FirstEnergy Corp.

Can the Coal Comply with the Capacity Scheme?

Equities

Americas
Electric Utilities

12-month rating	**Sell**
12m price target	**US$30.00**
	Prior: US$26.00
Price	**US$37.10**

RIC: FE.N **BBG:** FE US

Trading data and key metrics

52-wk range	US$38.84-30.22
Market cap.	US$15.6bn
Shares o/s	420m (COM)
Free float	100%
Avg. daily volume ('000)	726
Avg. daily value (m)	US$24.9
Common s/h equity (12/14E)	US$13.0bn
P/BV (12/14E)	1.2x
Net debt / EBITDA (12/14E)	4.8x

EPS (UBS, diluted) (US$)

	12/14E			
	From	To	% ch	Cons.
Q1	0.39	0.39	0.00	0.39
Q2	0.49	0.49	0.00	0.49
Q3	0.87	0.89	2.00	0.89
Q4E	0.72	0.72	-0.49	0.71
12/14E	2.47	2.48	0.63	2.48
12/15E	2.90	2.76	-5.04	2.95
12/16E	2.82	2.88	1.90	2.87

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Will FES be able to overcome "draconian" PJM penalties to benefit?

Management stated that the proposed PJM Capacity Performance (CP) reforms would be a significant positive for the fleet but exhibited concern about the potential penalties of the new product. We see FE as particularly exposed to failing to perform – and at risk of higher penalties given its weaker asset performance in 1Q. Meanwhile we see some risk to the transition auction impacts on its remaining wholesale and retail obligations – although appreciate that it's roll-off of the biz mitigates this risk. We don't expect PJM to loosen its penalties (rather the latest draft tightened the penalties) - and see the risk of penalties to coal plants as understated among investors (with most focusing on gas deliverability rather).

FES footing improves but could also ride the power curve lower

FES estimates are materially higher with power up ~4% in the past few weeks alone which is potent enough to pull forward EPS closer to breakeven in the future years. While the power recovery may be fleeting, management's steps to reduce the debt burden will put the segment on more solid footing.

Mgmt achieves a modest rate deal in W Va, but focus is really on NJ now

We acknowledge that regulatory risk was reduced for FE as it was able to reach a swift settlement with parties in its West Virginia rate case. Rather, we see data points around ALJ and ultimate BPU decision in its JCP&L case as the primary forthcoming risk. We also continue to see some risk to its authorized ROE for transmission as well (albeit no pending case has been levied at present).

Valuation: Increasing our Price Target $30, yet maintaining the Sell rating

Valuation remains based on 2016E SOTP and we now see incremental value at FES following latest run in power and the decision to reduce competitive borrowings. While recent data points around PJM have proven constructive, we continue to see shares as pricey relative to utility and parent standalone. With the generation business largely 'out-of-the-money', we suspect PJM reforms will accrue less to FE equity, and see the increase in its parent costs to ~$0.40/sh as the broader headwind takeaway.

Highlights (US$m)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Revenues	16,258	15,303	14,917	16,270	16,761	16,839	16,783	17,030
EBIT (UBS)	2,271	3,114	2,800	2,745	3,104	3,205	3,017	3,172
Net earnings (UBS)	1,458	1,394	1,270	1,041	1,162	1,219	1,102	1,194
EPS (UBS, diluted) (US$)	3.64	3.33	3.04	2.48	2.76	2.88	2.59	2.79
DPS (US$)	2.20	2.20	2.20	1.44	1.44	1.44	1.44	1.44
Net (debt) / cash	(17,135)	(18,975)	(20,432)	(21,861)	(22,500)	(23,743)	(24,408)	(24,663)

Profitability/valuation	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
EBIT margin %	14.0	20.3	18.8	16.9	18.5	19.0	18.0	18.6
ROIC (EBIT) %	6.2	7.0	6.1	5.8	6.3	6.3	5.8	6.0
EV/EBITDA (core) x	9.3	8.8	9.2	8.6	8.0	8.1	8.5	8.2
P/E (UBS, diluted) x	11.6	13.5	12.8	14.9	13.5	12.9	14.4	13.3
Equity FCF (UBS) yield %	8.1	3.4	1.9	(8.3)	(0.7)	(1.1)	(0.8)	1.8
Net dividend yield %	5.2	4.9	5.7	3.9	3.9	3.9	3.9	3.9

Source: Company accounts, Thomson Reuters, UBS estimates. UBS adjusted EPS is stated before goodwill-related charges and other adjustments for abnormal and economic items at the analysts' judgement. Valuations: based on an average share price that year, (E): based on a share price of US$37.10 on 05 Nov 2014 18:42 EST

Investment Thesis

FirstEnergy Corp.

12-month rating **Sell**

12m price target **US$30.00**

Investment case

We remain more conservatively biased given uncertainty over near term execution of its debt paydown target. While equity issuance remains a known backup behind asset sale in west Virgina and hydro plant sales, we believe future actions may be necessary in subsequent years. We continue to view management as among the most shrewd in the sector, and believe the company's pro-active strategy has substantially improved its outlook status quo through the aggressive implementation of retail municipal aggregation and move to PJM from MISO. Dividend remains intact, but is among the most at risk in sector should commodity prices see a protracted reversal.

Upside scenario

The upside case for FirstEnergy is based on a recovery in the power markets and expansion of the multiple at FirstEnergy Solutions. In a scenario where power prices return to their highs, we see upside to ~$37.

Downside scenario

Our downside case is premised on continued weakness in power prices and further economic softness in FE's markets. The resulting lower unregulated and regulated earnings could drive valuation below $28; if we assume dis-synergies and we see further downside to the low-$20s/high-teens in a scenario where FES obligations are recourse at FE Corp.

Upcoming catalysts

November 12-14th	EEI Financial Conference
November 13	ALJ Decision in JCP&L Rate Case
December/January	Hearings on Ohio ESP
January	Hearings on PA Rate Cases

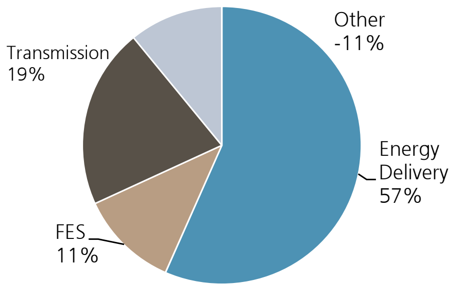
Business description

FirstEnergy Corp. (FE) is a diversified energy company involved in the generation, transmission, and distribution of electricity and other energy-related services. The regulated distribution business serves ~6m customers across five primary states (OH, PA, NJ, WV, and MD) with ~3.8GW of regulated generation. FE has 24,000 miles of regulated transmission lines in PJM, the largest system in the region. The competitive power business serves over 2.7m customers with 13GW of capacity, predominantly fueled by coal, as well as nuclear power, natural gas, hydroelectric/wind/biomass, and oil.

Industry outlook

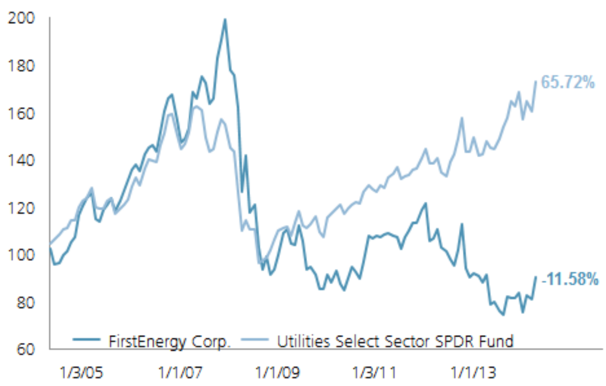
The electric utility industry is projected to experience weak or negative electric demand growth in coming years as a tepid economy and energy efficiency dampen demand. In the unregulated merchant power space, we see limited potential for a meaningful recovery from currently low power prices due to limited projected demand growth, growth of subsidized renewables and potential for only modest further retirements. At regulated utilities, we believe rising interest rates and robust valuations are a challenge to the sector, particularly as earnings growth stalls once EPA-mandated growth capex slow mid-decade. We expect cost-cutting and strategic planning to be a key theme across both regulated and competitive companies, with M&A at modest (at best) premiums designed to extract cost synergies. We believe utilities with high parent leverage will disproportionately suffer, as they are unable to recoup from rising interest rates.

EPS by Segment (2016E %)



Source: Company Filings and UBS Estimates

FirstEnergy vs XLU Long-Term Performance



Source: Company Filings and UBS Estimates

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The Power Line on FE:

Lifting our Price Target to $30 from $26 but still consider other integrateds/IPPs as better positioned to capitalize on the strengthening power market. While it is true that like Exelon, FE has upside potential (starting from a lower base) through PJM reforms, we believe the story has limited equity value remaining to this business. While PJM upside could take the form of clearing its previously 'uncleared' capacity in transition auctions, such as its 2.5GW Bruce Mansfield plant in interim auctions for 2016/2017 (only partially cleared) and 2017/2018. We suspect this could serve to offset the negative impacts to retail from such a transition auction. Our focus and rating on FirstEnergy remain on its ability to sustain and grow its regulated EPS profile amidst meaningful regulatory risk – and substantial leverage. While clear management is attempting to resolve issues expeditiously, we see the name as deserving of a discount to address these underlying concerns and leverage.

Links to our relevant recent research are below:
11/4/14 Focus on Regulated Execution (First Read)
10/15/14 3Q14 Earnings Playbook
8/6/14 Where's the Value in Power?
8/5/14 Asking For Help When Times are Tough in Ohio
7/30/14 Competitive Dis-Synergies

Making the Legality Claim around the Ohio PPA

Structure over form?

Much attention has been paid to the legality of the proposed Ohio PPA following the Maryland decision last year but FE believes it has "put in place mechanisms within the case so that we do not run afoul of the particular things in those cases that triggered FERC's finding that they were legally infirmed."

Amidst ongoing questions as to whether or not FE & AEP's proposed PPA in Ohio would run afoul of recent precedents established against the states of NJ and MD in pursuing similar constructs, FirstEnergy management stressed two points of differentiation:

1) The Edgar inter-company exemption: Around which FE has a historical FERC exemption to transact between its Utility operating companies and FES. As such, management believes this exemption would include any new PPA entered into.

2) Utilities would control the capacity: Mgmt also stressed that utilities would ultimately retain dispatch control of the units under the structure, continuing to regularly sell the associated energy and capacity products into the whole market.

Will NOT follow the NJ and MD example – most likely

The request notably does not require the plants to clear the RPM capacity auction in order to be paid. This should help avoid the problems encountered in Maryland last year when the state sought to encourage new generation construction with state PPAs that were conditional on clearing capacity markets (with the intention of providing customers a net benefit). Recall that the Maryland PPAs were rejected by the courts as state interference in PJM's interstate commerce and the FERC's authority to regulate capacity pricing under the Federal Power Act as those

contracts *required* the units clear in the capacity auction in order to receive revenues.

We see the case as pitting IPPs against each other in a rate case of differing ideologies. We're biased to think the Ohio contracts are allowed to pass, seeing any 'need' for the capacity to clear the plants as less relevant (emphasizing incremental energy revenues are the key focus/purpose of the contracts in any event).

But where's the pushback? We believe price at a minimum.

The question remains *why* Ohio would need to contract for these plants now – and under whose interest. Given the focus on not just jobs, but also long-term rate stability and perceived value, we view the exact pricing of any deal will be critical to any eventual settlement. Notably different from previous interventions, there is not the explicit threat (yet) of plant retirements without payments. As such, we see a clear focus on the price of the contracts, as there is not a clear value with which the commission would appear to 'solve for'.

What's next? Looking towards FirstEnergy's process

FirstEnergy's testimony and hearings on the proposal are set for December 19th and January 20th, respectively. Settlement negotiations typically take place in this window, and we understand this is indeed the intention on the current filing as well. We caution that Staff is likely to be persistent in rejecting against the contract in its initial testimony.

Garden State wait could end next week

As the September 30th deadline came for the ALJ in FE's Jersey Central Power & Light (JCP&L) ratecase, the New Jersey Board of Public Utilities (BPU) approved yet another extension to **Thursday November 13th** from September 29th. If you recall from our notes earlier this year, previously we had expected an initial ALJ decision by August 14th with a final decision by September 29th.

After months of waiting, we could finally get at proposed decision in FE's New Jersey rate case now that we have resolution on CTA.

Staying in New Jersey, management estimated the recent decision on Consolidated Tax Adjustments would reduce its revenue adjustment by $50Mn to ~$6Mn from $56Mn. As a reminder, in late October the BPU adopted Staff's recommendation on the use and calculation of the CTA, whereby the consolidated federal and state tax savings from a multi-state utility holding company (e.g., POM's ACE and FE's JCP&L) are effectively shared with NJ ratepayers, even if the tax reduction occurred at a subsidiary not located in NJ. NJ BPU Docket #: EO12121072 Further details on the change are available in our weekly power points note. With resolution on CTA, the probability of resolution on FE's rate case does increase.

Settling in West Virginia is first of many expected regulatory datapoints in upcoming months

In West Virginia management had requested an 11% ROE on 46.5% equity ratio and it appears that the settlement ROE is ~10% for the base rate increase of $15Mn for increased operating and Harrison transfer costs. Additionally the settlement grants the recovery of $47.6Mn for vegetation management and $46Mn for 2012 storm expenses. C-14-0702-E-42T and C-14-0701-E-D.

Consumer Advocates utilized a 9.9% settlement ROE in their calculations.

The PSC is scheduled to hold a settlement hearing on Friday November 7th and if approved the rates would go into effect in February 25th.

FE $400Mn Rate Case: "Should be Pretty Straightforward"

In early August FirstEnergy filed for rate cases across its four Pennsylvania regulated utilities and is requesting a $416Mn increase premised on a 10.9% ROE and equity ratio around 50%. These utilities' previous rate cases were all decided over seven years ago with the Penn Power case decided in 1988 with the latest delay due to the stay-out provision following the 2010 $4.7Bn Allegheny Energy acquisition. The ROEs previously were 10.1% at Met Ed and Penn Elec. with 10.9% at Penn Power and 11.5% at West Penn. In September we met with Pennsylvania Public Utility Commission (PUC) Chairman **Robert Powelson** who characterized the rate case as "pretty straightforward" and stated that since the case is based primarily on infrastructure spending he does not anticipate significant changes from management's initial request. FE will rely upon the Distribution System Improvement Charge (DSIC) in addition to other riders to receive accelerated recovery. A decision is expected in Pennsylvania in May 2015 with evidentiary hearings January 13-16th. Dockets: C-R-2014-2428742 - 2428745

FE's PA rate cases should be less risky than the pending NJ case.

Figure 1: Summary of FE Pending PA Ratecases

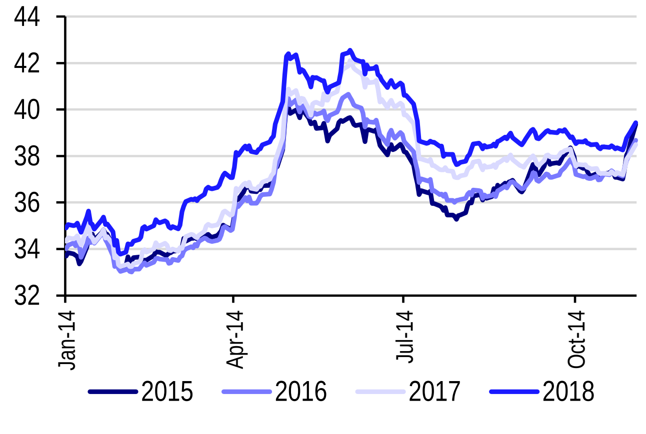
Utility	Rate Increase ($Mn)	Previous Rate Case	ROE	Previous ROE	Equity Ratio
Met Ed	151.9	2007	10.90%	10.10%	50.00%
Penn Elec	119.8	2007	10.90%	10.10%	49.90%
Penn Power	28.5	1988	10.90%	10.90%	50.10%
West Penn Power	115.5	1994	10.90%	11.50%	50.10%
Total	**415.7**		**10.90%**		**50.03%**

Source: SNL Energy

Power accelerates in last week of October

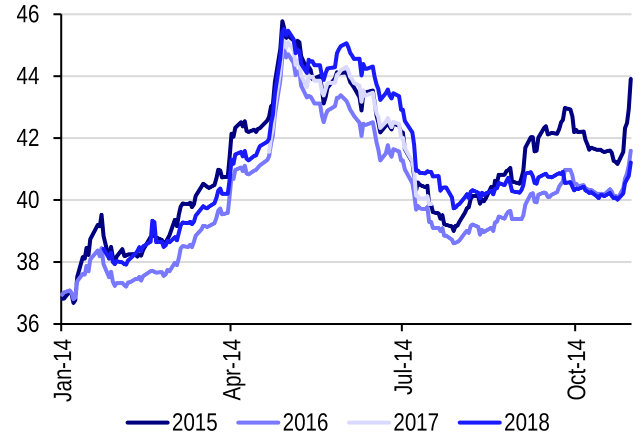
Since our last mid-October mark-to-market AD Hub ATC prices are up an average of 4.5% and PJM-West is also up an average of 3.5% over the same brief horizon. The recent recovery pushes power prices at least to the lower-end of the levels seen this summer and grants a material uplift to FE's merchant business.

Figure 2: AD Hub ATC Price ($/MWh)



Source: Platts and UBS estimates

Figure 3: PJM West ATC Price ($/MWh)



Source: Platts and UBS estimates

FES bounces off the mat with material pickup in the lesser hedged out-years

With management waiting on critical regulatory datapoints, it is unlikely that the company will provide consolidated 2015 guidance with either 3Q14 results or EEI but it provided an updated outlook on FES through 2016 and would update accordingly depending on the outcome in Ohio. The 2016E guidance of $850-$950Mn is only $50Mn lower than the reaffirmed guidance for 2015 and management stated that it is "comfortably in the upper end of that range." With a similar move in power pulling up estimates, we also expect 2016 to be above the $900Mn midpoint as well.

Figure 4: Updated FES EBITDA Estimates

Gross Margin	2012	2013	2014	2015	2016	2017	2018
Open Coal Energy Margins	210	322	396	588	541	571	628
Open Nuclear Energy Margins	921	730	761	840	829	844	876
Hedge Value (From Analyst Day+MtM Since)	373	805	451	(118)	(6)		
Capacity Revenues	405	170	340	892	670	374	385
Marketing Margin (UBSe Retail Margins)	397	259	44	100	90	90	90
Gross Margin (Gen/Retail-Only)	2,307	2,285	1,994	2,302	2,123	1,879	1,979
Other Gross Margin	946	719	883	883	873	873	873
Total Gross Margin	3,253	3,004	2,877	3,185	2,997	2,753	2,852
EBITDA	2012	2013	2014	2015	2016	2017	2018
Open Fossil EBITDA	(21)	(141)	53	727	492	217	245
Open Nuclear EBITDA	238	41.12	169	313	195	214	279
Retail & Hedges & Other EBITDA	1,288	1,329	466	(59)	231	177	177
FES Total	1,505	1,229	689	981	918	608	701
Adjusted EBITDA Guidance (Oct 21 Pricing)			640-680	900-1000	850-950		

Source: Company Filings and UBS Estimates

Long-term debt continues to mount but short-term offsets

FE's long-term debt continues to increase but fortunately it is at the expense of short-term revolver financing as management is finally starting to move its transmission subsidiary towards permanent financing. These moves reduce interest rate risk but will have a material impact on interest expense in the upcoming years. For example, $400Mn of ATSI thirty-year notes were issued at the end of the third quarter.

Net competitive debt is down ~$450Mn over the last six months keeping FCF generation constant.

Figure 5: Updated FE Liquidity Analysis

FE Liquidity Analysis 10/31 QoQ - Revolver										
		As of 10/31/14 ($Mn)			*As of 7/31/14 ($Mn)*			*Change*		
Borrowers	Maturity*	Commit.	Available Liquidity	Borrowed	Commit.	Available Liquidity	Borrowed	Commit.	Available Liquidity	Borrowed
FirstEnergy	March 2019	3,500	2,094	1,406	3,500	1,429	2,071	-	665	(665)
FES/AE Supply	March 2019	1,500	1,452	48	1,500	1,127	373	-	325	(325)
FET/ATSI/TrAIL Co	March 2019	1,000	925	75	1,000	1,000	-	-	(75)	75
AGC	Dec. 2013	-	-	-	-	-	-	-	-	-
	Subtotal	6,000	4,471	1,529	6,000	3,556	2,444	-	915	(915)
	Cash	-	97		-	119		-	(22)	
	Total	6,000	4,568	1,529	6,000	3,675	2,444	-	893	(915)

* Note: The maturities were amended to March 2019 from May 2018 previously

Source: Company Filings and UBS Estimates

Figure 6: UBSe FES Allocated Net Debt as of 3/31

UBSe FES Allocated Net Debt	3/31/2014
Compeitive LT Debt	3,606.7
Compeitive ST Debt	555.0
NPV of Sale Leasebacks	970.6
Negative FCF ('14+'15)	666.4
Projected Debt	5,798.7
Less: FES Cash	(2.2)
Projected Net Debt ('15)	5,796.5

Source: Company Filings and UBS Estimates

Figure 7: UBSe FES Allocated Net Debt as of 10/31

UBSe FES Allocated Net Debt	9/30/2014
Compeitive LT Debt	3,767.2
Compeitive ST Debt	60.0
NPV of Sale Leasebacks	838.1
Negative FCF ('14+'15)	666.4
Projected Debt	5,331.7
Less: FES Cash	(2.2)
Projected Net Debt ('15)	5,329.5

Source: Company Filings and UBS Estimates

Powering estimates higher, offset by tax bite

Our adjusted EPS estimates reflect the increased power prices which increase our 2016+ FES estimates by $0.15-20 and cause 2017E to swing to income from a loss previously. This strong recovery is mostly offset by ~$0.10-$0.15 higher parent drag related to an increase in the corporate effective tax rate and expectations of higher interest rates. 2015E is down 5% as the uplift for hedged year is not great enough to counter the higher expected parent drag.

Figure 8: Updated FirstEnergy EPS Estimates

UBS Adjusted EPS Estimates	2013E	2014E	2015E	2016E	2017E	2018E
Energy Delivery	2.05	1.95	2.02	2.08	2.13	2.20
FirstEnergy Solutions	0.73	0.16	0.55	0.42	(0.04)	0.09
Transmission (ATSI, Trail, and OpCo's)	0.51	0.56	0.58	0.77	0.86	0.91
Parent & Other	(0.25)	(0.18)	(0.39)	(0.40)	(0.36)	(0.40)
Total UBSe EPS	3.04	2.48	2.76	2.88	2.59	2.79
Previous UBSe (except Guidance)		2.47	2.90	2.82	2.55	2.76
Consensus		*2.47*	*2.96*	*2.87*	*2.71*	*2.91*

Power is higher on improved pricing...

... but that is offset by higher parent drag

Source: Company Filings, FactSet, and UBS Estimates

Valuation: Increasing Price Target $4 to $30

Our valuation remains based on a 2016E sum-of-the-parts analysis. Following the latest move in power and continued debt paydowns throughout the year as depicted earlier, we now calculate FirstEnergy Solutions as having positive equity value, excluding parent notes. Despite the fundamental outlook having improved for the unregulated subsidiary, we are maintaining our Sell rating and prefer other PJM generators with less interest rate exposure as a way to play the proposed PJM capacity market reforms. The recovery at FES is worth ~$3/sh in our valuation and the remaining $1/sh recovery relates to the regulated side of the business. The peer multiple is 1.5x-turns higher since our last mark-to-market but the uplift is mitigated by management guiding to higher parent drag for consolidated taxes and parent interest expectations.

Lifting our Price Target to $30 but still consider other integrateds/ IPPs as better positioned to capitalize on the strengthening power market.

Figure 9: Updated FirstEnergy Sum-of-the-Parts

Sum of the Parts Analysis - Combined Hedged and Open Analysis - UBSe - Using both EV/EBITDA and P/E	EBITDA/Net Income	EV/EBITDA & P/E Multiple			Enterprise Value		
Merchant Generation	2016 EBITDA	Low	Base	High	Low	Base	High
Open Fossil Energy EBITDA	492	7.0x	8.0x	9.0x	$3,446	$3,938	$4,430
Open Nuclear Energy EBITDA	195	7.0x	8.0x	9.0x	$1,363	$1,558	$1,753
Capacity Price Normalization @ $100/MW-day	(195)	7.0x	8.0x	9.0x	($1,362)	($1,556)	($1,751)
Marketing (Retail + Hedges)	231	4.0x	5.0x	6.0x	$924	$1,155	$1,386
Total / Implied	$723	*6.0x*	*7.0x*	*8.0x*	$4,371	$5,095	$5,818
Less: FES/AES Net Debt - Excluding Leasebacks (2015 YE)						($4,491)	
Net of FES						$603	
Add: Signal Peak Equity Value (PRB Coal Mine Stake)			After recent power recovery FES has positive equity value			$400	
Add: Capacity Payment Normalization for 2015/16 auction in ATSI				~+$3/sh		$195	
Less: Recourse FES Obligations (Sale Leaseback)						($838)	
Less: Other Parent Sale Leasebacks						($162)	
Less: Parent Notes (10/31)						($4,200)	
Less: Parent ST Borrowings			Assuming Parent revolver is used to finance regulated operations	~-$3/sh		($1,406)	
Add Back: FirstEnergy Transmission Borrowings						$1,000	
Allocate: 100% of Parent Borrowings to Regulated Utilities						$406	
FES Equity (Net of Parent Debt)					($4,726)	($4,002)	($5,200)
Number of Shares Outstanding - 2016 (Mn)					424	424	424
FES Open Equity Drag per Share (Net of Parent Debt)					($11.15)	($9.44)	($7.73)

Regulated Utilities	2016 Net Income	P/E Multiple					Equity Value		
		Low	Peers	Premium/ Discount	Base	High	Low	Base	High
Core Utilities									
Energy Delivery (FE and AYE Utilities)	883	13.8x	15.8x	-1.0x	14.8x	15.8x	$12,182	$13,065	$13,948
Transmission (ATSI, TRAIL)	327	15.8x	15.8x	1.0x	16.8x	17.8x	$5,169	$5,496	$5,823
Total EPS	*2.85*								
Parent Costs									
Net HoldCo/Parent Expenses (SG&A, etc)	(170)	14.8x	15.8x	0.0x	15.8x	16.8x	($2,516)	($2,686)	($2,856)
Add Back: Parent Interest Expense	107	14.8x	15.8x	0.0x	15.8x	16.8x	$1,584	$1,691	$1,798
Net Parent EPS (SG&A ex-Interest)	*(0.15)*								
Dis-Synergies	*(59)*	14.3x	15.8x	-0.5x	15.3x	16.3x	($844)	($903)	($962)
Total / Implied Utilities	1,088	17.6x			15.3x	20.1x	$16,419	$16,662	$18,712
Total Regulated EPS	*2.57*								
Number of Shares Outstanding - 2016 (Mn)							424	424	424
Regulated Utilities & Transmission Equity value per share							$38.73	$39.31	$44.15
FirstEnergy Combined (Regulated & FES) Equity Value							$27.59	$29.87	$36.41

Source: Company Filings, FactSet, and UBS Estimates

FirstEnergy: Pursuing the TrAIL Less Traveled

Requesting to pay dividends from TrAILCo up to the parent

Trans-Allegheny Interstate Line Company (TrAILCo) filed a request with the FERC on October 7th to periodically make dividend payments to its parent FirstEnergy Transmission (FET) from paid-in capital "to maintain a balance capital structure." As of its May 15th filing (Docket ER07-562), TrAILCo had a 59% equity ratio and stated that it will only make dividend payments to FET as long as its equity ratio is greater than 45%; management comments that FERC has not viewed dividends as excessive as long as the equity balance is 30%+ (citing an Entergy Louisiana case and consistent with FERC Form filings). Management has requested a declaratory order by December 8th.

Potential for $400Mn of dividends over time if targeting a 50% equity ratio, before accounting for additional earnings.

As of 2Q14 FERC filings TrAILCo has $853.5Mn of "Other Paid-In Capital" and total equity of $912Mn and total debt of $503Mn for a book capital structure of $1.4Bn, implying a 65% capital structure. Using this as a base, TrAILCo could dividend up to its parent ~$400Mn while still maintaining a 50% equity ratio.

Figure 10: Calculation of TrAILCo Dividend Potential as of 6/30/14

TrAILCo 6/30/14	$Mn	TrAILCo 6/30/14 Est.	$Mn
Other PIC	853.5	Other PIC	853.5
Retained Earnings	58.5	Retained Earnings	58.5
Less: Dividends	-	Less: Dividends	(400.0)
Total Equity	912.0	Total Equity	512.0
Long-Term Debt	451.4	Long-Term Debt	451.4
Note Payable	51.8	Note Payable	51.8
Total Debt	503.2	Total Debt	503.2
Total Cap.	1,415.2	Total Capitalization	1,015.2
Equity Ratio	**64%**	**Equity Ratio**	**50%**
Dividend Assumption	-	Dividend Assumption	(400.0)

Source: Company Filings and UBS Estimates

This request is consistent with management's stated intention of levering up the transmission business and using cash to paydown the revolver borrowings. As of 4/30/14 FE had $750Mn of borrowings on its FET/ATSI/TrAILCo revolver but as of the last update (10/31) there is only $75Mn outstanding as the company has switched to long-term debt financing for the segments.

While also reviewing transmission, last week FE also filed to switch to a forward test year for its ATSI transmission subsidiary and is requesting the change be effective for the start of 2015.

FirstEnergy Corp. (FE.N)

Income statement (US$m)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
Revenues	**16,258**	**15,303**	**14,917**	**16,270**	*9.1*	**16,761**	*3.0*	**16,839**	**16,783**	**17,030**
Gross profit	8,955	8,687	8,657	9,406	*8.7*	9,858	*4.8*	9,882	9,797	10,023
EBITDA (UBS)	**3,721**	**4,545**	**4,193**	**4,576**	*9.1*	**4,974**	*8.7*	**5,103**	**4,940**	**5,114**
Depreciation & amortization	(1,450)	(1,431)	(1,393)	(1,831)	*31.4*	(1,869)	*2.1*	(1,897)	(1,923)	(1,942)
EBIT (UBS)	**2,271**	**3,114**	**2,800**	**2,745**	*-2.0*	**3,104**	*13.1*	**3,205**	**3,017**	**3,172**
Associates & investment income	683	92	118	104	*-11.9*	104	*0.0*	104	104	104
Other non-operating income	0	0	0	0	-	0	-	0	0	0
Net interest	(938)	(927)	(937)	(1,209)	*-29.0*	(1,272)	*-5.2*	(1,277)	(1,284)	(1,286)
Exceptionals (incl goodwill)	0	0	0	0	-	0	-	0	0	0
Profit before tax	**2,016**	**2,279**	**1,981**	**1,640**	*-17.2*	**1,937**	*18.1*	**2,032**	**1,836**	**1,990**
Tax	(574)	(886)	(711)	(599)	*15.8*	(775)	*-29.4*	(813)	(735)	(796)
Profit after tax	**1,442**	**1,393**	**1,270**	**1,041**	*-18.0*	**1,162**	*11.6*	**1,219**	**1,102**	**1,194**
Preference dividends	0	0	0	0	-	0	-	0	0	0
Minorities	16	1	0	0	-	0	-	0	0	0
Extraordinary items	0	0	0	0	-	0	-	0	0	0
Net earnings (local GAAP)	**1,458**	**1,394**	**1,270**	**1,041**	*-18.0*	**1,162**	*11.6*	**1,219**	**1,102**	**1,194**
Net earnings (UBS)	**1,458**	**1,394**	**1,270**	**1,041**	*-18.0*	**1,162**	*11.6*	**1,219**	**1,102**	**1,194**
Tax rate (%)	28.5	38.9	35.9	36.5	*1.7*	40.0	*9.6*	40.0	40.0	40.0

Per share (US$)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
EPS (UBS, diluted)	3.64	3.33	3.04	2.48	*-18.2*	2.76	*11.0*	2.88	2.59	2.79
EPS (local GAAP, diluted)	3.64	3.33	3.04	2.48	*-18.2*	2.76	*11.0*	2.88	2.59	2.79
EPS (UBS, basic)	3.64	3.33	3.04	2.48	*-18.2*	2.76	*11.0*	2.88	2.59	2.79
Net DPS (US$)	2.20	2.20	2.20	1.44	*-34.5*	1.44	*0.0*	1.44	1.44	1.44
Cash EPS (UBS, diluted)[1]	7.25	6.76	6.36	6.85	*7.7*	7.19	*4.9*	7.35	7.10	7.32
Book value per share	31.80	31.25	30.30	31.12	*2.7*	31.94	*2.7*	32.61	33.02	33.20
Average shares (diluted)	401.00	418.00	418.40	419.18	*0.2*	421.53	*0.6*	423.88	426.24	428.59

Balance sheet (US$m)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
Cash and equivalents	202	172	218	216	*-1.1*	231	*7.0*	238	251	258
Other current assets	3,153	3,596	3,669	4,001	*9.1*	4,151	*3.7*	4,157	4,190	4,018
Total current assets	**3,355**	**3,768**	**3,887**	**4,217**	*8.5*	**4,382**	*3.9*	**4,394**	**4,441**	**4,276**
Net tangible fixed assets	30,337	32,903	33,252	35,232	*6.0*	36,157	*2.6*	37,747	38,648	39,236
Net intangible fixed assets	8,082	8,166	8,327	8,327	*0.0*	8,327	*0.0*	8,327	8,327	8,327
Investments / other assets	5,552	5,569	4,958	4,958	*0.0*	4,958	*0.0*	4,958	4,958	4,958
Total assets	**47,326**	**50,406**	**50,424**	**52,734**	*4.6*	**53,824**	*2.1*	**55,427**	**56,373**	**56,796**
Trade payables & other ST liabilities	3,234	3,637	2,818	2,963	*5.2*	2,977	*0.5*	2,974	2,988	2,998
Short term debt	1,621	3,968	4,819	5,152	*6.91*	5,305	*2.96*	5,596	5,754	5,816
Total current liabilities	**4,855**	**7,605**	**7,637**	**8,115**	*6.3*	**8,281**	*2.0*	**8,571**	**8,743**	**8,813**
Long term debt	15,716	15,179	15,831	16,925	*6.9*	17,426	*3.0*	18,384	18,904	19,105
Other long term liabilities	13,456	14,529	14,261	14,651	*2.7*	14,651	*0.0*	14,651	14,651	14,651
Preferred shares	0	0	0	0	-	0	-	0	0	0
Total liabilities (incl pref shares)	**34,027**	**37,313**	**37,729**	**39,691**	*5.2*	**40,359**	*1.7*	**41,606**	**42,297**	**42,569**
Common s/h equity	13,299	13,093	12,695	13,043	*2.7*	13,465	*3.2*	13,821	14,076	14,227
Minority interests	0	0	0	0	-	0	-	0	0	0
Total liabilities & equity	**47,326**	**50,406**	**50,424**	**52,734**	*4.6*	**53,824**	*2.1*	**55,427**	**56,373**	**56,796**

Cash flow (US$m)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
Net income (before pref divs)	1,458	1,394	1,270	1,041	*-18.0*	1,162	*11.6*	1,219	1,102	1,194
Depreciation & amortization	1,450	1,431	1,393	1,831	*31.4*	1,869	*2.1*	1,897	1,923	1,942
Net change in working capital	319	(107)	45	187	*316.0*	136	*-27.4*	8	20	(182)
Other operating	425	600	484	(2)	-	238	-	229	232	235
Operating cash flow	**3,652**	**3,318**	**3,192**	**3,057**	*-4.2*	**3,405**	*11.4*	**3,353**	**3,277**	**3,189**
Tangible capital expenditure	(2,278)	(2,678)	(2,888)	(4,353)	*-50.7*	(3,518)	*19.2*	(3,518)	(3,408)	(2,908)
Intangible capital expenditure	0	0	0	0	-	0	-	0	0	0
Net (acquisitions) / disposals	840	17	4	390	*NM*	0	-	0	0	0
Other investing	(108)	(40)	(49)	0	-	0	-	(548)	0	0
Investing cash flow	**(1,546)**	**(2,701)**	**(2,933)**	**(3,963)**	*-35.1*	**(3,518)**	*11.2*	**(4,066)**	**(3,408)**	**(2,908)**
Equity dividends paid	(881)	(920)	(920)	(604)	*34.4*	(607)	*-0.6*	(610)	(614)	(617)
Share issues / (buybacks)	0	0	0	80	-	80	*0.0*	80	80	80
Other financing	0	0	0	0	-	0	-	0	0	0
Change in debt & pref shares	(2,005)	1,779	1,580	1,427	*-9.71*	654	*-54.13*	1,249	678	263
Financing cash flow	**(2,886)**	**859**	**660**	**903**	*36.8*	**127**	*-85.9*	**719**	**144**	**(274)**
Cash flow inc/(dec) in cash	**(780)**	**1,476**	**919**	**(2)**	-	**15**	-	**7**	**13**	**7**
FX / non cash items	(37)	(1,506)	(873)	0	-	0	-	0	0	0
Balance sheet inc/(dec) in cash	**(817)**	**(30)**	**46**	**(2)**	-	**15**	-	**7**	**13**	**7**

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.[1]Cash EPS (UBS, diluted) is calculated using UBS net income adding back depreciation and amortization.

FirstEnergy Corp. (FE.N)

Valuation (x)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
P/E (local GAAP, diluted)	11.6	13.5	12.8	14.9	13.5	12.9	14.4	13.3
P/E (UBS, diluted)	11.6	13.5	12.8	14.9	13.5	12.9	14.4	13.3
P/CEPS	5.8	6.7	6.1	5.4	5.2	5.0	5.2	5.1
Equity FCF (UBS) yield %	8.1	3.4	1.9	(8.3)	(0.7)	(1.1)	(0.8)	1.8
Net dividend yield (%)	5.2	4.9	5.7	3.9	3.9	3.9	3.9	3.9
P/BV x	1.3	1.4	1.3	1.2	1.2	1.1	1.1	1.1
EV/revenues (core)	2.1	2.6	2.6	2.4	2.4	2.4	2.5	2.5
EV/EBITDA (core)	9.3	8.8	9.2	8.6	8.0	8.1	8.5	8.2
EV/EBIT (core)	15.3	12.8	13.8	14.3	12.9	12.8	13.9	13.3
EV/OpFCF (core)	19.7	22.7	24.1	NM	21.2	21.9	22.7	18.2
EV/op. invested capital	0.9	0.9	0.8	0.8	0.8	0.8	0.8	0.8

Enterprise value (US$m)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Market cap.	16,917	18,831	16,253	15,582	15,582	15,582	15,582	15,582
Net debt (cash)	16,035	18,975	20,432	21,861	22,500	23,743	24,408	24,663
Buy out of minorities	0	0	0	0	0	0	0	0
Pension provisions/other	2,823	3,080	2,689	2,689	2,689	2,689	2,689	2,689
Total enterprise value	**35,775**	**40,886**	**39,374**	**40,132**	**40,771**	**42,014**	**42,679**	**42,934**
Non core assets	(1,008)	(936)	(870)	(870)	(870)	(870)	(870)	(870)
Core enterprise value	**34,767**	**39,950**	**38,504**	**39,262**	**39,901**	**41,144**	**41,809**	**42,064**

Growth (%)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Revenue	17.6	-5.9	-2.5	9.1	3.0	0.5	-0.3	1.5
EBITDA (UBS)	-1.1	22.1	-7.7	9.1	8.7	2.6	-3.2	3.5
EBIT (UBS)	-1.0	37.1	-10.1	-2.0	13.1	3.3	-5.9	5.1
EPS (UBS, diluted)	5.0	-8.3	-9.0	-18.2	11.0	4.3	-10.1	7.8
Net DPS	0.0	0.0	0.0	-34.5	0.0	0.0	0.0	0.0

Margins & Profitability (%)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Gross profit margin	55.1	56.8	58.0	57.8	58.8	58.7	58.4	58.9
EBITDA margin	22.9	29.7	28.1	28.1	29.7	30.3	29.4	30.0
EBIT margin	14.0	20.3	18.8	16.9	18.5	19.0	18.0	18.6
Net earnings (UBS) margin	9.0	9.1	8.5	6.4	6.9	7.2	6.6	7.0
ROIC (EBIT)	6.2	7.0	6.1	5.8	6.3	6.3	5.8	6.0
ROIC post tax	4.4	4.3	3.9	3.7	3.8	3.8	3.5	3.6
ROE (UBS)	13.4	10.6	9.8	8.1	8.8	8.9	7.9	8.4

Capital structure & Coverage (x)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Net debt / EBITDA	4.6	4.2	4.9	4.8	4.5	4.7	4.9	4.8
Net debt / total equity %	128.8	144.9	160.9	167.6	167.1	171.8	173.4	173.4
Net debt / (net debt + total equity) %	56.3	59.2	61.7	62.6	62.6	63.2	63.4	63.4
Net debt/EV	49.3	47.5	53.1	55.7	56.4	57.7	58.4	58.6
Capex / depreciation %	NM	NM	NM	NM	NM	NM	NM	NM
Capex / revenue %	14.0	17.5	19.4	26.8	21.0	20.9	20.3	17.1
EBIT / net interest	2.4	3.4	3.0	2.3	2.4	2.5	2.3	2.5
Dividend cover (UBS)	1.7	1.5	1.4	1.7	1.9	2.0	1.8	1.9
Div. payout ratio (UBS) %	60.5	66.0	72.5	58.0	52.2	50.1	55.7	51.7

Revenues by division (US$m)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Others	16,258	15,303	14,917	16,270	16,761	16,839	16,783	17,030
Total	**16,258**	**15,303**	**14,917**	**16,270**	**16,761**	**16,839**	**16,783**	**17,030**

EBIT (UBS) by division (US$m)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Others	2,271	3,114	2,800	2,745	3,104	3,205	3,017	3,172
Total	**2,271**	**3,114**	**2,800**	**2,745**	**3,104**	**3,205**	**3,017**	**3,172**

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

Forecast returns

Forecast price appreciation	-19.1%
Forecast dividend yield	3.9%
Forecast stock return	-15.2%
Market return assumption	5.5%
Forecast excess return	-20.7%

Statement of Risk

FE's stock could be negatively affected by weather; weak wholesale power prices; economic downturn in its regulated service territories; interest rate risks; headline and financial risks of operating nuclear power plants; negative regulatory decisions for both its regulated and merchant subsidiaries; and disruption of trading activity in power markets. The company is also exposed to unfavorable regulatory developments at its Ohio, Pennsylvania, Maryland, West Virginia, and New Jersey regulated utilities from its respective state regulators as well as from the FERC which regulates its transmission and the PJM regional transmission operator. Its merchant generation portfolio remains subject to power and capacity price volatility, primarily linked to AD Hub, power price basis to the hub, PRB and Appalachian coal pricing and associated delivery costs, and marketing risks related to serving a broad array of wholesale and retail power contracts. Further, its generation portfolio remains subject to evolving EPA regulations; while already retrofitted with many substantially already retrofitted with control technologies, heightened ozone standards among others could lead to increased investment.

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UBS Investment Research: Global Equity Rating Definitions

12-Month Rating	**Definition**	**Coverage**[1]	**IB Services**[2]
Buy	FSR is > 6% above the MRA.	47%	34%
Neutral	FSR is between -6% and 6% of the MRA.	42%	28%
Sell	FSR is > 6% below the MRA.	11%	21%
Short-Term Rating	**Definition**	**Coverage**[3]	**IB Services**[4]
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%

Source: UBS. Rating allocations are as of 30 September 2014.
1:Percentage of companies under coverage globally within the 12-month rating category. 2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.
3:Percentage of companies under coverage globally within the Short-Term rating category. 4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

KEY DEFINITIONS: Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months. **Market Return Assumption (MRA)** is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium). **Under Review (UR)** Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation. **Short-Term Ratings** reflect the expected near-term (up to three months) performance of the stock and do not reflect any change in the fundamental view or investment case. **Equity Price Targets** have an investment horizon of 12 months.

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UBS Securities LLC: Julien Dumoulin-Smith; Michael Weinstein; Paul Zimbardo.

Company Disclosures

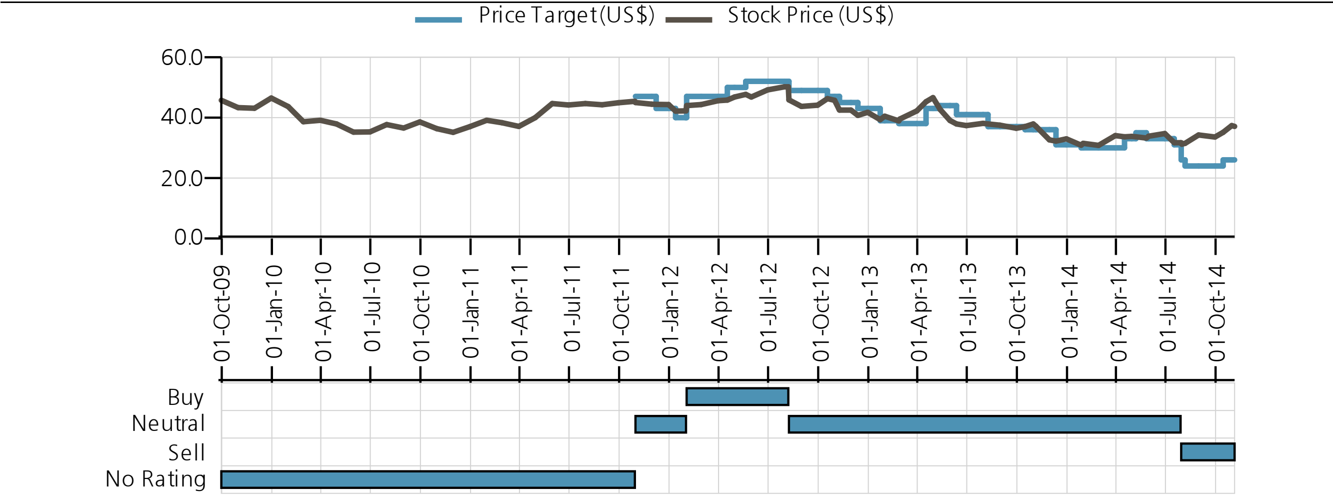
Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
FirstEnergy Corp.[16]	FE.N	Sell	N/A	US$37.10	05 Nov 2014

Source: UBS. All prices as of local market close.
Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

16. UBS Securities LLC makes a market in the securities and/or ADRs of this company.

Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report.

FirstEnergy Corp. (US$)



Source: UBS; as of 05 Nov 2014

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