# FirstEnergy (Neutral; $28 PT)

### EPS Up on Auction prices – "Clearing the Uncleared"

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| Figure 17:  Capacity Cleared in 18/19 base auction (%) |
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| Source:  Company Filings |

FE benefitted substantially from clearing generation assets that had not cleared earlier cleared in both the transition auctions for 2016/17 and 2017/18.

The 16/17 and 17/18 results are in stark contrast of its earlier BRA results disclosed on 7/30. Specifically, almost 2,500MW and 4,285MW of assets in the ATSI region that didn't clear the base auction held earlier for 16/17 and 17/18, cleared the recent CP transition auctions at ~$134/MW-day and ~$151.5/MW-day, realizing significant upside both from the capacity and from the higher prices (see table below).

Additionally, barring a total of 885MW of uncommitted assets set aside to hedge performance related risk, all the rest cleared in the 2018/2019 PJM BRA and CP auction (see table below).

We believe the clearance of all the capacity available, coupled with higher realized prices in the auctions will translate into higher EPS and higher EBITDA from 2016 through 2018. Specifically, FE expects to generate revenues of $810M and $590M up from $635M and $330M in 2016 and 2017, respectively. Additionally, it expects to generate $620M revenues in 2018 and $260M for the first 5 month of operations in 2019.

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| Figure 18: Base and Capacity Product – Current Status |  | Figure 19: Base Product – Previous Status  |
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| Source:  Company reports and UBSe |  | Source:  Company Reports |

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| Figure 20: Revised EBITDA estimates – Generation segment |
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| Source:  Company reports and UBSe |

### Increasing our EPS estimates

We hold our 2015 EPS estimate; incorporating the CP auction results, and making other modelling and MTM adjustments, we increase 2016E-2018E EPS estimates to $2.94, $2.57 and $2.65 (from $2.87, $2.41, and $2.55, respectively). We highlight that FES is now contributing a small but positive equity value to the consolidated net income.

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| Figure 21:  FE UBSe EBITDA, 2015E-2019E |
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| Source:  UBS Estimates, FactSet and Company filings |

### Valuation: Maintaining $28 PT

We continue to utilize a 2017E sum-of-the-parts methodology where we apply P/E multiples to the regulated utilities and non-interest parent drag, and EV/EBITDA multiple for FE's generation business.

**Regulated Utilities - $38:** While our valuation already included previously disclosed cost cutting plan worth ~$1/sh, we lowered our P/E multiple to 14.0x, in-line with the regulated peers and continue to ascribe a 0.5x P/E discount on FE's regulated side of the business.

**FES - ~$2:** Our updated SOP now includes FE's generation business, following uplift from incorporating latest CP and Base auction prices in the model, FES now contributing a small but positive equity value to the overall valuation. We arrived at ~$2 valuation by ascribing an 8.0x EV/EBITDA multiple to FE's generation business. Previously, we were viewing FirstEnergy Solutions as an outright negative drag and thus excluded and “zeroed-out” FES operations from our utility-only valuation.

**Parent Drag – ($12):** Separately, the negative parent drag is comprised entirely of $1Bn recourse sale leasebacks (~$1Bn of which are at FES) and $4.2Bn of parent notes. We're offsetting our lower utility multiple by haircutting the parent disynergy figure following the announced parent cost cuts.

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| Figure 22: FE SOP Valuation – Keeping the $28 PT |
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| Source:  Company Filings and UBS Estimates  |