

FirstEnergy

Dialing up the capex: FE ramps up utility spending to offset coal mining & pension

Maintain Rating: UNDERPERFORM | PO: 30.00 USD | Price: 35.79 USD

FY23 operating EPS in-line & FY24 beats. Large GAAP gap

We maintain Underperform on shares of relatively expensive diversified utility FirstEnergy (FE) after its 4Q23 update. FE reported \$0.62 4Q23 adjusted operating EPS, a beat vs \$0.60 BofAe/Consensus and \$0.55-\$0.65 quarterly guidance range. \$2.56 FY23 adjusted operating EPS, in-line with \$2.56 BofA and similarly +\$0.02 vs \$2.54 Consensus. \$2.56 adjusted operating EPS compares with the \$2.44-\$2.64 guidance and the original \$2.55-\$2.60 'target'. 4Q23 \$0.30 GAAP had -\$0.32 negative "special items" excluded such as -\$0.11 "strategic transaction costs", -\$0.03 employee retirement costs, -\$0.03 investigation costs, -\$0.02 regulatory charges, and -\$0.01 FE Forward costs. The \$0.60 "Special Items" is \$0.49 excluding strategic transaction costs and is the highest level of non-GAAP adjustments in the last four years. Many of the special items have been recurring for multiple years such as FE Forward costs and regulatory charges. \$2.61-\$2.81 FY24 adj op EPS was initiated, +5.9% YoY; above \$2.68 BofA/Consensus.

Large new capex program the key to the 6-8% EPS growth

The most significant update is proposing to increase its capital expenditures significantly. FE guides to 8.8% rate base CAGR 2024-2028 with 11% integrated growth, 9% transmission, and 6% distribution. FE's new plan is doubling annual capex to \$6Bn in 2028 from \$3.0-\$3.2Bn 2020-2023. The plan includes up to \$500Mn equity issuance, similar to the prior plan. Management reaffirmed the 6-8% annual adjusted operating EPS guidance and stated it runs through 2028, generally consistent with the prior disclosure of 6-8% annually post 2025. The new ~9% rate base CAGR with unchanged equity needs should help support stronger EPS growth. If management can execute this new ambitious investment plan with customer recovery, it would be a notable positive for shares. We look for details on the customer bill impact from the capital ramp. *FE's customer bills have nearly doubled in Ohio and are up 40-60% in Pennsylvania – before the rate case filings and capital increase since '20.*

Ohio organized crime review continues

FE stated that the Ohio Organized Crime Investigations Commission review is ongoing and FE continues to cooperate. \$0.03 investigation costs were flat YoY in the quarter.

Management says reducing "lower quality earnings"

FE reduced its expected contribution from coal mining and pension income to 8% in 2024 and de minimis (~2%) in 2025+. The company describes itself as having 27% "lower quality earnings" in 2022, 14% in 2023, 8% in 2024, and de minimis after (5-6% in 2025 per the presentation). FE completed a "lift-out" transaction for \$683Mn pension assets and \$719Mn pension liabilities which the company guided to reducing 10% earnings volatility. Management is exploring additional transactions in the future. This is a favorable update; however, FE's pension is still \$1.1Bn underfunded drag on value.

Credit: 8.8% FFO / debt in 2023 or 9.5% ex-weather

FY23 FFO / debt was 8.8%, well below the ~12% mgmt. guidance. See more in full report.

09 February 2024

Equity

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Stock Data

Price	35.79 USD
Price Objective	30.00 USD
Date Established	5-Feb-2024
Investment Opinion	B-3-7
52-Week Range	32.18 USD - 41.99 USD
Mkt Val (mn) / Shares Out (mn)	20,472 USD / 572.0
Free Float	94.8%
Average Daily Value (mn)	135.96 USD
BofA Ticker / Exchange	FE / NYS
Bloomberg / Reuters	FE US / FE.N
ROE (2023E)	13.4%
Net Dbt to Eqty (Dec-2022A)	198.2%
ESGMeter™	High

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OOCIC: Ohio Organized Crime

Investigations Commission

FFO: Funds from operations

CFO: Cash flow from operations

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Timestamp: 09 February 2024 06:45AM EST

In contrast to FE achieving its EPS guidance, the company was well below the 2023 credit metric guidance in 2023. FE had \$1.4Bn GAAP cash flow from operations and a 5.5% GAAP CFO / debt versus ~12% guidance. Using FE's estimated Moody's adjustments indicates an 8.8% FFO / debt, still significantly below its guidance. Despite the FY23 miss, FE continues to target 14-15% FFO / debt for 2024+. In 2024 believes there will be +2pp benefit from asset sale proceeds, +1pp rate case benefits, +1pp programmatic rate relief, and -1pp taxes & operating costs. FFO's 2024-2028 financial plan assumes \$20.4Bn cash flow from operations. This is stated at ~\$4Bn per year but with \$3.2Bn FY24 this represents \$4.3Bn average 2025-2028 and supports 14.1% FFO / debt, in the low-end of the range but a notable improvement with little equity.

Exhibit 1: FE Updated Avg Rate Base Guidance (\$Bn)

FE's new capex program is significantly larger across the board

Current Guide	2023	2024	2025	2026	2027	2028	'24-'28
Distribution	10.9	11.4	12.0	12.8	13.6	14.6	6.4%
Integrated	8.7	9.4	10.4	11.5	13.0	14.5	11.4%
Transmission	7.7	8.4	9.0	10.0	11.0	12.0	9.3%
Less: Est. Minority	(1.3)	(3.4)	(3.7)	(4.2)	(4.6)	(5.0)	10.1%
Total	26.0	25.8	27.7	30.1	33.0	36.1	8.8%
Consolidated	27.3	29.2	31.4	34.3	37.6	41.1	8.9%

Source: Company Filings and BofA Global Research

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Exhibit 2: FE Prior Avg Rate Base Guidance (\$Bn)

Using a 2023 starting point, FE has significant dilution to offset

Prior Guidance	2023	2024	2025	'23-'25
Distribution	17.4	18.2	19.2	5.0%
Transmission	9.4	10.4	11.5	10.6%
Less: Est. Minority	(1.3)	(3.5)	(3.9)	73.5%
Total	25.5	25.1	26.8	2.5%
Consolidated	26.8	28.6	30.7	7.0%

Source: Company Filings and BofA Global Research

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FE eliminated the guidance to have -30% Scope 1 emissions 2019-2030 due to 'West Virginia energy policy', market conditions, and resource adequacy concerns. FE plans to continue operating its Fort Martin (2035) and Harrison (2040) coal plants beyond 2030.

Exhibit 3: FE Avg Customer Monthly Bill Comparison

Utility bills in FE's states have increased dramatically. Watch OH rate case

Customer Bill	July '20	Feb '24	Change
Ohio Avg	\$90	\$181	101%
Cleveland (CEI)	\$92	\$175	90%
Ohio (OE)	\$91	\$178	96%
Toledo (TE)	\$94	\$181	93%
Pennsylvania Avg	130.0	186.0	43%
Metropolitan Ed (ME)	117.0	187.0	60%
Penn Elec (PE)	138.0	200.0	45%
Penn Power (PP)	128.0	181.0	41%
West Penn Power (WPP)	101.0	155.0	53%
New Jersey Avg	110.0	197.0	79%
Jersey Central (JCP&L)	90.0	155.0	72%
West Virginia Avg	118.0	152.0	29%
Mon Power (MP)	107.0	133.0	24%
Potomac Edison (PE)	107.0	133.0	24%
Maryland Avg	133.0	183.0	38%
Potomac Edison (PE)	102.0	138.0	35%

Source: Company Filings

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Exhibit 4: FE Annual Capex Program (\$Bn)

FE is pursuing one of the larger investment cycles in our coverage, despite limited 1% load growth

Capex Plan	\$Bn Capex	YoY %
2020	3.0	
2021	2.9	-3.3%
2022	3.2	10.3%
2023	3.7	15.6%
2024	4.3	16.2%
2025	4.7	9.3%
2026	5.2	10.6%
2027	5.7	9.6%
2028	6.2	8.8%

Source: Company Filings

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The regulatory calendar has been delayed somewhat with the Pennsylvania rate cases now targeted for August versus 1Q24 previously. The Ohio Grid Mod hearings were previously pushed out from late 2023 and are now set for hearings in April. Also in Ohio the Electric Security Plan (ESP) V is extending deeper into 2024 than we anticipated. Finally the New Jersey Infrastructure plan revised filing is expected at the end of February versus 4Q23. FirstEnergy recently reached a settlement in the New Jersey rate case. The three rate cases FE filed in 2023 to date have all lagged our expectations: Maryland final order, West Virginia settlement, and the New Jersey settlement.

Price objective basis & risk

FirstEnergy (FE)

Our \$30 price objective is based on a sum-of-the-parts valuation. Our multiples are driven by relative P/E premiums/discounts to the 13.4x 2025E regulated peer multiple. Peer P/E multiple is grossed up for a year by 5% to reflect capital appreciation across the sector, a consistent approach across our coverage universe. We apply -2x discount to reflect rate review risk, below average risk, and pension exposure. We subtract out the holding company debt given the above-average leverage. The unregulated coal mining business Signal peak is valued at 5x P/E

Upside and downside risks to the Price Objective are: 1) regulatory/political/legislative outcomes, 2) ability to earn the allowed ROEs and/or other changes in regulatory earnings, 3) weather and natural disasters, 4) investigation revelations and liabilities, 5) equity needs versus forecasts, 6) capital expenditures, 7) pension plan returns, discount rate changes, and interest/service costs associated with the plan, 8) economic conditions & interest rates, and 9) taxes.

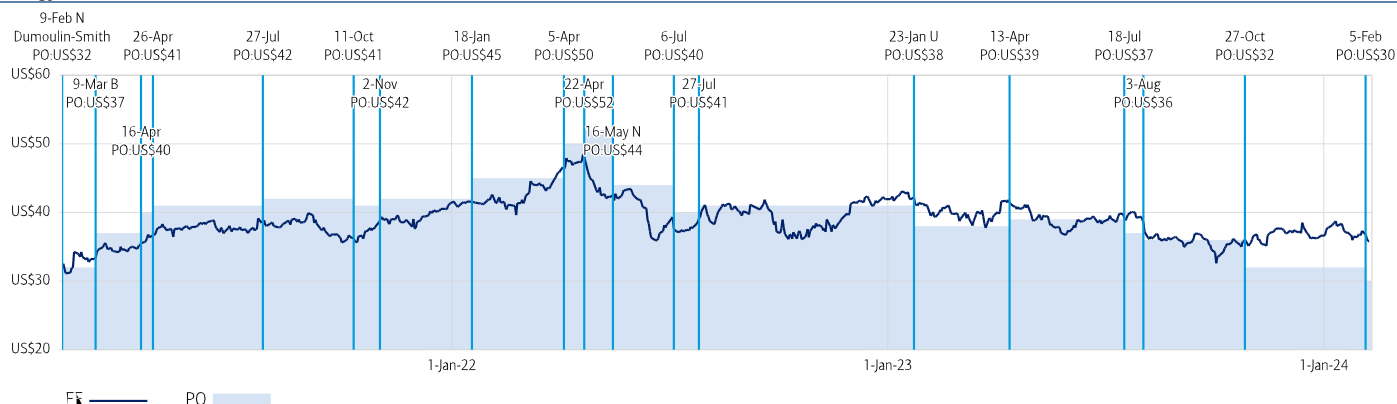
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FirstEnergy (FE) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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Equity Investment Rating Distribution: Utilities Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	72	46.45%	Buy	52	72.22%
Hold	45	29.03%	Hold	32	71.11%
Sell	38	24.52%	Sell	21	55.26%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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