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Initiating Coverage

Rating: Hold

AMERICAN ELECTRIC POWER
(AEP-NYSE-\$47)

Earnings & Market Profile

AEP	10/16						
Price Intraday	47						
52-week range	54-37				Price	Y-t-d	12 Mos.
Book Value (6/30/07)	24.14	195%	P/b	Performance	10/16	%	%
Reported - Ongoing				AEP	47	11	16
2004 Ongoing	2.33	20.2	P/e	Phil. Electric Index	545	10	16
2005	2.73	17.3		Dow Industrials	13,936	12	17
2006	2.77	17.0		Coverage			
2007 Consensus	2.92	16.2		Analyst Total	18		
2008 Consensus	3.16	14.9		Buys	7	39%	
2009 Guidance	3.35	14.1					
2010 Guidance	3.60	13.1		Shares (millions)	397		
Dividend Per Share	1.56	3.3%	Yield	Market - \$Bil.	19		

Reported EPS: 2006-\$2.53; 2005-\$2.09; 2004-\$2.75.

Summary and Recommendation

At AEP's investor conference on October 4, 2007, Mike Morris, Chief Executive Officer and Holly Koeppel, Chief Financial Officer, upped annual earnings growth guidance to 5%-9% versus 5%-7%. Increase in high guidance stemmed, not from improved growth prospects in kilowatt-hour-sales, but from higher construction expenditures and increased rate base expansion. Morris cited the formula "Capital Investment + Rate Relief = Earnings Growth." The formula is simple; but it also points out that regulators, not management, will determine AEP's growth rate.

Management's earnings range for 2007 is \$2.90-\$3.00 a share; 2008 - \$3.05-\$3.25 a share; 2009 - \$3.20-\$3.50 a share; and 2010 - \$3.45-\$3.80 a share. Guidance incorporates increases of \$338 million - 2007; \$280 million (excludes depreciation reduction of \$80 million) - 2008; \$773 million - 2009; and \$562 million - 2010. Returns on average common, using midpoint guidance, work out to 12.2% annually - 12.5% at the high-end and 11.5% at the low-end. Those returns could prove ambitious considering that 1) the weighted average of allowed returns on common equity (page 48 of the investor handout) is 11.4%, and 2) cost plus environments create regulatory lag that works against investors, causing the gap between earned and allowed returns to widen.

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See page 7 of report for Analyst's Certification, pages 7-8 for Important Disclosures and page 8 for Other Disclosures and Disclaimers

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Earnings guidance for 2007 was reaffirmed by management while higher AFC credits (\$0.07 a share) and reduced depreciation rates at the Cooke nuclear plant (\$0.08 a share) should support the 2008 guidance. The big hurdle is 2009 and re-regulation legislation in Ohio and an imputed \$773 million rate relief (not all included in earnings guidance). But a decline in the earned return on common to 11%-11.5% would cut the 2009 earnings to \$3.05-\$3.20 a share.

The market price supports management's midpoint guidance. Total return, assuming a constant 2 times book multiple and 5% dividend growth (\$0.08 a share annually), works out to about 10% annually. According to the traditional dividend discount formula (yield plus dividend growth), the return is 8.3% per annum. On a relative price/earnings basis, the 2008 multiple of 14.9 compares to 15.5 for 40 companies we screen. For the 12 months, AEP stock price increased 16%, matching Philadelphia Electric Index, and slightly underperforming the 17% advance registered by the Dow Industrials.

According to Bloomberg Financial Service, AEP is widely followed by the Sell Side with 18 active recommendations - 7 are rated either buy, overweight or outperform: Lehman, Jefferies, Matrix USA, Deutsche Bank, JP Morgan Chase, Credit Suisse, and Morgan Stanley. We're in the HOLD camp.

Shareholder Profile

AEP is large with a \$19 billion equity market value, widely followed by the sell side, and regulatory risk is spread among 11 states - all characteristics that make it a defensive core holding for income and utility investors. Its 10 largest shareholders account for 142 million shares, approximately 36% of shares outstanding.

Table 1
10 Largest Shareholders
(As of June 30, 2007)

	Shares Mil.		Shares Mil.
Barclays	24	Vanguard	12
UBS (Brinson Partners)	17	AXA	12
Morgan Stanley	15	JPM Chase	11
State Street Corp.	15	Franklin Res.	11
Capital Research	15	TCW	10

Construction - Financing - Returns

Construction expenditures, including AFUDC, are estimated at \$19 billion for the 5-years ending 12/31/11. Our source & Use of Funds Statement estimates 2011 outlays at 2010 levels. Capitalization of \$22.9 billion as of year-end 2006 increases 45% to \$33.2 billion. Internal cash generation for the 5-years totals \$10.6 billion or 58% of needed funds. Capital structure approximates 60% debt and 40% debt equity and incorporates no major new equity financings.

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Table 2
Estimated Source & Use of Funds
Based on Midpoint Guidance
2007-2011

Column	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Source & Use	Act.		Est.					Total 07-11
	2005	2006	2007	2008	2009	2010	2011	
Net Income - Cont.	1,071	1,077	1,176	1,265	1,360	1,475	1,582	6,859
Other Funds								
Dep. & Amort.	1,348	1,467	1,535	1,511	1,587	1,666	1,749	8,048
Gain (Loss) Ast Sale	(120)	(69)						
Carrying Cost Inc.	(55)	(114)	(60)	(60)	(60)	(60)	(60)	(300)
Equity Subs.	(10)	(3)	(3)	(1)	(1)	(1)	(1)	(7)
Defd. Inc. Tx	65	24	25	25	25	25	25	125
liv. Tx. Credit	(32)	(29)	(30)	(10)	(10)	(10)	(10)	(70)
Nuclear Amort.	56	50	50	50	50	50	50	250
Impairment	39	209						
Total Other	1,291	1,535	1,517	1,515	1,591	1,670	1,753	8,046
Gross Cash	2,362	2,612	2,693	2,780	2,951	3,145	3,335	14,904
Less								
AFC Total	56	112	124	153	160	160	160	757
Pref. Divs.	7	3	3	4	4	4	4	19
Common Divs.	553	591	622	660	699	736	779	3,495
Total	616	706	749	816	862	900	943	4,271
Funds Avail. Const.	1,746	1,906	1,944	1,964	2,088	2,246	2,391	10,633
% Generated Intl.	72.6%	54.0%	47.6%	50.1%	55.5%	63.1%	65.3%	58.3%
Gross Const.	2,404	3,528	4,086	3,923	3,760	3,561	3,660	18,990
Less AFC			124	153	160	160	160	757
Net Construction			3,962	3,770	3,600	3,401	3,500	18,233
Financing Required	658	1,622	2,018	1,806	1,512	1,155	1,109	7,600
Debt	(91)	829	1,604	1,541	1,305	830	944	6,224
Preferred			15	7	6	5	5	39
Asset Sales net	1,246	186	228	100	100	100	100	628
Common	(25)	99	171	158	160	160	59	709
Total Financing	1,130	1,114	2,018	1,806	1,571	1,096	1,109	7,600
Capitalization								
Total Debt	12,053	13,459	15,063	16,604	17,909	18,739	19,683	
Preferred Stock	91	61	76	83	89	94	100	
Common	9,058	9,412	10,134	10,894	11,712	12,608	13,466	
Total	21,202	22,932	25,273	27,581	29,650	31,442	33,248	
Pct Change		8	10	9	8	6	6	
Capital Structure								
Debt	56.8	58.7	59.6	60.2	60.4	59.6	59.2	
Preferred Stock	0.4	0.3	0.3	0.3	0.3	0.3	0.3	
Common	42.7	41.0	40.1	39.5	39.5	40.1	40.5	
Total	100.0	100.0	100.0	100.0	100.2	100.0	100.0	

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Equity Measures: Return on common averages 12% and ongoing earnings increase from \$2.71 a share (before discontinued items) to \$3.85 a share in 2011. Dividends increase \$0.08 a share per year as the payout declines from 53% in 2006 to 49% in 2011. Total return as measured by appreciation plus income approximates 10% annually.

**Table 3
Equity Measurements
Based on Midpoint Guidance
2007-2011**

Equity Measures	2005	2006	2007	2008	2009	2010	2011
Average Shares	391.4	396.5	400.1	403.2	406.1	408.9	409.8
Profitability							
Earnings	2.72	2.71	2.93	3.13	3.34	3.60	3.85
Pct Change			8	7	7	8	7
Return on average common	12.1	11.6	12.0	12.0	12.0	12.1	12.1
Ongoing Earnings	1,063	1,093					
Return ongoing	12.1	11.8					
Dividends							
Dividends Paid	1.41	1.49	1.56	1.64	1.73	1.81	1.90
Pct. Change		5	5	5	5	5	5
Payout	52.0	55.0	53.0	52.3	51.5	50.0	49.4
Dividend Return On Book	6.1	6.3	6.1	6.1	6.0	5.8	5.8
Yield		3.1	3.1	3.0	3.0	2.9	2.9
Market Returns							
Average Book	23.14	23.74	25.45	27.13	28.94	30.94	32.89
Market Price		48.00	50.89	54.25	57.89	61.88	65.79
Price to book		2.02	2.0	2.0	2.0	2.0	2.0
Price/Earnings		17.7	17.4	17.3	17.3	17.2	17.1
Appreciation %			6.0	6.6	6.7	6.9	6.3
Total Return %			9.3	9.8	9.9	10.0	9.4

Debt & Operating Outlook: Cash coverage of interest declines from 4.6 times to 3.9 times, cash flow as a percent of debt averages 22-23, and cash as a percent of capitalization, 13.5. Forecast is based on 1.5% annual kilowatt hour sales growth. Our proxy for relief, as measured by the difference in net revenue per kwh multiplied by kwh sales, is \$1,061 million for the five years.

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Table 4
Fixed Income & Operating Expense Assumptions
2007-2011

Debt & Fixed Income	2005	2006	2007	2008	2009	2010	2011
Interest		732	817	927	1,027	1,102	1,164
Pct. Change			12	13	11	7	6
Tax Rate	35.0%	39.3%	39.0%	39.0%	39.0%	39.0%	39.0%
Debt %		6.1	7.0	7.0	7.0	7.0	7.0
Preferred %		3.3	3.3	3.3	3.3	3.3	3.3
Cash Avail Interest		3,344	3,510	3,708	3,978	4,247	4,498
Coverage		4.6	4.3	4.0	3.9	3.9	3.9
Cash % Debt o/s		24.8	23.3	22.3	22.2	22.7	22.9
Cash % Capitalization		14.6	13.9	13.4	13.4	13.5	13.5
Operations							
kilowatt hour sales		213,313	216,513	219,761	223,057	226,403	229,799
Revenue Kwh		5.66	5.69	5.82	5.94	6.07	6.18
Net Revenue Kwh		3.73	3.80	3.85	3.97	4.09	4.20
O&M Kwh		1.71	1.71	1.71	1.71	1.71	1.71
Fuel & PP Kwh		2.19	2.19	2.26	2.26	2.26	2.26
Other Taxes Kwh		0.3	0.3	0.3	0.3	0.3	0.3
Rate Relief Proxy			152	124	258	277	249
Percent			1.2%	1.0%	1.9%	2.0%	1.8%
Cumulative				276	534	812	1,061

Income Statement: Table 5 converts our assumptions in the Source & Application of Funds Statement in Tables 2-4 into a 5-year income statement.

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Table 5
Income Statement
2004-2011

17-Oct-07	Actual			Estimates				
	2004	2005	2006	2007	2008	2009	2010	2011
Utility Revenue	10,620	11,157	12,066	12,322	12,790	13,254	13,740	14,204
Gas	3,068	463	(85)					
Other	557	491	641	640	640	640	640	640
Total	14,245	12,111	12,622	12,962	13,430	13,894	14,380	14,844
Fuel Gen	3,059	3,592	3,817	3,873	4,081	4,146	4,208	4,271
Pur Pwr	670	687	856	869	882	895	909	922
Gas	2,807	256						
Total Fuel & PP	6,536	4,535	4,673	4,742	4,963	5,041	5,117	5,193
Net Revenue	7,709	7,576	7,949	8,221	8,467	8,853	9,263	9,651
Operating Exp.								
O&M	3,676	3,619	3,639	3,702	3,758	3,814	3,871	3,930
Impairment		39	209					
Gain (Loss) Asset	(4)	(120)	(69)					
D&A	1,324	1,348	1,467	1,535	1,511	1,587	1,666	1,749
Other Taxes	730	763	737	650	659	669	679	689
Oper. Expenses	5,726	5,649	5,983	5,887	5,928	6,070	6,217	6,368
Operating Income	1,983	1,927	1,966	2,334	2,539	2,783	3,046	3,283
Interest Expense	781	697	732	817	927	1,027	1,102	1,164
Coverage	2.54	2.76	2.69	2.86	2.74	2.71	2.77	2.82
Pre Tax Income	1,202	1,230	1,234	1,516	1,612	1,756	1,945	2,119
Income Taxes	572	430	485	591	629	685	758	826
Tax Rate	47.6%	35.0%	39.3%	39.0%	39.0%	39.0%	39.0%	39.0%
After Tax Income	630	800	749	925	983	1,071	1,186	1,293
Other Income								
Equity Subsidiaries	18	10	3	2	2	2	2	2
Interest & Inv.	33	105	99	70	70	70	70	70
Carrying Cost Inc.	302	55	114	60	60	60	60	60
AFC Debt	15	35	82	83	90	85	85	85
AFC Equity		21	30	39	63	75	75	75
Inv. Value (Losses)	(15)	(7)						
Gain Sale Equity Inv.	153	56	3					
Total Other	506	275	331	254	285	292	292	292
Income After Other	1,136	1,075	1,080	1,179	1,268	1,363	1,478	1,585
Minority	3	4	3	3	3	3	3	3
Net Income	1,133	1,071	1,077	1,176	1,265	1,360	1,475	1,582
Preferred Dividends	6	7	3	3	4	4	4	4
Balance to Common	1,127	1,064	1,074	1,173	1,262	1,356	1,471	1,577
Average Shares	390.0	394.0	396.5	398.3	401.6	404.6	407.5	409.4
Earnings Per Share	2.75	2.09	2.71	2.93	3.14	3.35	3.61	3.85
Pct. Change		(24)	30	8.2	7.2	6.7	7.7	6.7
Return on common		12.1	11.6	12.0	12.0	12.0	12.1	12.1

Analyst's Certification

I Raymond E. Moore certify that the views expressed in this research report accurately reflect my personal views about the subject companies and their securities. I also certify that I have not been and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendations in this report.

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Buy Total return is expected to exceed significantly the average total return of the analyst's industry coverage universe over the next 12 months.

Market Perform & Hold Total return is expected to equal the average total return of the analyst's industry coverage universe over the next 12 months.

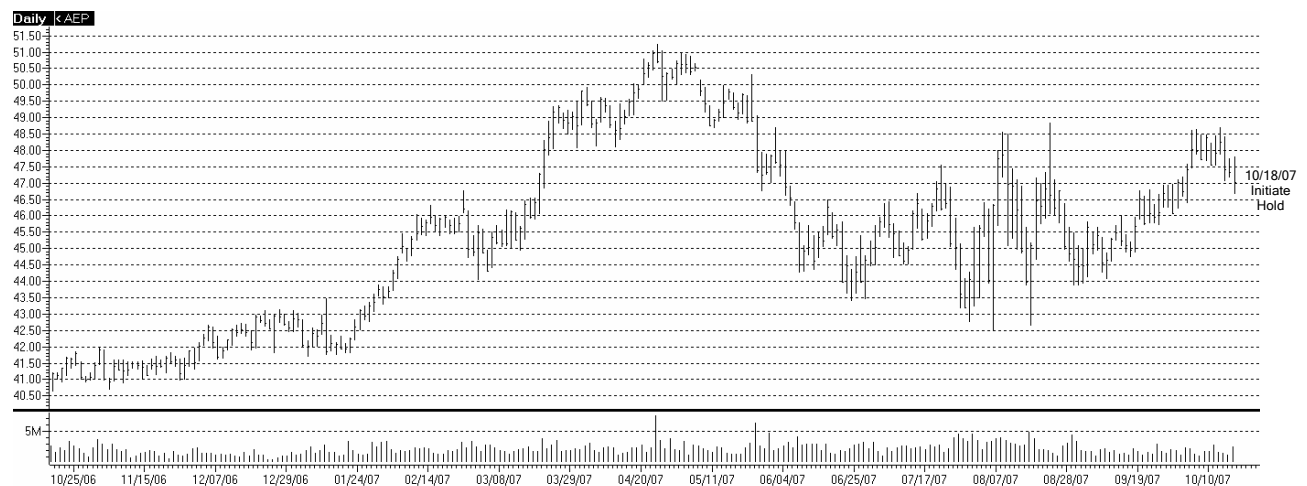
Sell Total return is expected to significantly under perform (15% plus) the total return of the industry coverage universe over the next 12 months.

Analyst's Ratings Distribution

		% Investment Banking
Buy	19%	0%
Hold	81%	0%
Sell	0%	0%

The principal risks to the achievement of our price targets include general market trends, disappointing earnings and lower energy prices and adverse regulatory developments

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