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UBS sees AEP divesting Ohio coal plants, Duke and AES to follow

By Dan Testa

[American Electric Power Co. Inc.](#) is likely to sell off its merchant generation business, according to a recent report by UBS Investment Research, and [Dynergy Inc.](#) could potentially be a buyer for its coal-fired Ohio assets. But with other integrated utilities in the region potentially looking to sell their coal portfolios, the profitability of such deals is difficult to predict.

AEP is in the [process of restructuring](#) to accommodate Ohio's competitive retail market in Ohio. Among the changes the company is making is transferring power plants and interconnection facilities from its [Ohio Power Co.](#) utility to [AEP Generation Resources](#). In an Aug. 22 report, UBS analyst Julien Dumoulin-Smith calculated a sale of AEP Generation could net the parent company approximately \$2.1 billion, and a sales process is likely following corporate separation by the end of the year, pending FERC approvals. UBS named Dynergy as the most likely acquirer of AEP's Ohio coal assets, and anticipated the sales process could take "well into 2014."

Potentially weighing on the sale of AEP's Ohio coal-fired assets, and keeping them from being more profitable, however, is the potential for [Duke Energy Corp.](#) and [AES Corp.](#) to pursue divestment of their own coal portfolios in Ohio in 2014, according to UBS. "What holds us back from being more constructive is the potential competition between integrated utilities, as they likely all reach for the door to divest," Dumoulin-Smith wrote.

Given the low clearing prices in the [PJM Interconnection LLC](#) 2016-2017 forward capacity auction, UBS sees cost cuts and timing shifts in operations and maintenance spending as the key ways AEP can [maintain management's stated goal](#) of 4% to 6% in annual earnings growth. If the outlook for power and capacity prices remains depressed, Dumoulin-Smith posited, more retirements could be in store for the least economic of Ohio Power's coal-fired fleet, particularly rail-served plants such as the 1,089-MW Conesville plant.

UBS maintained a "neutral" rating for AEP shares, and lowered the target price to \$45 from \$48, but noted that the company's focus on growth through the building of its transmission rate base, which is FERC-regulated, could lead to a re-rating over the next year.