution services. The major business segments include vertically integrated utilities, transmission and distribution utilities, transmission networks and competitive generation. AEP operates regulated services in 11 states stretching from Texas to Michigan, and owns about 8 GW of merchant generation located in the PJM market.

Vertically Integrated Utilities Segment

This segment includes five state-regulated integrated utilities operating in Arkansas, Indiana, Kentucky, Louisiana, Michigan, Oklahoma, Texas, Virginia and West Virginia. This segment contributed about 48% of earnings in first-half 2015.

Distribution and Transmission Segment

The wires-only segment consists of three companies operating in Ohio and Texas, and represented about 17% of earnings in first-half 2015.

Transmission Business

AEP’s management is focused on investing in transmission infrastructure regulated by FERC for growth. The transmission business grew to 10% of earnings during first-half 2015, and is expected to rise with elevated investments in the rate base over the rating horizon.

Competitive Generation Business

AEP owns about 8 GW of competitive generating capacity, mainly located in the PJM wholesale market. About 67% of the capacity owned uses coal as the primary fuel, with the remainder of the fleet mostly gas fueled. This segment provided about 25% of earnings in first-half 2015. However, its share should decline with elimination of the rate stability rider in 2016 and increased investment in regulated operations.

Business Trends

Revenue Dynamics

Source: Company data, Fitch.

EBITDA Dynamics

Source: Company data, Fitch.

<table>
<thead>
<tr>
<th>($ Mil., As of June 30, 2015; IDR: BBB/Rating Outlook Stable)</th>
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<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>LTM 6/30/15</th>
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<td><strong>Fundamental Ratios</strong></td>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating EBITDAR/(Gross Interest Expense + Rents) (x)</td>
<td>3.7</td>
<td>3.6</td>
<td>4.1</td>
<td>4.5</td>
<td>4.6</td>
</tr>
<tr>
<td>FFO Fixed-Charge Coverage (x)</td>
<td>3.5</td>
<td>3.8</td>
<td>4.1</td>
<td>4.7</td>
<td>4.8</td>
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<td>Total Adjusted Debt/Operating EBITDAR (x)</td>
<td>4.0</td>
<td>4.0</td>
<td>3.9</td>
<td>3.8</td>
<td>3.8</td>
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<td>FFO/Total Adjusted Debt (%)</td>
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<td>26.1</td>
<td>25.6</td>
<td>28.0</td>
<td>27.5</td>
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<tr>
<td>FFO-Adjusted Leverage (x)</td>
<td>4.2</td>
<td>3.8</td>
<td>3.9</td>
<td>3.6</td>
<td>3.6</td>
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<tr>
<td>Common Dividend Payout (%)</td>
<td>46.3</td>
<td>72.8</td>
<td>64.5</td>
<td>61.1</td>
<td>59.1</td>
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<td>Internal Cash/Capex (%)</td>
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<td>90.5</td>
<td>80.1</td>
<td>80.0</td>
<td>74.2</td>
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<tr>
<td>Capex/Depreciation (%)</td>
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<td>192.8</td>
<td>242.9</td>
<td>254.7</td>
<td>259.5</td>
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<tr>
<td>ROE (%)</td>
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<td>8.4</td>
<td>9.5</td>
<td>9.9</td>
<td>10.2</td>
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<td><strong>Profitability</strong></td>
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<tr>
<td>Revenues</td>
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<td>15,015</td>
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<td>Revenue Growth (%)</td>
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<td>(1.5)</td>
<td>2.6</td>
<td>10.6</td>
<td>1.9</td>
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<td>9,456</td>
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<td>Operating and Maintenance Expense</td>
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<td>4,077</td>
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<td>Operating EBITDAR</td>
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<td>4,431</td>
<td>4,482</td>
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<td>4,968</td>
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<td>Operating EBITDAR</td>
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<td>4,809</td>
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<td>Depreciation and Amortization Expense</td>
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<td>1,569</td>
<td>1,492</td>
<td>1,623</td>
<td>1,708</td>
</tr>
<tr>
<td>Operating EBIT</td>
<td>2,829</td>
<td>2,862</td>
<td>2,990</td>
<td>3,132</td>
<td>3,261</td>
</tr>
<tr>
<td>Gross Interest Expense</td>
<td>904</td>
<td>963</td>
<td>855</td>
<td>829</td>
<td>846</td>
</tr>
<tr>
<td>Operating Maintenance Expense % of Net Revenues</td>
<td>44.4</td>
<td>43.6</td>
<td>43.2</td>
<td>44.7</td>
<td>43.1</td>
</tr>
<tr>
<td>Operating EBIT % of Net Revenues</td>
<td>30.6</td>
<td>30.6</td>
<td>31.6</td>
<td>30.5</td>
<td>31.4</td>
</tr>
<tr>
<td><strong>Cash Flow</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash Flow from Operations</td>
<td>3,622</td>
<td>3,591</td>
<td>3,855</td>
<td>4,307</td>
<td>4,321</td>
</tr>
<tr>
<td>Change in Working Capital</td>
<td>473</td>
<td>(49)</td>
<td>246</td>
<td>128</td>
<td>(5)</td>
</tr>
<tr>
<td>Funds from Operations</td>
<td>3,149</td>
<td>3,640</td>
<td>3,609</td>
<td>4,179</td>
<td>4,326</td>
</tr>
<tr>
<td>Dividends</td>
<td>(900)</td>
<td>(916)</td>
<td>(954)</td>
<td>(998)</td>
<td>(1,030)</td>
</tr>
<tr>
<td>Capex</td>
<td>(2,767)</td>
<td>(3,025)</td>
<td>(3,624)</td>
<td>(4,134)</td>
<td>(4,433)</td>
</tr>
<tr>
<td>FCF</td>
<td>(45)</td>
<td>(350)</td>
<td>(723)</td>
<td>(825)</td>
<td>(1,142)</td>
</tr>
<tr>
<td>Net Other Investment Cash Flow</td>
<td>156</td>
<td>(114)</td>
<td>(23)</td>
<td>(97)</td>
<td>33</td>
</tr>
<tr>
<td>Net Change in Debt</td>
<td>(104)</td>
<td>473</td>
<td>303</td>
<td>756</td>
<td>842</td>
</tr>
<tr>
<td>Net Equity Proceeds</td>
<td>28</td>
<td>83</td>
<td>84</td>
<td>73</td>
<td>100</td>
</tr>
<tr>
<td><strong>Capital Structure</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Short-Term Debt</td>
<td>1,650</td>
<td>981</td>
<td>757</td>
<td>1,346</td>
<td>1,105</td>
</tr>
<tr>
<td>Total Long-Term Debt</td>
<td>14,828</td>
<td>15,476</td>
<td>15,426</td>
<td>16,039</td>
<td>17,144</td>
</tr>
<tr>
<td><strong>Total Debt with Equity Credit</strong></td>
<td>16,478</td>
<td>16,457</td>
<td>16,183</td>
<td>17,385</td>
<td>18,249</td>
</tr>
<tr>
<td>Total Adjusted Debt with Equity Credit</td>
<td>18,475</td>
<td>18,964</td>
<td>18,730</td>
<td>18,967</td>
<td>19,851</td>
</tr>
<tr>
<td>Total Hybrid Equity and Minority Interest</td>
<td>8</td>
<td>1</td>
<td>1</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Total Common Shareholders’ Equity</td>
<td>14,664</td>
<td>15,237</td>
<td>16,085</td>
<td>16,820</td>
<td>17,434</td>
</tr>
<tr>
<td><strong>Total Capital</strong></td>
<td>31,143</td>
<td>31,694</td>
<td>32,269</td>
<td>34,209</td>
<td>35,691</td>
</tr>
<tr>
<td>Total Debt/Total Capital (%)</td>
<td>52.9</td>
<td>51.9</td>
<td>50.2</td>
<td>50.8</td>
<td>51.1</td>
</tr>
<tr>
<td>Total Hybrid Equity and Minority Interest/Total Capital (%)</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Common Equity/Total Capital (%)</td>
<td>47.1</td>
<td>48.1</td>
<td>48.8</td>
<td>49.2</td>
<td>48.8</td>
</tr>
</tbody>
</table>

IDR – Issuer Default Rating.

Source: Company data, Fitch.
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American Electric Power Company, Inc.

Full Rating Report

Key Rating Drivers

Diversified Utility Footprint: American Electric Power Company, Inc. (AEP) is a utility holding company with subsidiaries operating regulated utility businesses in 11 states and a growing investment in regulated transmission networks. Investment in low-risk utility businesses, service territory diversity, regulatory diversity and the strategic focus on rate base growth are embedded in Fitch Ratings’ assigned Issuer Default Rating (IDR).

Improving Business Risk Profile: Future planned investments in Federal Energy Regulatory Commission (FERC)-regulated transmission networks will further diversify and improve AEP’s business risk profile with over 90% of consolidated earnings and cash flows derived from regulated activities. Fitch believes AEP’s merchant generating business will not be a strategic focus and will be conservatively managed.

Challenging Merchant Business Environment: The cost to comply with the stricter environmental regulations, low electricity demand and weak pricing environment will adversely affect the financial performance of AEP’s merchant business. A divesture of the competitive generation business, if undertaken by management, would be supportive of AEP’s current credit profile.

Large Future Capex Spending: Management plans average annual capex of about $3.8 billion between 2014 and 2016, a level significantly higher than previous periods. FERC-regulated transmission projects with attractive and concurrent investment returns dominate the capex budget. Fitch expects AEP to fund capex with a combination of internal cash flow and debt. Negative FCF at the utilities will likely be financed with a mixture of cash flow from operations, debt and equity infusion by the parent to maintain the regulatory capital structure.

Cash Flow Diversity: AEP’s earnings and cash flows are predominantly derived from its portfolio of state-regulated utilities and FERC-regulated transmission networks. In Fitch financial models, approximately 93% of AEP’s consolidated EBITDA over the long term will be from regulated businesses, including the FERC-regulated transmission networks.

Financial Metrics: Fitch expects pressure on FFO-based credit measures with the absence of bonus depreciation-related cash tax benefits, weak power prices and a large capital investment in the regulated rate base. Fitch forecasts FFO-based interest coverage to average between 3.5x and 4.0x, and the adjusted debt to FFO to be around 5x through 2016.

Rating Sensitivities

Positive Rating Action: A rating upgrade at this time appears unlikely given the large capex program through 2016, and future liquidity and capital support needed for AEP’s competitive energy business over the rating horizon.

Negative Rating Action: Factors that could individually or collectively lead to a rating downgrade include lower than expected margins and volumes, and higher capex spending at AEP’s merchant generating business. Adverse regulatory outcomes that prevent an adequate and timely return on invested capital, deterioration in consolidated EBITDA-based credit metrics, and EBITDA-based leverage above 4.3x and EBITDA-to-interest ratio below 3.5x on a sustainable basis could also lead to a downgrade.

Related Research

2014 Outlook: Utilities, Power, and Gas (Electricity Sales Unplugged) (December 2013)

Rating Sensitivities

Positive Rating Action: A rating upgrade at this time appears unlikely given the large capex program through 2016, and future liquidity and capital support needed for AEP’s competitive energy business over the rating horizon.

Negative Rating Action: Factors that could individually or collectively lead to a rating downgrade include lower than expected margins and volumes, and higher capex spending at AEP’s merchant generating business. Adverse regulatory outcomes that prevent an adequate and timely return on invested capital, deterioration in consolidated EBITDA-based credit metrics, and EBITDA-based leverage above 4.3x and EBITDA-to-interest ratio below 3.5x on a sustainable basis could also lead to a downgrade.

Analysts

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August xx, 2014
Financial Overview

Liquidity and Debt Structure

**Sufficient Liquidity**

AEP has sufficient liquidity to support its operations and working capital needs. Consolidated liquidity at June 30, 2014, was $2.9 billion, including $190 million in cash and $2.7 billion available under two revolving bank credit facilities of $1.75 billion each, expiring in June 2016 and July 2017, respectively. These facilities support AEP’s commercial paper program ($732 million outstanding at the end of June 2014) and up to $1.2 billion in letters of credit ($49 million outstanding at the end of June 2014).

**Money Pool**

AEP operates separate money pools for its regulated and nonregulated subsidiaries. AEP is responsible for the cash and treasury management function of its subsidiaries. For its utility pool, each utility subsidiary has a sublimit and can contribute excess cash to the pool, but AEP is prohibited to use these funds for its corporate use.

**Manageable Debt Maturities**

AEP will be reliant on external financing to meet upcoming debt maturities and future capex expenditures. The debt maturities over the 2014–2016 rating horizon are manageable.

### Consolidated Debt Maturities and Liquidity

<table>
<thead>
<tr>
<th></th>
<th>($ Mil., As of March 31, 2014)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>1,324</td>
</tr>
<tr>
<td>2015</td>
<td>2,292</td>
</tr>
<tr>
<td>2016</td>
<td>1,183</td>
</tr>
<tr>
<td>2017</td>
<td>1,714</td>
</tr>
<tr>
<td>After 2017</td>
<td>10,067</td>
</tr>
<tr>
<td>Cash and Cash Equivalents</td>
<td>118</td>
</tr>
<tr>
<td>Undrawn Committed Facilities</td>
<td>2,823</td>
</tr>
</tbody>
</table>

Source: Company reports, Fitch Ratings.

**Cash Flow Analysis**

Fitch expects continued growth in cash flow from operations with improved economic activity in AEP’s service territories, settlement of new general rate cases and cash return on FERC-regulated transmission investments. Fitch also expects capex to remain elevated, at least over the rating horizon, with growth-related investment in FERC-regulated transmission businesses. Cash flow has been sufficient to permit a modest decrease in leverage and increase the dividend payout ratio.
Peer Group

<table>
<thead>
<tr>
<th>Issuer</th>
<th>Country</th>
<th>Rating</th>
<th>Outlook</th>
</tr>
</thead>
<tbody>
<tr>
<td>Duke Energy Corp.</td>
<td>U.S.</td>
<td>BBB+</td>
<td>Stable</td>
</tr>
<tr>
<td>American Electric Power Company, Inc.</td>
<td>U.S.</td>
<td>BBB</td>
<td>Stable</td>
</tr>
<tr>
<td>PPL Corporation</td>
<td>U.S.</td>
<td>BBB</td>
<td>Stable</td>
</tr>
</tbody>
</table>

Source: Fitch Ratings.

Issuer Rating History

<table>
<thead>
<tr>
<th>Date</th>
<th>LT IDR (FC)</th>
<th>Outlook/Watch</th>
</tr>
</thead>
<tbody>
<tr>
<td>April 7, 2014</td>
<td>BBB</td>
<td>Stable</td>
</tr>
<tr>
<td>Feb. 20, 2014</td>
<td>BBB</td>
<td>Stable</td>
</tr>
<tr>
<td>Feb. 22, 2013</td>
<td>BBB</td>
<td>Negative</td>
</tr>
<tr>
<td>Feb. 27, 2012</td>
<td>BBB</td>
<td>Stable</td>
</tr>
<tr>
<td>Feb. 28, 2011</td>
<td>BBB</td>
<td>Stable</td>
</tr>
<tr>
<td>Jan. 26, 2010</td>
<td>BBB</td>
<td>Stable</td>
</tr>
<tr>
<td>Nov. 10, 2008</td>
<td>BBB</td>
<td>Stable</td>
</tr>
<tr>
<td>April 17, 2007</td>
<td>BBB</td>
<td>Stable</td>
</tr>
<tr>
<td>April 24, 2006</td>
<td>BBB</td>
<td>Stable</td>
</tr>
<tr>
<td>Dec. 6, 2005</td>
<td>BBB</td>
<td>Stable</td>
</tr>
<tr>
<td>March 11, 2003</td>
<td>BBB</td>
<td>Stable</td>
</tr>
<tr>
<td>Oct. 9, 2001</td>
<td>BBB+</td>
<td>Stable</td>
</tr>
<tr>
<td>June 1, 2000</td>
<td>BBB+</td>
<td>Stable</td>
</tr>
</tbody>
</table>

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

Peer and Sector Analysis

Peer Group Analysis

<table>
<thead>
<tr>
<th>Issuer</th>
<th>Country</th>
<th>LTM as of</th>
<th>Long-Term IDR</th>
<th>Rating Outlook</th>
</tr>
</thead>
<tbody>
<tr>
<td>PPL Corporation</td>
<td>U.S.</td>
<td>3/31/14</td>
<td>BBB</td>
<td>Stable</td>
</tr>
<tr>
<td>Duke Energy Corporation</td>
<td>U.S.</td>
<td>3/31/14</td>
<td>BBB+</td>
<td>Stable</td>
</tr>
</tbody>
</table>

Financial Statistics ($ Mil.)

<table>
<thead>
<tr>
<th></th>
<th>American Electric Power Company, Inc.</th>
<th>PPL Corporation</th>
<th>Duke Energy Corporation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>15,780</td>
<td>9,804</td>
<td>25,324</td>
</tr>
<tr>
<td>YoY Revenue Growth (%)</td>
<td>6.5</td>
<td>(22.4)</td>
<td>15.7</td>
</tr>
<tr>
<td>EBITDA</td>
<td>4,782</td>
<td>4,162</td>
<td>8,561</td>
</tr>
<tr>
<td>EBITDA Margin (%)</td>
<td>30.3</td>
<td>42.5</td>
<td>33.8</td>
</tr>
<tr>
<td>FCF</td>
<td>(483)</td>
<td>(1,592)</td>
<td>(918)</td>
</tr>
<tr>
<td>Capex/Depreciation (%)</td>
<td>245.2</td>
<td>355.6</td>
<td>183.2</td>
</tr>
</tbody>
</table>

Credit Metrics (x)

<table>
<thead>
<tr>
<th></th>
<th>American Electric Power Company, Inc.</th>
<th>PPL Corporation</th>
<th>Duke Energy Corporation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt/FFO</td>
<td>4.5</td>
<td>5.8</td>
<td>5.6</td>
</tr>
<tr>
<td>FFO Interest Coverage</td>
<td>5.4</td>
<td>4.5</td>
<td>5.4</td>
</tr>
</tbody>
</table>

Source: Fitch Ratings.

PPL Corporation’s ratings and Outlook reflect its transformation from a company heavily reliant on commodity-sensitive businesses to one that is highly regulated with substantially less business risk. Driven by the acquisitions of Central Networks in April 2011 and LG&E and KU Energy, LLC in November 2010, regulated operations are expected to provide over 75% of consolidated EBITDA by 2013, in Fitch’s opinion.

Sector Outlook Distribution

Source: Company data, Fitch Ratings.
Duke Energy Corporation owns six regulated utilities that provide a relatively predictable and diverse cash flow stream. Each of the utilities has a solid credit profile and is well positioned within its respective rating level. The percentage of parent-level debt is high, at about 30% of consolidated debt, due to levered acquisitions, but should be trending down to about 27% over the next few years.

Key Rating Issues

Competitive Energy Business

The competitive generating business faces headwinds from an extended period of, and expectation for, low power prices, weak demand for power and large capital investments to comply with the more stringent environmental regulations. With over 70% of AEP’s competitive generation capacity being coal fired, the economics of AEP’s competitive generation has been pressured by low power prices, and future environmental costs may not be recoverable under the current power-pricing environment. Operating in a wholesale electricity market requires access to a large liquidity pool and the capital support from AEP to cover margin calls and collateral requirements arising from volatility in electricity and fuel commodity prices.

The majority of AEP’s generating assets comply with the currently effective environmental regulations. Any future carbon regulation without a corresponding investment recovery mechanism will be negative for the company.

Large Capex

AEP is emphasizing transmission investments as a primary growth platform. FERC-regulated transmission investment earns an attractive and timely return on invested capital. This strategy will not only require large capex spending over the next three years to support the creation of a new transmission rate base, but also a sizeable investment in the mandatory investment needed for the reliability and safety of its existing utility businesses.

The company has identified investments worth $4 billion–$6 billion over the rating horizon in the FERC-regulated transmission assets, which will provide a cash return on investment during construction, mitigating pressure on credit protection measures during the construction phase. Under FERC regulations, these assets will enter the company’s rate base once the work is complete. The FERC regulations provide for an annual true-up for the over-and-under recoveries. The capex includes about $2 billion of in-state transmission projects. Some of these projects may require the state regulatory approval and may not earn a cash return during construction.
### Organizational Structure

**Organizational Structure — American Electric Power Co., Inc.**
($Mil., As of March 31, 2014)

<table>
<thead>
<tr>
<th>Company</th>
<th>IDR</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>American Electric Power Co., Inc.</td>
<td>BBB+</td>
<td>1.650% Sr. Unsecured Notes due 12/15/17  550  2.950% Sr. Unsecured Notes due 12/15/22  300  Credit Facility draw down  1,000  (Relates to selling of generating assets)</td>
</tr>
<tr>
<td>Appalachian Power Co.</td>
<td>BBB</td>
<td>4.95% Sr. Unsecured Notes due 2/1/15  200  3.400% Sr. Unsecured Notes due 5/2/15  300  5.000% Sr. Unsecured Notes due 6/1/17  250  7.950% Sr. Unsecured Notes due 11/5/20  350  4.600% Sr. Unsecured Notes due 3/30/21  350  5.950% Sr. Unsecured Notes due 6/5/33  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 6/15/37  250  7.000% Sr. Unsecured Notes due 4/1/38  500  5.000% Sr. Unsecured Notes due 6/15/38  30  3.250% Pollution Control Bonds due 5/1/19  40  3.250% 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 2/1/36  50  Floating Rate Pollution Control Bonds due 2/1/36  50  5.375% Pollution Control Bonds due 12/1/38  50  2.250% Pollution Control Bonds due 11/1/41  65  Floating Rate Pollution Control Bonds due 12/1/42  54  Floating Rate Pollution Control Bonds due 12/1/42  50</td>
</tr>
<tr>
<td>Southwestern Electric Power Co.</td>
<td>BBB</td>
<td>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 11/15/17  250  5.875% Sr. Unsecured Notes due 3/1/18  300  6.450% Sr. Unsecured Notes due 11/5/19  400  3.550% Sr. Unsecured Notes due 2/15/22  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 11/1/19  54  4.580% Notes Payable due 2/21/22  60  6.370% Notes Payable due 10/31/24  25</td>
</tr>
<tr>
<td>AEP Texas North Co.</td>
<td>BBB</td>
<td>Floating Rate Term Loan due 7/31/16  75  5.090% Sr. Unsecured Notes due 4/1/18  30  3.090% Sr. Unsecured Notes due 2/28/23  125  6.760% Sr. Unsecured Notes due 4/1/38  70  4.480% Sr. Unsecured Notes due 2/28/43  75  4.450% Pollution Control Bonds due 6/1/20  44</td>
</tr>
<tr>
<td>AEP Texas Central Co.</td>
<td>BBB+</td>
<td>6.650% Sr. Unsecured Notes due 2/15/33  275  6.625% 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 9/1/30  112  5.200% Pollution Control Bonds due 5/1/30  60  4.550% Pollution Control Bonds due 9/1/30  30  4.250% Securitization Bond due 1/15/16  192  5.090% Securitization Bond due 7/1/15  208  5.170% Securitization Bond due 1/11/18  437  5.306% Securitization Bond due 7/1/20  495  2.845% Securitization Bond due 12/1/24  312  3.990% Securitization Bond due 12/1/17  247  1.976% Securitization Bond due 6/1/20  180</td>
</tr>
<tr>
<td>Indiana Michigan Power Co.</td>
<td>BBB</td>
<td>Floating Rate Term Loan due 5/15/15  106  5.650% Sr. Unsecured Notes due 11/15/14  175  5.650% Sr. Unsecured Notes due 12/11/15  125  7.000% Sr. Unsecured Notes due 3/15/19  475  3.200% Sr. Unsecured Notes due 3/15/23  250  6.050% Sr. Unsecured Notes due 3/15/37  400  Floating Rate Pollution Control Bonds due 10/11/19  25  Floating Rate Pollution Control Bonds due 11/1/21  52  5.250% Pollution Control Bonds due 4/1/25  48  4.625% 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  2.120-5.440% Nuclear Fuel Leases due 2013–2016  233</td>
</tr>
<tr>
<td>Public Service Co. of Oklahoma</td>
<td>BBB</td>
<td>6.150% Sr. Unsecured Notes due 8/1/16  150  5.150% Sr. Unsecured Notes due 12/9/19  250  4.400% Sr. Unsecured Notes due 3/31/21  250  6.625% Sr. Unsecured Notes due 11/15/23  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  Variable Other Long-Term Debt  50</td>
</tr>
<tr>
<td>Kentucky Power Co.</td>
<td>BBB</td>
<td>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  8.630% Sr. Unsecured Notes due 6/18/29  30  6.625% Sr. Unsecured Notes due 12/1/32  75  8.130% Sr. Unsecured Notes due 6/18/39  60</td>
</tr>
</tbody>
</table>

*Securitization bonds not included in Fitch’s analysis. IDR – Issuer Default Rating. NR – Not rated.

Source: Company filings, Bloomberg, Fitch Ratings.

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**American Electric Power Company, Inc.**

August xx, 2014
**Key Metrics**

**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.
- **FCF/Revenue:** FCF after dividends divided by revenue.
- **FFO/Debt:** FFO divided by gross debt plus lease adjustment minus equity credit for hybrid instruments plus preferred stock.

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**Leverage: Total Adjusted Debt/Operating EBITDAR**

- **American Electric Power Company, Inc.**
- **Power and Utility U.S. Median**
- **BBB U.S. Medians**

**Interest Coverage: Operating EBITDA/Gross Interest Expense**

- **American Electric Power Company, Inc.**
- **Power and Utility U.S. Median**
- **BBB U.S. Medians**

**FCF/Revenues**

- **American Electric Power Company, Inc.**
- **Power and Utility U.S. Median**
- **BBB U.S. Medians**

**FFO/Debt**

- **American Electric Power Company, Inc.**
- **Power and Utility U.S. Median**
- **BBB U.S. Medians**

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Source: Company data, Fitch Ratings.
Company Profile

AEP is a public utility holding company providing generation, transmission and distribution services. The major business segments include vertically integrated utilities, transmission and distribution utilities, transmission networks, and competitive generation and transportation business. Through operating subsidiaries, AEP operates an extensive portfolio of assets, including about 37,600 MW of generating capacity, approximately 40,000 miles of transmission lines, approximately 221,000 miles of distribution lines and a substantial commodity transportation business.

Vertically Integrated Utilities Segment

This segment includes state regulated, integrated utilities operating in Arkansas, Indiana, Kentucky, Louisiana, Michigan, Oklahoma, Texas, Virginia and West Virginia. This segment contributed about 51% of total EBITDA for AEP in 2014. Fitch expects this segment to provide similar EBITDA contributions in the future.

Vertically Integrated Utilities

<table>
<thead>
<tr>
<th>Utility</th>
<th>States</th>
<th>Asset Base ($ Mil.)</th>
<th>Authorized ROE (%)</th>
<th>Capex Forecast ($ Mil., 2014–2016)</th>
<th>Coal-Fired Generation Capacity (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Appalachian Power Company</td>
<td>Virginia and West Virginia</td>
<td>7</td>
<td>10.90 and 10.00</td>
<td>1,636</td>
<td>73</td>
</tr>
<tr>
<td>Kentucky Power Company</td>
<td>Kentucky</td>
<td>1,548</td>
<td>10.50</td>
<td>314</td>
<td>100</td>
</tr>
<tr>
<td>Indiana Michigan Power Company</td>
<td>Indiana and Michigan</td>
<td>3,849</td>
<td>10.20 and 10.20</td>
<td>1,386</td>
<td>51</td>
</tr>
<tr>
<td>Public Service</td>
<td>Indiana and Michigan</td>
<td>3,849</td>
<td>10.20 and 10.20</td>
<td>1,386</td>
<td>51</td>
</tr>
<tr>
<td>Oklahoma Power Company</td>
<td>Oklahoma</td>
<td>2,200</td>
<td>10.15</td>
<td>1,004</td>
<td>23</td>
</tr>
<tr>
<td>Southwest Electric Power Company</td>
<td>Arkansas, Louisiana and Texas</td>
<td>4,275</td>
<td>10.25, 10.00 and 9.65</td>
<td>1,500</td>
<td>40</td>
</tr>
</tbody>
</table>

ROE – Return on equity. Source: Company reports.

Off-System Sales Sharing Mechanism by State

<table>
<thead>
<tr>
<th>State</th>
<th>Off-System Sharing</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Arkansas</td>
<td>Yes</td>
<td>Ratepayers receive 100% of $758,600 in annual margins from off-system sales. The ratepayers receive 85% from off-system margins between $758.6 million and $1.167 million. Any annual margins above $1.167 million in off-system sales are shared 50:50 with the ratepayers.</td>
</tr>
<tr>
<td>Indiana</td>
<td>Yes</td>
<td>Sharing occurs above and below levels included in base rates of $26.9 million. Ratepayers receive 50%.</td>
</tr>
<tr>
<td>Kentucky</td>
<td>Yes</td>
<td>Sharing occurs above and below levels included in base rates of $15.29 million. The ratepayers receive 100% of the margins from off-system sales. Anything above the base rate is kept by the utility.</td>
</tr>
<tr>
<td>Louisiana</td>
<td>Yes</td>
<td>Up to $874,000 in annual margin from off-system sales, ratepayers receive 100% of margins. From $874,000 and $1.314 million, ratepayers receive 85%, and ratepayers receive 50% for margins from off-system sales above $1.314 million.</td>
</tr>
<tr>
<td>Michigan</td>
<td>Yes</td>
<td>80% of profits from off-system sales are shared with ratepayers.</td>
</tr>
<tr>
<td>Oklahoma</td>
<td>Yes</td>
<td>75% of profits from off-system sales are shared with ratepayers.</td>
</tr>
<tr>
<td>Texas</td>
<td>Yes</td>
<td>90% of profits from off-system sales are shared with ratepayers.</td>
</tr>
<tr>
<td>Virginia</td>
<td>Yes</td>
<td>75% of profits from off-system sales are shared with ratepayers.</td>
</tr>
<tr>
<td>West Virginia</td>
<td>Yes</td>
<td>100% of profits passed back to ratepayers through the Expanded Net Energy Cost clause.</td>
</tr>
</tbody>
</table>

Source: Company reports.
Distribution and Transmission Segment

The wires-only segment consists of three companies operating in Ohio and Texas. The segment represents about 27% of the asset base and about 26% of total EBITDA in 2014. Fitch expects total contribution from this segment will continue to be around

### Distribution and Transmission Subsidiaries

<table>
<thead>
<tr>
<th>Utility</th>
<th>States</th>
<th>Asset Base ($ Mil.)</th>
<th>Authorized ROE (%)</th>
<th>Capex Forecast ($ Mil., 2014–2016)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ohio Power Company</td>
<td>Ohio</td>
<td>4,403</td>
<td>10.20</td>
<td>978</td>
</tr>
<tr>
<td>AEP Texas Central Company</td>
<td>Texas</td>
<td>2,439</td>
<td>9.96</td>
<td>721</td>
</tr>
<tr>
<td>AEP Texas North Company</td>
<td>Texas</td>
<td>901</td>
<td>9.96</td>
<td>372</td>
</tr>
</tbody>
</table>

ROE – Return on equity.
Source: Company reports.

### Competitive Generation Business

AEP owns about 8,700 MW of competitive generating capacity, mainly located in the PJM Interconnection LLC-operated wholesale market. About 70% of the capacity owned uses coal as the primary fuel. AEP expects to spend about $500 million in maintenance capex over 2014–2016. This segment currently provides about 19% of total EBITDA before eliminations. However, its share should decline with increased investment in the transmission segment of the business and elimination of the rate stability rider in 2016.

### Transmission Business

AEP’s management is focused on investing in transmission infrastructure regulated by FERC for growth. AEP plans to invest about $2.4 billion between 2014 and 2016 on the FERC-regulated transmission projects. FERC’s regulatory framework allows a contemporaneous return on the investment during construction, improving cash flow from operations. The transmission business is currently only 3% of the group’s total EBITDA, but is expected to rise with elevated investment in the rate base over the rating horizon.

### Business Trends

#### Revenue Dynamics

![Revenue Dynamics Graph](source: Fitch Ratings)

#### EBITDA Dynamics

![EBITDA Dynamics Graph](source: Fitch Ratings)

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

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013 LTM Ended 3/31/14</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Fundamental Ratios (x)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FFO/Interest Expense</td>
<td>4.3</td>
<td>4.5</td>
<td>4.8</td>
<td>5.2</td>
</tr>
<tr>
<td>CFO/Interest Expense</td>
<td>3.6</td>
<td>5.0</td>
<td>4.7</td>
<td>5.5</td>
</tr>
<tr>
<td>FFO/Debt (%)</td>
<td>18.6</td>
<td>19.1</td>
<td>22.1</td>
<td>22.3</td>
</tr>
<tr>
<td>Operating EBIT/Interest Expense</td>
<td>2.7</td>
<td>3.1</td>
<td>3.0</td>
<td>3.5</td>
</tr>
<tr>
<td>Operating EBITDA/Interest Expense</td>
<td>4.3</td>
<td>4.8</td>
<td>4.6</td>
<td>5.2</td>
</tr>
<tr>
<td>Operating EBITDAR/(Interest Expense + Rent)</td>
<td>3.4</td>
<td>3.7</td>
<td>3.7</td>
<td>4.1</td>
</tr>
<tr>
<td>Debt/Operating EBITDA</td>
<td>4.2</td>
<td>3.8</td>
<td>3.7</td>
<td>3.6</td>
</tr>
<tr>
<td>Common Dividend Payout (%)</td>
<td>68.0</td>
<td>46.3</td>
<td>72.8</td>
<td>64.5</td>
</tr>
<tr>
<td>Internal Cash/Capital Expenditures (%)</td>
<td>73.4</td>
<td>104.5</td>
<td>90.5</td>
<td>80.1</td>
</tr>
<tr>
<td>Capital Expenditures/Depreciation (%)</td>
<td>162.8</td>
<td>185.8</td>
<td>192.8</td>
<td>242.9</td>
</tr>
<tr>
<td><strong>Profitability</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted Revenues</td>
<td>14,173</td>
<td>14,858</td>
<td>14,638</td>
<td>15,015</td>
</tr>
<tr>
<td>Net Revenues</td>
<td>9,144</td>
<td>9,246</td>
<td>9,358</td>
<td>9,456</td>
</tr>
<tr>
<td>Operating and Maintenance Expense</td>
<td>4,274</td>
<td>4,104</td>
<td>4,077</td>
<td>4,083</td>
</tr>
<tr>
<td>Operating EBITDA</td>
<td>4,050</td>
<td>4,318</td>
<td>4,431</td>
<td>4,482</td>
</tr>
<tr>
<td>Depreciation and Amortization Expense</td>
<td>1,488</td>
<td>1,489</td>
<td>1,569</td>
<td>1,492</td>
</tr>
<tr>
<td>Operating EBIT</td>
<td>2,562</td>
<td>2,829</td>
<td>2,862</td>
<td>2,990</td>
</tr>
<tr>
<td>Gross Interest Expense</td>
<td>951</td>
<td>904</td>
<td>963</td>
<td>855</td>
</tr>
<tr>
<td>Net Income for Common</td>
<td>1,211</td>
<td>1,941</td>
<td>1,259</td>
<td>1,480</td>
</tr>
<tr>
<td>Operating and Maintenance Expense % of Net Revenues</td>
<td>46.7</td>
<td>44.4</td>
<td>43.6</td>
<td>43.2</td>
</tr>
<tr>
<td>Operating EBIT % of Net Revenues</td>
<td>28.0</td>
<td>30.6</td>
<td>30.6</td>
<td>31.6</td>
</tr>
<tr>
<td><strong>Cash Flow</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash Flow from Operations</td>
<td>2,509</td>
<td>3,622</td>
<td>3,591</td>
<td>3,855</td>
</tr>
<tr>
<td>Change in Working Capital</td>
<td>(620)</td>
<td>473</td>
<td>(49)</td>
<td>246</td>
</tr>
<tr>
<td>Funds From Operations</td>
<td>3,129</td>
<td>3,149</td>
<td>3,640</td>
<td>3,609</td>
</tr>
<tr>
<td>Dividends</td>
<td>(827)</td>
<td>(900)</td>
<td>(916)</td>
<td>(954)</td>
</tr>
<tr>
<td>Capital Expenditures</td>
<td>(2,422)</td>
<td>(2,767)</td>
<td>(3,025)</td>
<td>(3,624)</td>
</tr>
<tr>
<td>FCF</td>
<td>(740)</td>
<td>(45)</td>
<td>(350)</td>
<td>(723)</td>
</tr>
<tr>
<td>Net Other Investment Cash Flow</td>
<td>11</td>
<td>156</td>
<td>(114)</td>
<td>(29)</td>
</tr>
<tr>
<td>Net Change in Debt</td>
<td>402</td>
<td>(104)</td>
<td>473</td>
<td>303</td>
</tr>
<tr>
<td>Net Equity Proceeds</td>
<td>93</td>
<td>28</td>
<td>83</td>
<td>84</td>
</tr>
<tr>
<td><strong>Capital Structure</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Short-Term Debt</td>
<td>1,346</td>
<td>1,650</td>
<td>981</td>
<td>757</td>
</tr>
<tr>
<td>Long-Term Debt</td>
<td>15,468</td>
<td>14,828</td>
<td>15,476</td>
<td>15,426</td>
</tr>
<tr>
<td><strong>Total Debt</strong></td>
<td>16,814</td>
<td>16,478</td>
<td>16,457</td>
<td>16,183</td>
</tr>
<tr>
<td>Total Hybrid Equity and Minority Interest</td>
<td>30</td>
<td>1</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Common Equity</td>
<td>13,622</td>
<td>14,664</td>
<td>15,237</td>
<td>16,085</td>
</tr>
<tr>
<td><strong>Total Capital</strong></td>
<td>30,466</td>
<td>31,143</td>
<td>31,694</td>
<td>32,269</td>
</tr>
<tr>
<td>Total Debt/Total Capital (%)</td>
<td>55.2</td>
<td>52.9</td>
<td>51.9</td>
<td>50.2</td>
</tr>
<tr>
<td>Total Hybrid Equity and Minority Interest/Total Capital (%)</td>
<td>0.1</td>
<td>—</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Common Equity/Total Capital (%)</td>
<td>44.7</td>
<td>47.1</td>
<td>48.1</td>
<td>49.9</td>
</tr>
</tbody>
</table>

Source: Company reports.
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Fitch Ratings-New York-20 February 2014: Fitch Ratings has affirmed the ratings of American Electric Power Company (AEP) and its subsidiaries. Fitch has revised the Outlook to Stable from Negative for AEP and two of its subsidiaries - Ohio Power Company (OPCO), and Kentucky Power Company (KPCO). The Rating Outlook remains Stable for AEP's other operating subsidiaries. A complete list of rating actions is provided at the end of this release.

The revision of AEP's Outlook to Stable reflects successful completion of OPCO's transition to a wires-only company. The transition was achieved with lower than expected increase in AEP leverage. The regulator-approved transfer of 1,647 MWs of generation capacity at net book value to two of AEP's regulated subsidiaries has reduced the overall merchant risk for AEP. Fitch had expected the transfer of these assets at net book value to be challenging in the current depressed power pricing environment.

AEP management has publicly articulated a strategy for its competitive generating business that Fitch considers conservative. This mitigates, to some extent, the merchant risk and associated liquidity needs for AEP over Fitch's rating horizon. Fitch believes the consolidated business-risk profile for AEP will also improve with significant new investment in the transmission networks. The company plans to spend about $4.5 billion between 2014 and 2016 on the Federal Energy Regulatory Commission (FERC) regulated transmission networks which provides a contemporaneous return on investment. Current rate-base of regulated transmission companies is below $1 billion, excluding transmission related investment through Electric Transmission Texas, LLC (a joint venture) and integrated utilities.

For OPCO, the revision to a Stable Outlook reflects a moderate regulatory capital structure. The debt-to-regulatory capital ratio for OPCO remains moderate and the concurrent recovery of infrastructure investments through rate-riders also supports the Stable Outlook. Fitch had previously anticipated significantly higher regulatory debt-to-capital at OPCO due to lack of market support for the transfer price of generating assets.

The revision of KPCO's Outlook to Stable reflects the regulatory approval of its newly acquired generating capacity from an affiliate. In assigning the Negative Outlook, Fitch viewed regulatory approval of the new capacity critical for the assigned Issuer Default Rating (IDR), as KPCO's credit metrics would have deteriorated without any new cash flow with the retirement of its only baseload plant in 2015. Fitch's view was that the regulators may not approve the acquisition at the requested transfer price under the current power pricing environment and a long-term power purchase agreement -a viable alternative - would have further constrained the cash flows.

The Stable Outlook for other AEP subsidiaries reflects Fitch's view that subsidiary-level cash flows and regulatory capital structure would remain commensurate with their credit profiles. Fitch anticipates that each subsidiary would continue to timely file general rate increase application with the regulators and achieve constructive outcomes.

**KEY RATING DRIVERS**

Improving Business Risk Profile: Investment in the regulated transmission networks will help lower AEP's business risk profile. Fitch's assessment of the company's current risk profile also includes the expectation that AEP will conservatively manage its merchant generation business. Fitch believes power prices are unlikely to recover over the intermediate term. Long-term performance of these
assets is expected to be affected by compliance with stricter environmental regulations, low capacity utilization, and a low electricity commodity price environment. A divesture of the competitive generation business, if undertaken by management, will be supportive of AEP's credit profile.

Large Capital Expenditure Program: Average capital expenditures are forecast to be about $3.8 billion annually through 2016, significantly higher than historical levels. Fitch expects capital expenditures to be funded with a combination of internal cash flow and debt. Negative free cash flow at the subsidiary levels will be financed with a mixture of cash flow from operations, debt, and equity infusion by the parent to maintain the regulatory capital structure. Regulated earnings from future investment in transmission networks provide offset to the lost earnings from the generation assets transferred by OPCO to the non-regulated affiliate.

Cash flow Diversity: AEP's earnings and cash flows are predominantly derived from eight regulated electric utilities in 11 separate but balanced regulatory jurisdictions and the FERC-regulated transmission networks. Liquidity is good and debt maturities remain manageable. Approximately 93% of AEP's consolidated EBITDA will be generated by its regulated businesses, including the FERC-regulated transmission networks.

Financial Metrics: AEP's historical credit metrics are in line with its current IDR. However, Fitch expects EBITDA-based credit measures to decline moderately through 2016 due to the absence of bonus depreciation-related cash tax benefit, continued depressed power prices, and high capital investment in the regulated rate-base. About 95% of new investment will be in the regulated businesses subject to either contemporaneous returns or a small regulatory recovery lag. Fitch forecasts EBITDA-based interest coverage to average between 5x and 5.5x and adjusted debt-to-EBITDA to be close to or slightly below 4x over the rating horizon.

OPCO: Fitch does not expect OPCO's credit metrics to be as robust as they have been historically given that deleveraging related to generating asset transfer has not been fully completed. Future cash flow will also be affected by the absence of bonus depreciation-related cash tax benefits. Fitch expects adjusted debt-to-EBITDA to decline slightly below 4x by 2016 and that EBITDA-based interest coverage, under Fitch's forecast, will be slightly higher than 4x for the same period. By 2016, these ratios will be within Fitch's rating guidelines for a wires-only, regulated utility.

KPCO: Beginning 2014, KPCO's credit metrics will benefit from a $44 million increase in its regulatory rates as partial compensation for its newly acquired coal plant. Fitch expects full recovery of the acquired plant-related non-fuel costs once its existing baseload capacity is retired in 2015. Fitch's expectations include adjusted debt-to-EBITDA leverage of 3.8x or lower by the end of 2016 and EBITDA-to-interest of 4.5x or higher for the same period. Fitch expectations are based on timely recovery of KPCO's ratebase-related investments.

Appalachian Power Company (APCO): APCO is an integrated utility with service territories in Virginia and West Virginia. Regulatory approval of 867MWs of new power generation capacity in 2013 and recovery of non-fuel costs should improve the company's credit protection measures. In affirming the IDR, Fitch expectations include adjusted debt-to-EBITDA of 3.8x or lower and EBITDA-to-interest staying above 4.3x over the rating horizon (2014-2016).

Indiana Michigan Power Company (IMPCO): A large capex over next three years, including life extension of its nuclear power plant for about $1.2 billion, will constrain the credit protection measures over the rating horizon. However, approval by the Indiana Utility Regulatory Commission to let IMPCO earn a contemporaneous return on its portion of the life extension costs is cash flow positive. Approval of the nuclear power plant life extension project by the Michigan Public Service Commission has also been a positive credit consideration in affirming the ratings. Fitch expects the company to timely file for regulatory rate increases to limit leverage and improve cash flow stability. Fitch expects adjusted debt-to-EBITDA will remain between 4x and 4.5x, but improve once it begins
to earn cash returns on its rating period investments through increased regulated retail rate increases. EBITDA-to-interest over next three years will remain above 4x under Fitch's model.

Public Service Company of Oklahoma (PSO): With expected regulatory approval of the general rate increase request filed in January 2014, the company should achieve strong financial metrics that are within Fitch's guidelines for its current rating category. Adjusted debt-to-EBITDA and EBITDA-to-interest for PSO will remain between 3x and 3.5x and 5.3x and 5.9x, respectively, through 2016. Fitch expects PSO to maintain these measures through cost reduction and increased retail rates.

Southwestern Electric Power Company (SWEPCO): SWEPCO's future cash flow will benefit from approval recently approved general rate case in Texas and inclusion of its new generating capacity in Louisiana's formula base rate. Fitch expects adjusted debt to EBITDA and EBITDA to interest ratios to remain between 4x and 4.5x and 5.5x and 6.3x respectively over the rating horizon.

AEP Texas Central Company (AEPTC): AEPTC is an electric distribution company in Texas. Fitch expects EBITDA/interest expenses and adjusted debt/EBITDA to remain around 7x and 2.5x, respectively, over the rating horizon.

AEP Texas North Company (AEPTN): Like AEPTC, AEPTN benefits from a low risk profile and stable cash flows. Fitch expects EBITDA-to-interest expense to remain over 5.0x and adjusted debt-to-EBITDA to be between 3.2x and 3.5x, which are well within the current rating guidelines.

Strong Liquidity: AEP currently has approximately $3.5 billion of total liquidity available under its credit agreements, including $118 million of cash and cash equivalents. $1.75 billion of the consolidated revolving credit facilities will mature in July 2016, $1.75 billion will mature in July 2017, and the remaining $1 billion credit line established to fund OPCO maturities will expire in May 2015.

Manageable Maturities: Consolidated debt maturities over the next three years are manageable and include $1.140 billion in 2014, $2.145 million in 2015, and $1.105 billion in 2016. Maturing debt will be funded through a combination of internal cash flow and debt.

RATING SENSITIVITY:

Positive: An upgrade of AEP or any of its subsidiaries is considered unlikely given their current financial profile.

Negative: Future developments that may, individually or collectively, lead to negative rating action include:

--For AEP: Decline in EBITDA-based credit metrics on a sustainable basis with EBITDA/interest expenses declining below 4.3x and adjusted debt/EBITDA increasing to 3.5x or higher.

--For OPCO, AEPTN and APETC: Decline in the EBITDA-based credit metrics on a sustainable basis with EBITDA/interest expenses declining below 4.4x and adjusted debt/EBITDA increasing to 3.4x or higher.

--For all other rated operating subsidiaries: Decline in the EBITDA-based credit metrics on a sustainable basis with EBITDA/interest expenses declining below 3.9x and adjusted debt to EBITDA increasing to 3.8x or higher.

In addition, new environmental rules or significantly adverse changes to the regulatory framework of the individual regulated operating company could lead to a negative rating action. Significant increase in parent-level leverage to maintain a strong shareholder distribution policy remains a rating concern.
Fitch affirms the following ratings and revised the Rating Outlook to Stable from Negative:

American Electric Power Company
--Long-term IDR at 'BBB';
--Senior unsecured at 'BBB';
--Short-term IDR and commercial paper 'F2'.

Ohio Power Company (OPCO)
--Long-term IDR at 'BBB+';
--Senior unsecured and pollution control revenue bonds (PCRBs) at 'A-';
--Short-term IDR and commercial paper at 'F2'.

Kentucky Power Company (KPCO)
--Long-term IDR 'BBB-';
--Senior unsecured at 'BBB';

AEP Texas Central Company (AEPTC)
--Long-term IDR at 'BBB+';
--Senior unsecured and PCRBs at 'A-';
--Short-term IDR 'F2'.

AEP Texas North Company (AEPTN)
--Long-term IDR at 'BBB+';
--Senior unsecured at 'A-';
--Short-term IDR at 'F2'.

Appalachian Power Company (APCO)
--Long-term IDR at 'BBB-';
--Senior unsecured and PCRBs at 'BBB'.

Indiana Michigan Power Company (IMPC)
--Long-term IDR at 'BBB-';
--Senior unsecured and PCRBs at 'BBB'.

Public Service Company of Oklahoma (PSCO)
--Long-term IDR at 'BBB';
--Senior unsecured and PCRBs at 'BBB+';
--Short-term IDR at 'F2'.

Southwestern Electric Power Company (SWEPCO)
--Long-term IDR at 'BBB-';
--Senior unsecured at 'BBB'.

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Additional information is available on www.fitchratings.com.

Applicable Criteria and Related Research:

Applicable Criteria and Related Research:
Corporate Rating Methodology: Including Short-Term Ratings and Parent and Subsidiary Linkage

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Research Update:
American Electric Power Co. Inc. And Subsidiaries Upgraded To 'A-', Off Watch; Outlook Stable

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Research Update:
American Electric Power Co. Inc. And Subsidiaries Upgraded To 'A-', Off Watch; Outlook Stable

Overview

- American Electric Power Co. Inc. (AEP) completed the sale of 5,200 megawatts (MW) of merchant generation capacity raising about $1.6 billion in after-tax proceeds. Divesting the high-risk assets improves AEP's credit profile that will now be dominated by regulated utilities.
- We are raising our issuer credit ratings on AEP and all its utility subsidiaries--Appalachian Power Co., Indiana Michigan Power Co., Kentucky Power Co., Ohio Power Co., Public Service Co. of Oklahoma, Southwestern Electric Power Co., AEP Texas Inc., AEP Transmission Co. LLC, and Wheeling Power Co.--to 'A-' from 'BBB+'. At the same time, we are removing the ratings from CreditWatch, where we placed them with positive implications on Sept. 16, 2016. The outlook is stable.
- The stable outlook on AEP and its subsidiaries reflects the company's improved business risk profile that now benefits from a preponderance of regulated utility operations, expectations that non-utility operations will remain a modest part of AEP, and that the company's financial profile will remain robust, with funds from operations (FFO) to debt of about 18% on a consistent basis.

Rating Action

On Feb. 2, 2017, S&P Global Ratings raised its issuer credit ratings on American Electric Power Co. Inc. (AEP) and all its subsidiaries--Appalachian Power Co., Indiana Michigan Power Co., Kentucky Power Co., Ohio Power Co., Public Service Co. of Oklahoma, Southwestern Electric Power Co., AEP Texas Inc., AEP Transmission Co. LLC, and Wheeling Power Co.--to 'A-' from 'BBB+'. At the same time, we are removing the ratings from CreditWatch, where we placed them with positive implications on Sept. 16, 2016. The outlook is stable.

Rationale

The upgrade on AEP and its subsidiaries reflects the improvement in business risk stemming from the close of the sale of 5,200 MW of merchant generation capacity to a third party while the company's financial performance remains robust with FFO to debt of about 18%.

The asset sale, along with the impairment of AEP's remaining merchant generation assets totaling about 2,700 MW of capacity in third quarter 2016, is in line with AEP's strategy to exit the merchant generation business and
focus primarily on regulated utility operations. AEP's emphasis on its regulated operations is evident through a recent round of generally constructive regulatory outcomes and earned returns that have been improving at the individual regulated utility company level. AEP plans to use the $1.6 billion in after-tax sales proceeds to supplement funding needs, reducing the total amount of debt that needs to be issued, and supporting its financial risk profile. While AEP plans to continue growing its renewable generation investments, we do not expect that such investments will contribute more than 5% of the company's total credit profile over the next several years, especially given the modest level of planned capital spending relative to AEP's total capital spending plan.

Over the next several years AEP's capital spending program will range from $5.5 billion to $6 billion annually with about 5% allocated to contracted renewables and the balance to regulated operations, including over 50% allocated to Federal Energy Regulatory Commission (FERC)-regulated transmission investments which benefit from a constructive regulatory framework that provides for timely investment recovery. The use of the asset sale proceeds to fund capital spending and other needs will help support AEP's financial profile by offsetting the need for external borrowings and highlighting the company's generally conservative financial policies.

Under our base-case scenario we account for the loss of gross margin from the sale of the merchant generation operations. We expect gross margins to grow by about 4% to 6% annually; capital spending of $5.7 billion in 2017, $6 billion in 2018, and $5.7 billion in 2019; use of the after-tax asset sale proceeds of about $1.6 billion in the prompt year; dividend payout ratio of about 60% and modest growth in operations and maintenance costs. Over the next few years we project that AEP will generate funds from operations (FFO) to debt that ranges from 18%-19% while its debt leverage will average about 4x, with both measures demonstrating the strength of the company's financial profile.

**Liquidity**

We assess AEP's liquidity as adequate to cover its needs over the next 12 months. We expect that the company's liquidity sources will exceed its uses by 1.1x or more, the minimum threshold for an adequate designation under our criteria, and that the company will also meet our other criteria for such a designation. AEP benefits from the preponderance of regulated utility operations that provide for stable cash flow generation. Moreover, we expect that liquidity should benefit from the company's likely ability to absorb high-impact, low-probability events without the need for refinancing, well-established and solid relationships with banks, and its satisfactory standing in the credit markets.

AEP has $3.5 billion in revolving credit facilities with $3 billion maturing in 2021 and $500 million maturing in 2018.

Principal liquidity sources:
- Cash FFO of about $4.8 billion-$5 billion;
Credit facility availability of $3.5 billion and cash on hand of about $200 million;  
After tax proceeds from asset sale of about $1.6 billion in 2017

Principal liquidity uses:  
Maintenance capital spending of about $4.5 billion;  
Debt maturities and outstanding commercial of about $3.3 billion; and  
Dividends of about $1.1 billion to $1.2 billion.

Outlook

The stable outlook on AEP and its subsidiaries reflects the company's improved business risk profile that now benefits from a preponderance of regulated utility operations while generating FFO to debt of about 18% on a consistent basis.

Downside scenario

We could lower the ratings on AEP and its subsidiaries if the company's financial performance weakens such that FFO to debt is consistently below 14% or if its business risk increases as a result of ineffective management of regulatory risk or the pursuit of un-regulated operations.

Upside scenario

While not expected under our base-case scenario, we could raise the ratings on AEP and its subsidiaries primarily if the company's financial performance improves with FFO to debt that remains consistently above 20% while business risk remains unchanged.

Ratings Score Snapshot

Corporate Credit Rating: A-/Stable/A-2

Business risk: Excellent  
Country risk: Very low  
Industry risk: Very low  
Competitive position: Strong

Financial risk: Significant  
Cash flow/Leverage: Significant

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

Stand-alone credit profile: 'a-
• Group credit profile: 'a-

Related Criteria

• Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
• Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
• Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
• General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
• General Criteria: Methodology: Industry Risk, Nov. 19, 2013
• General Criteria: Group Rating Methodology, Nov. 19, 2013
• Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
• General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 07, 2013
• General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
• General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

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<td>A-</td>
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Research Update: American Electric Power Co. Inc. And Subsidiaries Upgraded To 'A-', Off Watch; Outlook Stable

AEP Transmission Company, LLC
Senior Unsecured A- BBB+/Watch Pos

Appalachian Power Co.
Senior Unsecured A- BBB+/Watch Pos

Indiana Michigan Power Co.
Senior Unsecured A- BBB+/Watch Pos

Kentucky Power Co.
Senior Unsecured A- BBB+/Watch Pos

Ohio Power Co.
Senior Unsecured A- BBB+/Watch Pos

Public Service Co. of Oklahoma
Senior Unsecured A- BBB+/Watch Pos

RGS (AEGCO) Funding Corp.
Senior Unsecured BBB+ BBB/Watch Pos

RGS (I&M) Funding Corp.
Senior Unsecured BBB+ BBB/Watch Pos

Southwestern Electric Power Co.
Senior Unsecured A- BBB+/Watch Pos

Upgraded; CreditWatch/Outlook Action; Ratings Affirmed
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American Electric Power Co. Inc.
Appalachian Power Co.
Corporate Credit Rating A-/Stable/A-2 BBB+/Watch Pos/A-2

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.
Research Update:
American Electric Power Co. Inc.
Ratings Raised And Placed On Watch
Positive On Sale Of Merchant
Generation Assets

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Overview

• American Electric Power Co. Inc. (AEP) has agreed to sell 5,200 MW of merchant generation capacity for $2.217 billion with the transaction expected to close in first-quarter 2017.
• We are raising the issuer credit rating on AEP and its subsidiaries--Appalachian Power Co., Indiana Michigan Power Co., Kentucky Power Co., Ohio Power Co., Public Service Co. of Oklahoma, Southwestern Electric Power Co., AEP Texas Central Co., and AEP Texas North Co.—to 'BBB+' from 'BBB' and placing the ratings on CreditWatch with positive implications.
• We are revising the comparable rating analysis assessment on AEP to positive from neutral, reflecting our view that the company's business risk profile is at the higher end of the strong business risk profile category. This incorporates our view that the proposed transaction demonstrates AEP's efforts to focus on regulated utility operations, strengthening the company's business risk profile.
• The CreditWatch with positive implications reflects the possibility for higher ratings upon the close of the sale of the 5,200 MW of merchant generation capacity.

Rating Action

On Sept. 16, 2016, S&P Global Ratings raised its issuer credit ratings on American Electric Power Co. Inc. (AEP) and its subsidiaries--Appalachian Power Co., Indiana Michigan Power Co., Kentucky Power Co., Ohio Power Co., Public Service Co. of Oklahoma, Southwestern Electric Power Co., AEP Texas Central Co., and AEP Texas North Co.—to 'BBB+' from 'BBB' and placing the ratings on CreditWatch with positive implications. In addition, we are raising the senior unsecured debt ratings at AEP and its subsidiaries by one notch, and placing the ratings on CreditWatch with positive implications.

Rationale

The rating action reflects the reduced contribution of AEP's merchant generation operation overall along management's strategy to grow the company primarily through lower-risk regulated utility operations. Additionally, the potential for higher ratings is dependent upon the successful close of the sale of about 5,200 MW of the company's merchant generation capacity, which
could lead to an improved business risk profile.

The ratings on AEP reflect our assessments of the company's currently strong business and significant financial risk profiles. Moreover, the ratings on AEP reflect our view that the company's business risk profile is improving, given the declining contribution of the merchant assets, management's explicit strategy to primarily grow through lower-risk regulated utility operations, and plans to eliminate the remaining merchant generation exposure.

We expect AEP's financial risk profile to remain robust and well within the significant financial risk profile category. Under our base-case scenario, which assumes that the asset sale closes in first-quarter 2017, generating about $1.6 billion of cash after tax, but before any debt repayments, we expect that AEP will achieve funds from operations (FFO) to debt of about 18% and debt to EBITDA of consistently below 4.5x, with both measures readily supporting the company's significant financial risk profile assessment.

**Liquidity**

We assess AEP's liquidity as adequate to cover its needs over the next 12 months. We expect that the company's liquidity sources will exceed its uses by 1.1x or more, the minimum threshold for an adequate designation under our criteria, and that the company will also meet our other criteria for such a designation. AEP benefits from the preponderance of regulated utility operations that provide for stable cash flow generation. Moreover, we expect that liquidity should benefit from the company's likely ability to absorb high-impact, low-probability events without the need for refinancing, well-established and solid relationships with banks, and its satisfactory standing in the credit markets.

AEP has $3.5 billion in revolving credit facilities with $3 billion maturing in 2021 and $500 million maturing in 2018.

**Principal liquidity sources:**
- FFO of about $4.6 billion annually;
- Credit facility availability of $3.5 billion; and
- After tax proceeds from pending asset sale of about $1.6 billion in next 12 months.

**Principal Liquidity uses:**
- Projected maintenance capital spending of about $3.4 billion;
- Debt maturities and outstanding commercial of about $4.1 billion as of June 30, 2016; and
- Dividends of about $1.1 billion annually.

**CreditWatch**

The CreditWatch listing with positive implications on AEP and its subsidiaries reflects the potential for higher ratings in the next three to six months upon the close of the sale of 5,200 MW of merchant generation capacity that would
lead to an improvement of the company's business risk profile, while the company maintains FFO to debt of about 18%.

We could affirm the ratings if AEP's business risk remains unchanged while its financial risk profile remains toward the middle of the significant category, with FFO to debt of 15%-20%. Alternatively, we could affirm the ratings if the business risk profile improves but FFO to debt consistently weakens to below 15%.

Upon the close of the transaction, expected in the next three to six months, we could raise the issuer credit rating on AEP and its subsidiaries by one notch, reflecting improvement in business risk stemming from the sale of a portion of its merchant generation assets while the company maintains FFO to debt of about 18% or consistent with the middle of the range for the significant financial risk profile category.

Related Criteria And Research

Related Criteria

- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Upgraded; CreditWatch/Outlook Action

| AEP Texas Central Co.                 | To     | From |
| Wheeling Power Company               |        |      |
| Southwestern Electric Power Co.      |        |      |

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RGS (I&M) Funding Corp.
RGS (AEGCO) Funding Corp.
Public Service Co. of Oklahoma
Ohio Power Co.
Kentucky Power Co.
Indiana Michigan Power Co.
AEP Texas North Co.
Corporate Credit Rating BBB+/Watch Pos/-- BBB/Positive/--

American Electric Power Co. Inc.
Senior Unsecured BBB/Watch Pos BBB-

AEP Texas Central Co.
Senior Unsecured BBB+/Watch Pos BBB

Appalachian Power Co.
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Indiana Michigan Power Co.
Senior Unsecured BBB+/Watch Pos BBB

Kentucky Power Co.
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Ohio Power Co.
Senior Unsecured BBB+/Watch Pos BBB

Public Service Co. of Oklahoma
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RGS (AEGCO) Funding Corp.
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Southwestern Electric Power Co.
Senior Unsecured BBB+/Watch Pos BBB

Upgraded; CreditWatch/Outlook Action; Ratings Affirmed
To From
American Electric Power Co. Inc.
Appalachian Power Co.
Corporate Credit Rating BBB+/Watch Pos/A-2 BBB/Positive/A-2

Ratings Affirmed
American Electric Power Co. Inc.
Commercial Paper A-2

Certain terms used in this report, particularly certain adjectives used to
express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.
American Electric Power Co. Inc.

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Related Criteria And Research
American Electric Power Co. Inc.

**Business Risk: STRONG**

- Vulnerable
- Excellent

**Financial Risk: SIGNIFICANT**

- Highly leveraged
- Minimal

**Corporation Credit Rating**

- BBB/Positive/A-2

### Rationale

<table>
<thead>
<tr>
<th>Business Risk: Strong</th>
<th>Financial Risk: Significant</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Expected improvement in the business risk profile resulting from a planned reduction of the merchant generation business combined with regulatory clarity in the Ohio regulated utility operations</td>
<td></td>
</tr>
<tr>
<td>• Large and diverse regulated utility franchise benefiting from generally constructive regulatory frameworks</td>
<td></td>
</tr>
<tr>
<td>• Environmental rules continue to add costs to coal fleet</td>
<td></td>
</tr>
<tr>
<td>• Merchant generation business will be fully exposed to market prices starting in mid-2015</td>
<td></td>
</tr>
<tr>
<td>• Credit measures that support the assessment of the financial risk profile as &quot;significant&quot;</td>
<td></td>
</tr>
<tr>
<td>• Cash flow generation benefits from timely recovery of transmission investments, base rate increases, and the recovery of fuel and capacity costs in Ohio</td>
<td></td>
</tr>
<tr>
<td>• Large capital spending program results in negative discretionary cash flow</td>
<td></td>
</tr>
</tbody>
</table>
Outlook: Positive

The positive rating outlook on American Electric Power Co. Inc. (AEP) and its subsidiaries reflects the potential for a one-notch upgrade resulting from an expected improvement in business risk while the company preserves its "significant" financial risk profile.

Downside scenario

We could affirm the ratings if AEP's business risk increases, either through additional unregulated business ventures or due to unfavorable regulatory outcomes, which could also weaken the company's financial risk profile.

Upside scenario

We could raise the issuer credit rating on AEP and its subsidiaries by one notch upon the planned reduction in unregulated generation capacity, along with a constructive outcome in Ohio Power's rate filing, which should also address the timely recovery of deferred capacity costs. Notably, any upgrade would depend on AEP maintaining credit protection measures that are in the middle of the significant financial risk profile category, with funds from operations (FFO) to debt of 16% to 18% and debt to EBITDA that remains at less than 4x.

Standard & Poor's Base-Case Scenario

<table>
<thead>
<tr>
<th>Assumptions</th>
<th>Key Metrics</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Operating income grows in the low- to mid-single digits, benefiting from recent base rate increases and transmission cost recovery</td>
<td>2014E 2015E 2016E</td>
</tr>
<tr>
<td>• Capital spending of about $4 billion annually over the next few years</td>
<td>FFO/total debt (%)</td>
</tr>
<tr>
<td>• Ongoing recovery of fuel cost deferrals in Ohio and subsequent recovery of capacity cost deferrals</td>
<td>16-18 16-18 16-18</td>
</tr>
<tr>
<td>• Dividend distributions of about $1 billion annually</td>
<td>Total debt/EBITDA (x)</td>
</tr>
<tr>
<td></td>
<td>3.5–4 3.5–4 3.5–4</td>
</tr>
<tr>
<td></td>
<td>CFO/total debt (%)</td>
</tr>
<tr>
<td></td>
<td>19-21 19-21 17-19</td>
</tr>
<tr>
<td></td>
<td>E—Estimate. CFO—Cash flow from operations.</td>
</tr>
</tbody>
</table>

Company Description

American Electric Power Co. Inc. is a large electric utility holding company in the U.S., with operations in 11 states in the midwest and southwest of the country, serving about 5.3 million customers.

Business Risk: Strong

We currently assess AEP’s business risk profile as "strong," accounting for the company's preponderance of regulated utility operations that combine both integrated electric and transmission and distribution-only operations and that are
complemented by a large fleet of unregulated generation assets. AEP has operations in 11 states, benefiting from operating and regulatory diversity, but the company's operations in Ohio, Texas, Virginia, and West Virginia represent about two-thirds of revenues. AEP has reached largely constructive regulatory outcomes in the jurisdictions in which it operates, ensuring a measure of cash flow stability over the next few years. In an effort to diversify its operations, AEP has begun to invest in transmission projects over the past few years, a trend that is likely to continue in the future, providing ongoing support to credit quality through cash flow and regulatory diversity.

Moreover, the company has sought to mitigate the impact of the corporate reorganization of Ohio Power, which resulted in the transfer of the company's generation assets into a separate unregulated generation subsidiary and the transition of that company into an electric transmission and distribution-only utility, enhancing its stand-alone business risk profile.

We expect that the size of AEP's unregulated generation exposure will reduce by mid-2015 through the transfer of additional generation assets to regulated affiliates and the planned retirement of about 2,500 megawatts (MW) of generation capacity. However, the improvement in business risk stemming from the reduction of the merchant generation fleet will be partially offset by the fully merchant exposure of the remaining 7,888MW of generation capacity as of mid-2015. Given the outlook for capacity prices in the Pennsylvania-Jersey-Maryland (PJM) region through 2016, we expect that the contribution of the unregulated generation assets to operating income will decline over time. In light of AEP's inclination to continue owning and operating regulated utility assets, the company has sought to enter into a long-term purchased power agreement with Ohio Power for the output of some of the unregulated generation assets. Alternatively, the company could also eventually decide to monetize its investment in the unregulated generation fleet.

**S&P Base-Case Operating Scenario**

- AEP remains focused on expanding its regulated utility operations
- The company continues to effectively manage regulatory risk in all its jurisdictions, ensuring timely investment recovery
- Completion of transfer and retirement of merchant generation assets, as planned, by June 2015
- Large construction projects continue to be well-managed and are completed on time and on budget

**Peer comparison**

**Table 1**

**American Electric Power Co. Inc. -- Peer Comparison**

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Rating as of Jan. 5, 2015</td>
<td>BBB/Positive/A-2</td>
<td>BBB/Positive/A-2</td>
<td>A-/Negative/A-2</td>
<td>BBB+/Stable/A-2</td>
<td>BBB+/Positive/A-2</td>
<td>A/Negative/A-1</td>
</tr>
</tbody>
</table>
### Table 1

**American Electric Power Co. Inc. -- Peer Comparison (cont.)**

---Average of past three fiscal years---

<table>
<thead>
<tr>
<th>(Mil. $)</th>
<th>2015</th>
<th>2014</th>
<th>2013</th>
<th>2012</th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues</td>
<td>14,838.8</td>
<td>10,851.6</td>
<td>4,417.3</td>
<td>11,785.3</td>
<td>19,583.7</td>
<td>15,861.3</td>
</tr>
<tr>
<td>EBITDA</td>
<td>5,021.1</td>
<td>4,035.0</td>
<td>1,501.7</td>
<td>4,322.6</td>
<td>7,222.3</td>
<td>6,511.0</td>
</tr>
<tr>
<td>Funds from operations (FFO)</td>
<td>3,835.6</td>
<td>3,087.6</td>
<td>1,232.4</td>
<td>3,925.5</td>
<td>5,501.9</td>
<td>5,161.9</td>
</tr>
<tr>
<td>Net income from cont. oper.</td>
<td>1,437.3</td>
<td>988.8</td>
<td>545.5</td>
<td>1,479.7</td>
<td>2,028.3</td>
<td>1,963.3</td>
</tr>
<tr>
<td>Cash flow from operations</td>
<td>3,874.7</td>
<td>2,739.5</td>
<td>1,221.3</td>
<td>4,146.8</td>
<td>5,038.2</td>
<td>5,143.6</td>
</tr>
<tr>
<td>Capital expenditures</td>
<td>3,242.3</td>
<td>3,170.2</td>
<td>738.1</td>
<td>3,397.7</td>
<td>5,080.9</td>
<td>4,664.5</td>
</tr>
<tr>
<td>Free operating cash flow</td>
<td>632.4</td>
<td>(430.7)</td>
<td>483.2</td>
<td>749.2</td>
<td>(42.8)</td>
<td>479.1</td>
</tr>
<tr>
<td>Discretionary cash flow</td>
<td>(295.2)</td>
<td>(1,031.8)</td>
<td>185.8</td>
<td>728.2</td>
<td>(1,816.1)</td>
<td>(1,243.8)</td>
</tr>
<tr>
<td>Cash and short-term investments</td>
<td>132.4</td>
<td>163.8</td>
<td>6.3</td>
<td>190.7</td>
<td>466.8</td>
<td>207.3</td>
</tr>
<tr>
<td>Debt</td>
<td>19,611.6</td>
<td>14,630.5</td>
<td>5,599.6</td>
<td>25,775.7</td>
<td>35,510.5</td>
<td>23,656.9</td>
</tr>
<tr>
<td>Equity</td>
<td>15,381.8</td>
<td>9,407.9</td>
<td>4,375.7</td>
<td>16,163.0</td>
<td>35,102.3</td>
<td>18,946.5</td>
</tr>
<tr>
<td><strong>Adjusted ratios</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>EBITDA margin (%)</td>
<td>33.8</td>
<td>37.2</td>
<td>34.0</td>
<td>36.7</td>
<td>36.9</td>
<td>41.0</td>
</tr>
<tr>
<td>Return on capital (%)</td>
<td>7.9</td>
<td>7.4</td>
<td>9.6</td>
<td>6.4</td>
<td>6.7</td>
<td>8.6</td>
</tr>
<tr>
<td>EBITDA interest coverage (x)</td>
<td>4.2</td>
<td>4.1</td>
<td>5.1</td>
<td>3.3</td>
<td>4.2</td>
<td>5.6</td>
</tr>
<tr>
<td>FFO cash int. cov. (X)</td>
<td>5.2</td>
<td>7.0</td>
<td>5.9</td>
<td>4.6</td>
<td>5.5</td>
<td>7.9</td>
</tr>
<tr>
<td>Debt/EBITDA (x)</td>
<td>3.9</td>
<td>3.6</td>
<td>3.7</td>
<td>6.0</td>
<td>4.9</td>
<td>3.6</td>
</tr>
<tr>
<td>FFO/debt (%)</td>
<td>19.6</td>
<td>21.1</td>
<td>22.0</td>
<td>15.2</td>
<td>15.5</td>
<td>21.8</td>
</tr>
<tr>
<td>Cash flow from operations/debt (%)</td>
<td>19.8</td>
<td>18.7</td>
<td>21.8</td>
<td>16.1</td>
<td>14.2</td>
<td>21.7</td>
</tr>
<tr>
<td>Free operating cash flow/debt (%)</td>
<td>3.2</td>
<td>(2.9)</td>
<td>8.6</td>
<td>2.9</td>
<td>(0.1)</td>
<td>2.0</td>
</tr>
<tr>
<td>Discretionary cash flow/debt (%)</td>
<td>(1.5)</td>
<td>(7.1)</td>
<td>3.3</td>
<td>2.8</td>
<td>(5.1)</td>
<td>(5.3)</td>
</tr>
</tbody>
</table>

### Financial Risk: Significant

We assess AEP's financial risk profile as being in the "significant" category using the medial volatility financial ratio benchmarks. Under our base case scenario, we project that the company will maintain credit protection measures that remain toward the middle of the category, with FFO to debt of about 16% to 18% and debt to EBITDA that remains at
less than 4x. We expect the financial profile to benefit from recent base rate increases as well as from the timely recovery of transmission investments and deferred fuel and capacity costs.

**S&P Base-Case Cash Flow And Capital Structure Scenario**

- Economic conditions in the company's service territories continue to improve modestly, supporting a gradual increase in load growth.
- Elevated level of capital spending to fund transmission and environmental investments and timely recovery of these costs
- The merchant generation assets receive PJM auction capacity prices and day-ahead energy prices after June 2015.

**Financial summary**

### Table 2

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

<table>
<thead>
<tr>
<th>Industry sector: energy</th>
<th>--Fiscal year ended Dec. 31--</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Mil. $)</td>
<td></td>
</tr>
<tr>
<td>Revenues</td>
<td>15,021.6</td>
</tr>
<tr>
<td>EBITDA</td>
<td>5,094.0</td>
</tr>
<tr>
<td>Funds from operations (FFO)</td>
<td>4,108.1</td>
</tr>
<tr>
<td>Net income from continuing operations</td>
<td>1,480.0</td>
</tr>
<tr>
<td>Cash flow from operations</td>
<td>3,910.9</td>
</tr>
<tr>
<td>Capital expenditures</td>
<td>3,738.0</td>
</tr>
<tr>
<td>Free operating cash flow</td>
<td>163.9</td>
</tr>
<tr>
<td>Discretionary cash flow</td>
<td>(790.1)</td>
</tr>
<tr>
<td>Cash and short-term investments</td>
<td>117.8</td>
</tr>
<tr>
<td>Debt</td>
<td>19,111.5</td>
</tr>
<tr>
<td>Equity</td>
<td>16,086.0</td>
</tr>
</tbody>
</table>

**Adjusted ratios**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>EBITDA margin (%)</td>
<td>33.9</td>
<td>34.4</td>
<td>33.2</td>
<td>32.7</td>
<td>34.6</td>
</tr>
<tr>
<td>Return on capital (%)</td>
<td>7.7</td>
<td>7.5</td>
<td>8.5</td>
<td>7.4</td>
<td>8.0</td>
</tr>
<tr>
<td>EBITDA interest coverage (x)</td>
<td>4.6</td>
<td>4.0</td>
<td>4.1</td>
<td>3.6</td>
<td>3.5</td>
</tr>
<tr>
<td>FFO cash int. cov. (x)</td>
<td>5.7</td>
<td>5.0</td>
<td>5.0</td>
<td>4.7</td>
<td>5.4</td>
</tr>
<tr>
<td>Debt/EBITDA (x)</td>
<td>3.8</td>
<td>3.9</td>
<td>4.1</td>
<td>4.3</td>
<td>4.4</td>
</tr>
<tr>
<td>FFO/debt (%)</td>
<td>21.5</td>
<td>19.4</td>
<td>17.9</td>
<td>17.2</td>
<td>19.9</td>
</tr>
<tr>
<td>Cash flow from operations/debt (%)</td>
<td>20.4</td>
<td>19.2</td>
<td>19.7</td>
<td>17.5</td>
<td>12.0</td>
</tr>
<tr>
<td>Free operating cash flow/debt (%)</td>
<td>0.9</td>
<td>3.6</td>
<td>5.1</td>
<td>5.6</td>
<td>(2.5)</td>
</tr>
<tr>
<td>Discretionary cash flow/debt (%)</td>
<td>(4.1)</td>
<td>(1.1)</td>
<td>0.6</td>
<td>1.4</td>
<td>(6.3)</td>
</tr>
</tbody>
</table>
Liquidity: Adequate

In our opinion, AEP's liquidity is "adequate" to cover its needs over the next 12 to 18 months. We expect that the company's liquidity sources will exceed its uses by 1.1x or more, the minimum threshold for an "adequate" designation under our criteria, and that the company will also meet our other criteria for such a designation.

AEP has $3.5 billion in revolving credit facilities, with $1.75 billion maturing in June 2016 and $1.75 billion maturing in July 2017. As of Sept. 30, 2014, about $2.9 billion was still undrawn.

<table>
<thead>
<tr>
<th>Principal Liquidity Sources</th>
<th>Principal Liquidity Uses</th>
</tr>
</thead>
<tbody>
<tr>
<td>• We estimate FFO of about $4 billion annually in 2014 and 2015</td>
<td>• Debt maturities and outstanding commercial paper of $2.45 billion in 2014 and debt maturities of $2.52 billion in 2015</td>
</tr>
<tr>
<td>• Ongoing availability under the credit facilities of about $3.5 billion</td>
<td>• Maintenance capital spending of about $2.5 billion</td>
</tr>
<tr>
<td></td>
<td>• Dividends of about $1 billion annually</td>
</tr>
</tbody>
</table>

Debt maturities

Table 3

<table>
<thead>
<tr>
<th>American Electric Power Co. Inc. Debt maturities</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
</tr>
<tr>
<td>2015</td>
</tr>
<tr>
<td>2016</td>
</tr>
<tr>
<td>2017</td>
</tr>
<tr>
<td>2018</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Debt maturities</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014 $1,549 million</td>
</tr>
<tr>
<td>2015 $2,519 million</td>
</tr>
<tr>
<td>2016 $1,147 million</td>
</tr>
<tr>
<td>2017 $1,724 million</td>
</tr>
<tr>
<td>2018 $1,135 million</td>
</tr>
</tbody>
</table>

Covenant Analysis

<table>
<thead>
<tr>
<th>Compliance Expectations</th>
<th>Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>As of Sept. 30, 2014, AEP and its subsidiaries were in compliance with the financial covenants in their credit facilities and had sufficient cushion.</td>
<td>• AEP and its subsidiaries are required to maintain a total debt-to-capitalization ratio of 67.5% or less</td>
</tr>
<tr>
<td>Under our base case scenario, we expect AEP and its subsidiaries to remain in compliance with these covenants, especially given the stability of its regulated utility operations.</td>
<td>• The covenant thresholds remain unchanged through the expiration of the credit facilities</td>
</tr>
</tbody>
</table>
Other Modifiers

Our assessment of modifiers results in no further changes to the anchor score.

Group Influence

Under the group rating methodology criteria, we assess AEP as the parent of the group whose group credit profile (GCP) is 'bbb' and issuer credit rating is 'BBB'.

We assess the status of all of AEP's operating subsidiaries as core because we view them as integral to the group's identity, they are highly unlikely to be sold, and they have strong management commitment given the company's emphasis on maintaining the size and scope of the regulated utility business relative to the unregulated operations. Because there are no structural or ring-fencing provisions in place that could restrict AEP's access to the resources of its subsidiaries, the issuer credit rating on each subsidiary is 'BBB', based on AEP's GCP.

Notching Analysis

• We rate the senior unsecured debt at AEP one notch lower than the corporate credit rating because priority obligations exceed 20% of total assets.
• We rate the senior unsecured debt at the operating utilities at the same level as our respective corporate credit ratings on the companies.

Ratings Score Snapshot

Corporate Credit Rating
BBB/Positive/A-2

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)
• Financial policy: Neutral (no impact)
- **Liquidity**: Adequate (no impact)
- **Management and governance**: Satisfactory (no impact)
- **Comparable rating analysis**: Neutral (no impact)

**Stand-alone credit profile**: bbb

**Group credit profile**: bbb

### Reconciliation

**Table 4**

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

<table>
<thead>
<tr>
<th></th>
<th>Debt</th>
<th>Shareholders' equity</th>
<th>Revenues</th>
<th>EBITDA</th>
<th>Operating income</th>
<th>Interest expense</th>
<th>EBITDA</th>
<th>Cash flow from operations</th>
<th>Dividends paid</th>
<th>Capital expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Reported</strong></td>
<td>19,134.0</td>
<td>16,086.0</td>
<td>15,357.0</td>
<td>4,824.0</td>
<td>2,855.0</td>
<td>906.0</td>
<td>4,824.0</td>
<td>4,106.0</td>
<td>954.0</td>
<td>3,778.0</td>
</tr>
<tr>
<td><strong>Standard &amp; Poor's adjustments</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest expense (reported)</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Interest income (reported)</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Current tax expense (reported)</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Operating leases</td>
<td>1,552.0</td>
<td>--</td>
<td>--</td>
<td>295.0</td>
<td>114.0</td>
<td>114.0</td>
<td>181.0</td>
<td>181.0</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Postretirement benefit obligations/deferred compensation</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>20.0</td>
<td>20.0</td>
<td>16.2</td>
<td>31.2</td>
<td>(50.8)</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Surplus cash</td>
<td>(353.3)</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Capitalized interest</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>40.0</td>
<td>(40.0)</td>
<td>(40.0)</td>
<td>(40.0)</td>
<td>--</td>
<td>(40.0)</td>
</tr>
<tr>
<td>Share-based compensation expense</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>56.4</td>
<td>--</td>
<td>--</td>
<td>56.4</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Securitized stranded costs</td>
<td>(2,686.0)</td>
<td>--</td>
<td>(335.4)</td>
<td>(335.4)</td>
<td>(92.4)</td>
<td>(92.4)</td>
<td>(243.0)</td>
<td>(243.0)</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Asset retirement obligations</td>
<td>412.8</td>
<td>--</td>
<td>--</td>
<td>103.0</td>
<td>103.0</td>
<td>103.0</td>
<td>29.8</td>
<td>(51.3)</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Non-operating income (expense)</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>219.0</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Debt - Accrued interest not included in reported debt</td>
<td>245.0</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Debt - Other</td>
<td>806.9</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>EBITDA - Other income/(expense)</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>131.0</td>
<td>131.0</td>
<td>--</td>
<td>131.0</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>D&amp;A - Impairment charges/(reversals)</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>226.0</td>
<td>--</td>
<td>--</td>
<td>--</td>
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<td>--</td>
</tr>
</tbody>
</table>
Table 4
Reconciliation Of American Electric Power Co. Inc. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. $) (cont.)

<table>
<thead>
<tr>
<th></th>
<th>Debt</th>
<th>Equity</th>
<th>Revenues</th>
<th>EBITDA</th>
<th>EBIT</th>
<th>Interest expense</th>
<th>Funds from operations</th>
<th>Cash flow from operations</th>
<th>Dividends paid</th>
<th>Capital expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjusted</td>
<td>19,111.5</td>
<td>16,086.0</td>
<td>15,021.6</td>
<td>5,094.0</td>
<td>3,444.7</td>
<td>1,117.0</td>
<td>4,108.1</td>
<td>3,901.9</td>
<td>954.0</td>
<td>3,738.0</td>
</tr>
</tbody>
</table>

Related Criteria And Research

Related Criteria
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria – Corporates – Industrials: Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Business And Financial Risk Matrix

<table>
<thead>
<tr>
<th>Business Risk Profile</th>
<th>Minimal</th>
<th>Modest</th>
<th>Intermediate</th>
<th>Significant</th>
<th>Aggressive</th>
<th>Highly leveraged</th>
</tr>
</thead>
<tbody>
<tr>
<td>Excellent</td>
<td>aaa/aa+</td>
<td>aa</td>
<td>a+/a</td>
<td>a-</td>
<td>bbb</td>
<td>bbb-/bb+</td>
</tr>
<tr>
<td>Strong</td>
<td>aa/aa-</td>
<td>a+/a</td>
<td>a-/bbb+</td>
<td>bbb</td>
<td>bb+</td>
<td>bb</td>
</tr>
<tr>
<td>Satisfactory</td>
<td>a/a-</td>
<td>bb+</td>
<td>bbb/bbb-</td>
<td>bbb-/bb+</td>
<td>bb</td>
<td>b+</td>
</tr>
<tr>
<td>Fair</td>
<td>bbb/bbb-</td>
<td>bb-</td>
<td>bb+</td>
<td>bbb</td>
<td>bb</td>
<td>b</td>
</tr>
<tr>
<td>Weak</td>
<td>bb+</td>
<td>bb+</td>
<td>bb</td>
<td>bb-</td>
<td>b+</td>
<td>b/b-</td>
</tr>
<tr>
<td>Vulnerable</td>
<td>bb-</td>
<td>bb-</td>
<td>bb-/b+</td>
<td>b+</td>
<td>b</td>
<td>b-</td>
</tr>
</tbody>
</table>

Ratings Detail (As Of February 19, 2015)

American Electric Power Co. Inc.
Corporate Credit Rating BBB/Positive/A-2
### Ratings Detail (As Of February 19, 2015) (cont.)

**Commercial Paper**
- **Local Currency**: A-2
- **Senior Unsecured**: BBB-

**Corporate Credit Ratings History**
- **29-Sep-2014**: BBB/Positive/A-2
- **07-Mar-2003**: BBB/Stable/A-2
- **24-Jan-2003**: BBB+/Watch Neg/A-2

**Related Entities**

<table>
<thead>
<tr>
<th>Entity</th>
<th>Issuer Credit Rating</th>
<th>Senior Unsecured</th>
</tr>
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<tbody>
<tr>
<td>AEP Texas Central Co.</td>
<td>BBB/Positive/--</td>
<td>AA-/Stable</td>
</tr>
<tr>
<td>AEP Texas North Co.</td>
<td>BBB/Positive/--</td>
<td>BBB</td>
</tr>
<tr>
<td>Appalachian Power Co.</td>
<td>BBB/Positive/--</td>
<td>AA-/Stable</td>
</tr>
<tr>
<td>Indiana Michigan Power Co.</td>
<td>BBB/Positive/--</td>
<td>BBB</td>
</tr>
<tr>
<td>Kentucky Power Co.</td>
<td>BBB/Positive/--</td>
<td>BBB</td>
</tr>
<tr>
<td>Ohio Power Co.</td>
<td>BBB/Positive/--</td>
<td>BBB</td>
</tr>
<tr>
<td>Public Service Co. of Oklahoma</td>
<td>BBB/Positive/--</td>
<td>AA-/Stable</td>
</tr>
<tr>
<td>RGS (AESCA) Funding Corp.</td>
<td>BBB/Positive/--</td>
<td>BBB</td>
</tr>
<tr>
<td>RGS (I&amp;M) Funding Corp.</td>
<td>BBB/Positive/--</td>
<td>BBB</td>
</tr>
<tr>
<td>Southwestern Electric Power Co.</td>
<td>BBB/Positive/--</td>
<td>AA-/Stable</td>
</tr>
</tbody>
</table>

*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. Issue and...*
Ratings Detail (As Of February 19, 2015) (cont.)

debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.
Research Update:

American Electric Power Co. Inc. And Subsidiaries Outlook Revised To Positive From Stable; 'BBB' Credit Ratings Affirmed

Primary Credit Analyst:
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Secondary Contact:
Gerrit W Jepsen, CFA, New York (1) 212-438-2529; gerrit.jepsen@standardandpoors.com

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Rating Action
Rationale
Outlook
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WWW.STANDARDANDPOORS.COM/RATINGSDIRECT SEPTEMBER 29, 2014 1
Research Update:

American Electric Power Co. Inc. And Subsidiaries
Outlook Revised To Positive From Stable; 'BBB' Credit Ratings Affirmed

Overview

- We are affirming the 'BBB' issuer credit rating on American Electric Power Co. Inc. and all its subsidiaries.
- We are revising the outlook on AEP and its subsidiaries to positive from stable to reflect the potential for higher ratings stemming from incremental moderation in business risk.
- We are also revising our assessments of the stand-alone credit profiles (SACP) for AEP Texas Central Co. and Appalachian Power Co. to 'a-' from 'bbb' and for Indiana Michigan Power Co. and Southwestern Electric Power Co. to 'bbb+' from 'bbb'.

Rating Action

On Sept. 29, 2014, Standard & Poor's Ratings Services affirmed the 'BBB' issuer credit rating on American Electric Power Co. (AEP) and its subsidiaries. At the same time, we revised the outlook to positive from stable to reflect the potential for higher ratings stemming from anticipated incremental moderation in business risk.

Rationale

We are affirming the 'BBB' issuer credit rating on AEP, reflecting our current assessment of the company's business risk profile as "strong" and its financial risk profile as "significant."

We are revising the rating outlook on AEP and its subsidiaries to positive from stable to reflect the potential for improvement in the company's business risk profile to "excellent" from "strong." The expected improvement in AEP's business risk profile incorporates the company's plan to reduce the size of the merchant generation fleet after mid-2015 as a result of scheduled plant retirements, with the benefits somewhat offset by full commodity price exposure for the remaining generation assets, combined with clarity as to how Ohio Power will operate post mid-2015 under the company's proposed rate plan that will govern rates for the next three years, including the recovery of deferred capacity costs. Moreover, the positive outlook reflects our base case projections that AEP's credit protection measures will remain comfortably within the middle of the "significant" financial risk profile category.
We are also revising our assessments of the stand-alone credit profiles (SACP) for AEP Texas Central Co. and Appalachian Power Co. to 'a-' from 'bbb' and for Indiana Michigan Power Co. and Southwestern Electric Power Co. to 'bbb+' from 'bbb'. The revisions are driven by improvements in each company's competitive position assessment to "strong" from "fair," reflecting our expectation of incremental stability in the companies' returns largely stemming from the termination of the interconnection agreement earlier in the year. For AEP Texas Central and Appalachian Power, the competitive position improvement leads to an "excellent" business risk profile and an SACP of 'a-' for each company. For Indiana Michigan Power, the improvement in competitive position is somewhat offset by our "negative" comparable rating analysis modifier reflecting our view of increased operating risk stemming from the ownership of the Cook nuclear plant, which leads to an SACP of 'bbb+'. For, Southwestern Electric Power the improvement in competitive position is partly offset by our "negative" comparable rating analysis modifier reflecting our view of the company's somewhat weaker business and financial risk profiles relative to peers, which leads to an SACP of 'bbb+'.

We currently assess AEP's business risk profile as "strong," accounting for the company's preponderance of regulated utility operations that combine both integrated electric and transmission and distribution-only operations. AEP has operations in 10 states, benefiting from operating and regulatory diversity, although the company's operations in Ohio, Texas, Virginia, and West Virginia represent about two-thirds of revenues. AEP has reached largely constructive regulatory outcomes in the jurisdictions in which it operates, ensuring a measure of cash flow stability over the next few years. Moreover, the company has sought to mitigate the impact of the corporate re-organization of Ohio Power, which resulted in the transfer of the company's generation assets into a separate unregulated generation subsidiary and the transition of that company into an electric transmission and distribution-only utility. AEP's unregulated generation exposure should lessen by mid-2015 through the planned transfer of additional generation assets to regulated affiliates and the planned retirement of about 2,500 megawatts (MW) of generation capacity. However, the moderation in risk arising from lower unregulated capacity is offset by the fully merchant exposure of the remaining 7,888MW of generation capacity as of mid-2015. Given the outlook for capacity prices in PJM through 2016, we expect that the contribution of the unregulated generation assets to operating income will decline over time.

As part of its transition to competition, Ohio Power has proposed a new three-year rate plan to the Public Utility Commission of Ohio (PUCO) that could provide clarity and certainty for the company through a constructive rate case outcome. Importantly, the plan proposes a method to recover Ohio Power's capacity deferrals, which we expect to be material through May 2015. The company expects a response from the PUCO in 2015. AEP's business risk profile also benefits from the company's increasing transmission investments, which are largely regulated by the FERC and which provide an additional source of cash flow and regulatory diversity.

We view AEP's financial risk profile as being in the "significant" category...
using the medial volatility financial ratio benchmarks. Under our base case scenario, we project that the company will maintain credit protection measures that remain toward the middle of the category, with FFO to debt of about 16% to 18% and debt to EBITDA that remains at less than 4x. We expect the financial profile to benefit from recent base rate increases as well as from the timely recovery of transmission investments.

Our base case assumes:
• Operating income grows in the low- to mid-single digits, benefiting from recent base rate increases and transmission cost recovery
• Capital spending of about $4 billion annually over the next few years
• Ongoing recovery of fuel cost deferrals in Ohio and subsequent recovery of capacity cost deferrals
• Dividend distributions of about $1 billion annually

Based on these assumptions, we arrive at the following credit measures:
• FFO/debt of 16% to 18% annually over the next few years
• Debt/EBITDA that remains under 4x
• Cash from operations/debt that averages about 20%

Liquidity
In our opinion, AEP's liquidity is "adequate" to cover its needs over the next 12 to 18 months. We expect that the company's liquidity sources will exceed its uses by 1.1x or more, the minimum threshold for an "adequate" designation under our criteria, and that the company will also meet our other criteria for such a designation.

AEP has $3.5 billion in revolving credit facilities with $1.75 billion maturing in June 2016 and $1.75 billion maturing in July 2017. As of June 30, 2014, about $2.7 billion was still undrawn.

Principal liquidity sources:
• We estimate FFO of about $4 billion annually in 2014 and 2015
• Undrawn availability under the credit facilities of about $2.7 billion

Principal liquidity uses:
• Maintenance capital spending of about $2.5 billion
• Debt maturities of $1.55 billion in 2014 and $2.52 billion in 2016
• Dividends of about $1 billion annually

Outlook
The positive outlook on AEP and its subsidiaries reflects the potential for a one-notch upgrade resulting from a moderation in business risk while the company preserves its "significant" financial risk profile.

Upside scenario
We could raise the issuer credit rating on AEP and its subsidiaries by one notch upon the planned reduction in un-regulated generation capacity along
with a constructive outcome in Ohio Power's rate filing, which also addresses the timely recovery of deferred capacity costs. Importantly, any upgrade would depend on AEP maintaining credit protection measures that are in the middle of the "significant" financial risk profile category, with FFO/debt of 16% to 18% and debt/EBITDA that remains at less than 4x.

**Downside scenario**

We could affirm the ratings if AEP's business risk increases, either through additional unregulated business ventures or due to unfavorable regulatory outcomes, which could also weaken the company's financial risk profile.

**Other Modifiers**

We assess all modifiers as "neutral" resulting in no further changes to AEP's 'bbb' anchor score.

**Group Influence**

AEP is subject to the group rating methodology criteria, under which we assess AEP as the parent of the group. AEP's stand-alone credit profile of 'bbb' becomes the group credit profile and leads to an issuer credit rating of 'BBB'.

We assess the status of AEP's operating subsidiaries as core because we view them as integral to the group's identity, they are highly unlikely to be sold, and have strong management commitment given the company's emphasis on maintaining the size and scope of the regulated utility operations relative to unregulated operations. Because there are no structural or regulatory insulation provisions in place that could restrict AEP's access to the assets and cash flows of its subsidiaries, the issuer credit rating on each subsidiary is 'BBB', which is based on the group credit profile of AEP of 'bbb'.

**Ratings Score Snapshot**

**Corporate Credit Rating: BBB/Positive/A-2**

**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)

Related Criteria And Research

Related Criteria
- Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- 2008 Corporate Criteria: Commercial Paper, April 15, 2008
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

Ratings Affirmed; Outlook Revised To Positive

<table>
<thead>
<tr>
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<th>From</th>
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</thead>
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<td>American Electric Power Co. Inc.</td>
<td>BBB/Positive/A-2</td>
<td>BBB/Stable/A-2</td>
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<td>Southwestern Electric Power Co.</td>
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<tr>
<td>RGS (AEGCO) Funding Corp.</td>
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<td></td>
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<tr>
<td>Public Service Co. of Oklahoma</td>
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<tr>
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<td>Indiana Michigan Power Co.</td>
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<td>Appalachian Power Co.</td>
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<tr>
<td>AEP Texas North Co.</td>
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<tr>
<td>Corporate Credit Rating</td>
<td>BBB/Positive/--</td>
<td>BBB/Stable/--</td>
</tr>
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</table>
Ratings Affirmed

American Electric Power Co. Inc.
  Senior Unsecured          BBB-
  Commercial Paper          A-2

AEP Texas Central Co.
  Senior Unsecured          BBB

Appalachian Power Co.
  Senior Unsecured          BBB

Indiana Michigan Power Co.
  Senior Unsecured          BBB

Kentucky Power Co.
  Senior Unsecured          BBB

Ohio Power Co.
  Senior Unsecured          BBB

Public Service Co. of Oklahoma
  Senior Unsecured          BBB

RGS (AEGCO) Funding Corp.
  Senior Unsecured          BBB-

RGS (I&M) Funding Corp.
  Senior Unsecured          BBB-

Southwestern Electric Power Co.
  Senior Unsecured          BBB

Complete ratings information is available to subscribers of RatingsDirect at
www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected
by this rating action can be found on Standard & Poor's public Web site at
www.standardandpoors.com. Use the Ratings search box located in the left
column.
Summary:

American Electric Power Co. Inc.

Primary Credit Analyst:
Gerrit W Jepsen, CFA, New York (1) 212-438-2529; gerrit.jepsen@standardandpoors.com

Secondary Contact:
Dimitri Nikas, New York (1) 212-438-7807; dimitri.nikas@standardandpoors.com

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Rationale
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Standard & Poor's Base-Case Scenario
Business Risk
Financial Risk
Liquidity
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Related Criteria And Research
Summary:
American Electric Power Co. Inc.

**Business Risk: STRONG**
- Vulnerable
- Excellent

**Financial Risk: SIGNIFICANT**
- Highly leveraged
- Minimal

---

**CORPORATE CREDIT RATING**

**BBB/Stable/A-2**

---

**Rationale**

**Business Risk: Strong**
- 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

**Financial Risk: Significant**
- 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%
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

<table>
<thead>
<tr>
<th>Assumptions</th>
<th>Key Metrics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic conditions in the company's service territories are improving, which will likely increase customer usage</td>
<td>2013A</td>
</tr>
<tr>
<td>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.</td>
<td>FFO/ debt (%)</td>
</tr>
<tr>
<td>Retail stability rider recovery of about $500 million through the Ohio transition period ending May 31, 2015.</td>
<td>Debt/EBITDA (x)</td>
</tr>
<tr>
<td>Capital spending and dividend payouts lead to negative discretionary cash flow, indicating external funding needs</td>
<td>CFO/debt (%)</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Principal Liquidity Sources</th>
<th>Principal Liquidity Uses</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Cash on hand of roughly $500 million in 2014</td>
<td>• Debt maturities of about $1.5 billion in 2014</td>
</tr>
<tr>
<td>• FFO of roughly $4.2 billion in 2014</td>
<td>• Capital spending of about $4.3 billion in 2014</td>
</tr>
<tr>
<td>• Credit facility availability of about $2.5 billion in 2014</td>
<td>• Dividends of about $970 million in 2014</td>
</tr>
<tr>
<td>• Working capital of about $350 million in 2014</td>
<td></td>
</tr>
</tbody>
</table>

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
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
- 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
## Business And Financial Risk Matrix

<table>
<thead>
<tr>
<th>Business Risk Profile</th>
<th>Minimal</th>
<th>Modest</th>
<th>Intermediate</th>
<th>Significant</th>
<th>Aggressive</th>
<th>Highly leveraged</th>
</tr>
</thead>
<tbody>
<tr>
<td>Excellent</td>
<td>aaa/aa+</td>
<td>aa</td>
<td>a+/a</td>
<td>a-</td>
<td>bbb</td>
<td>bbb-/bb+</td>
</tr>
<tr>
<td>Strong</td>
<td>aa/aa-</td>
<td>a+/a</td>
<td>a-/bbb+</td>
<td><strong>bbb</strong></td>
<td>bb+</td>
<td>bb</td>
</tr>
<tr>
<td>Satisfactory</td>
<td>a/a-</td>
<td>bbb+</td>
<td>bbb/bbb-</td>
<td>bbb-/bb+</td>
<td>bb</td>
<td>b+</td>
</tr>
<tr>
<td>Fair</td>
<td>bbb/bbb-</td>
<td>bbb-</td>
<td>bb+</td>
<td>bb</td>
<td>bb-</td>
<td>b</td>
</tr>
<tr>
<td>Weak</td>
<td>bb+</td>
<td>bb+</td>
<td>bb</td>
<td>bb-</td>
<td>b+</td>
<td>b/b-</td>
</tr>
<tr>
<td>Vulnerable</td>
<td>bb-</td>
<td>bb-</td>
<td>bb-/b+</td>
<td>b+</td>
<td>b</td>
<td>b-</td>
</tr>
</tbody>
</table>