

No fault lines; solid quarter

Seeing gold. PCG still a shiny story

We continue to view PCG as an attractive, large-cap regulated investment with a compelling regulated growth story. PCG trades at an average 10% discount to its large regulated peer group, and a 4% discount to the our overall regulated average, a discount we believe is unwarranted given the high quality earnings growth story. In addition, we see upside to our current estimates from Solar PV, Cornerstone and potentially Manzana Wind. We maintain our Buy rating.

Solid quarter; reaffirm 2010 and 2011 guidance

PCG reported 2Q10 earnings of \$0.91/sh above consensus of \$0.90/sh. Positives were increase in rate revenue (+\$0.05) and lack of/lower severance costs, environmental liability and uncollectible expenses (+\$0.01/each). PCG reaffirmed 2010 and 2011 guidance of \$3.35-\$3.50/sh and \$3.65-\$3.85/sh, respectively. Our 2011 estimate (\$3.73/sh) includes \$300M of equity, though PCG could choose to do some pre-financing in 2010.

Next catalysts: election, rate case decision

The California political and regulatory uncertainty has been an overhang on PCG shares. To that end, we are mindful of CA elections, but believe regardless of the new gov.'s political party, the overall commission should not materially change. PCG has made positive strides in its rate case with a settlement in the gas case to be filed soon. We expect the valuation gap to narrow as a GRC decision nears.

Maintain Buy, \$49 price objective

Our valuation assumes a premium P/E of 12.75x 2012E earnings to account for above average growth. We view the risks as: 1) the outstanding 2011 general rate case and 2) any unforeseen changes to California regulation.

Estimates (Dec)

(US\$)	2008A	2009A	2010E	2011E	2012E
EPS	3.02	3.20	3.41	3.73	3.90
GAAP EPS	3.02	3.20	3.41	3.73	3.90
EPS Change (YoY)	8.6%	6.0%	6.6%	9.4%	4.6%
Consensus EPS (Bloomberg)			3.40	3.70	3.91
DPS	1.56	1.68	1.82	1.97	2.12

Valuation (Dec)

	2008A	2009A	2010E	2011E	2012E
P/E	15.0x	14.2x	13.3x	12.1x	11.6x
GAAP P/E	15.0x	14.2x	13.3x	12.1x	11.6x
Dividend Yield	3.4%	3.7%	4.0%	4.3%	4.7%
EV / EBITDA*	11.7x	10.8x	9.4x	8.7x	8.1x
Free Cash Flow Yield*	-5.0%	-5.2%	-1.8%	-1.1%	1.7%

* For full definitions of *iQmethod*SM measures, see page 7.

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Stock Data

Price	US\$45.30
Price Objective	US\$49.00
Date Established	16-Dec-2009
Investment Opinion	A-1-7
Volatility Risk	LOW
52-Week Range	US\$34.95-45.80
Mrkt Val / Shares Out (mn)	US\$17,740 / 391.6
BofAML Ticker / Exchange	PCG / NYS
Bloomberg / Reuters	PCG US / PCG.N
ROE (2010E)	12.3%
Total Dbt to Cap (Dec-2009A)	49.5%
Est. 5-Yr EPS / DPS Growth	8.0% / 6.0%

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Refer to important disclosures on page 8 to 10. Analyst Certification on Page 6. Price Objective Basis/Risk on page 6. Link to Definitions on page 6. 10962427

*iQprofile*SM PG&E Corporation

*iQmethod*SM – Bus Performance*

(US\$ Millions)	2008A	2009A	2010E	2011E	2012E
Return on Capital Employed	4.9%	4.8%	4.8%	5.1%	5.3%
Return on Equity	12.1%	12.5%	12.3%	12.4%	12.4%
Operating Margin	14.6%	17.7%	19.9%	21.1%	22.0%
Free Cash Flow	(879)	(919)	(326)	(190)	300

*iQmethod*SM – Quality of Earnings*

(US\$ Millions)	2008A	2009A	2010E	2011E	2012E
Cash Realization Ratio	2.5x	2.5x	2.4x	2.4x	2.4x
Asset Replacement Ratio	2.2x	2.3x	2.0x	2.1x	1.9x
Tax Rate	28.2%	27.2%	39.1%	39.0%	39.0%
Net Debt-to-Equity Ratio	106.8%	109.7%	103.7%	105.8%	101.3%
Interest Cover	2.9x	3.4x	3.6x	3.7x	3.7x

Income Statement Data (Dec)

(US\$ Millions)	2008A	2009A	2010E	2011E	2012E
Sales	14,628	13,399	15,188	15,718	16,276
% Change	10.5%	-8.4%	13.4%	3.5%	3.6%
Gross Profit	8,113	8,397	9,556	10,053	10,577
% Change	4.5%	3.5%	13.8%	5.2%	5.2%
EBITDA	3,791	4,118	4,721	5,107	5,461
% Change	-3.1%	8.6%	14.6%	8.2%	6.9%
Net Interest & Other Income	(634)	(672)	(826)	(876)	(925)
Net Income (Adjusted)	1,081	1,234	1,337	1,485	1,617
% Change	7.5%	14.2%	8.3%	11.1%	8.9%

Free Cash Flow Data (Dec)

(US\$ Millions)	2008A	2009A	2010E	2011E	2012E
Net Income from Cont Operations (GAAP)	1,081	1,234	1,337	1,485	1,617
Depreciation & Amortization	1,651	1,752	1,702	1,796	1,885
Change in Working Capital	(739)	(814)	0	0	0
Deferred Taxation Charge	590	809	(100)	(100)	(50)
Other Adjustments, Net	166	58	206	404	423
Capital Expenditure	(3,628)	(3,958)	(3,470)	(3,775)	(3,575)
Free Cash Flow	-879	-919	-326	-190	300
% Change	-292.4%	-4.6%	64.5%	41.7%	NM

Balance Sheet Data (Dec)

(US\$ Millions)	2008A	2009A	2010E	2011E	2012E
Cash & Equivalents	1,509	1,160	1,285	575	572
Trade Receivables	2,436	2,280	2,280	2,280	2,280
Other Current Assets	2,458	2,217	2,397	2,397	2,397
Property, Plant & Equipment	26,261	28,892	30,275	31,850	33,116
Other Non-Current Assets	8,196	8,396	8,396	8,396	8,996
Total Assets	40,860	42,945	44,633	45,498	47,361
Short-Term Debt	887	1,175	1,175	1,175	1,175
Other Current Liabilities	6,369	5,252	5,252	4,619	4,619
Long-Term Debt	10,904	11,594	12,256	12,852	13,529
Other Non-Current Liabilities	13,071	14,339	14,239	14,139	14,089
Total Liabilities	31,231	32,360	32,922	32,785	33,412
Total Equity	9,629	10,585	11,711	12,713	13,949
Total Equity & Liabilities	40,860	42,945	44,633	45,498	47,361

* For full definitions of *iQmethod*SM measures, see page 7.

Company Description

PG&E Corp is one of the largest combination natural gas and electric utilities in the United States and the third largest regulated utility in our coverage universe. Based in San Francisco, California, the company primary business is the transmission and delivery of energy. The company provides natural gas and electric service to approximately 15 million people throughout a 70,000-square-mile service area to most of the northern two-thirds of California.

Investment Thesis

PCG offers a compelling regulated growth story with well below average risk. PCG benefits from very supportive state regulation in CA. Key positive CA regulatory mechanisms include revenue decoupling, cost of capital adjustment mechanism, and a pension balancing account. We project earnings growth of 6-7% over the next 5 years driven by a 10% growth in ratebase, through investments in transmission and distribution and generation. We expect PCG to increase the dividend as earnings grow.

Stock Data

Average Daily Volume 2,282,704

Quarterly Earnings Estimates

	2009	2010
Q1	0.65A	0.79A
Q2	0.83A	0.88E
Q3	0.93A	NA
Q4	0.79A	NA

Updating our work on PCG

PCG is a high quality utility with 6-7% LT EPS growth, but trades at a discount to its peers due to perceived regulatory risk

PCG remains one of the highest quality utilities in our coverage universe, in our view. Political, regulatory concerns and California economic uncertainty have pressured the stock year to date. We project over 9% rate base growth over the next five years resulting in average 6-7% of earnings growth, which could be conservative in our view. While we do not project negative outcomes in the GRC or California regulatory environment, we believe PCG is over-pricing the risk as it is trading at a meaningful discount to the large-cap regulated group (Table 1) and a more modest discount to the overall regulated group (Table 2).

Table 1: Large cap regulated comparables

Company Name	Ticker	Current Price	BofAML Rating	Mkt Cap (\$M)	P/E				Div Yield	Div Growth (E)
					2010E	2011E	2012E	2013E		
ConEd	ED	\$46.94	A-2-7	\$13,236	14.3x	13.5x	13.2x	13.0x	5.0%	0.8%
Duke	DUK	17.37	A-3-7	22,809	13.7x	13.5x	13.3x	12.6x	5.5%	2.0%
PG&E	PCG	45.30	A-1-7	17,701	13.3x	12.1x	11.6x	10.9x	3.7%	8.1%
Progress	PGN	42.70	A-1-7	12,262	14.2x	13.3x	12.6x	12.3x	5.8%	0.4%
Southern	SO	35.77	A-3-7	29,494	14.3x	14.4x	13.6x	12.7x	4.8%	4.3%
Average					14.0x	13.4x	12.9x	12.3x	5.0%	2.9%

Source: BofAML Global Research

PCG should trade at a premium to its regulated peer group following a constructive GRC outcome

PCG trades at an average 4% discount to our overall regulated comp group. Historically the company has traded at a slight premium to its regulated peers, closer in-line with its large-cap peers. We expect this premium to return following a constructive rate case outcome.

Table 2: Regulated Utilities Comparables

Company Name	Ticker	Current Price	BofAML Rating	Mkt Cap (\$M)	P/E				Div Yield	Div Growth (E)
					2010E	2011E	2012E	2013E		
Alliant Energy	LNT	\$35.05	B-2-7	\$3,883	13.8x	12.6x	12.8x	12.0x	4.5%	2.8%
CMS Energy	CMS	16.06	B-1-7	3,697	11.9x	11.1x	10.6x	10.0x	3.7%	12.5%
Consolidated Edison	ED	46.94	A-2-7	13,236	14.3x	13.5x	13.2x	13.0x	5.1%	0.8%
DPL Inc.	DPL	25.69	B-3-7	3,056	10.6x	10.4x	10.4x	13.7x	4.7%	2.4%
DTE Energy	DTE	46.45	B-3-7	7,840	12.8x	12.5x	11.8x	11.3x	4.8%	4.1%
Duke Energy	DUK	17.37	A-3-7	22,809	13.7x	13.5x	13.3x	12.6x	5.6%	2.0%
Hawaiian Electric	HE	23.88	B-3-7	2,225	17.4x	13.2x	12.4x	11.8x	5.2%	0.0%
Northeast Utilities	NU	28.77	A-1-7	5,063	15.1x	13.2x	12.5x	11.2x	3.6%	3.9%
NSTAR	NST	38.00	A-2-7	3,936	15.0x	14.1x	13.6x	13.2x	4.2%	5.9%
NV Energy	NVE	12.78	B-3-7	3,003	13.6x	13.0x	10.1x	10.1x	3.4%	8.4%
PG&E	PCG	45.30	A-1-7	17,701	13.3x	12.1x	11.6x	10.9x	4.0%	8.0%
Pinnacle West	PNW	39.48	B-2-7	4,289	13.1x	12.9x	11.3x	11.0x	5.3%	3.3%
Portland General	POR	19.52	B-2-7	1,469	14.7x	10.7x	10.8x	10.4x	5.3%	1.7%
Progress Energy	PGN	42.70	A-1-7	12,262	14.2x	13.3x	12.6x	12.3x	5.8%	0.5%
SCANA	SCG	39.44	B-2-7	5,231	13.1x	12.2x	11.6x	11.1x	4.8%	1.0%
Southern Company	SO	35.77	A-3-7	29,494	14.3x	14.4x	13.6x	12.7x	5.1%	4.0%
TECO Energy	TE	16.96	B-1-7	3,628	12.9x	12.6x	11.3x	10.9x	4.8%	2.4%
Wisconsin Energy	WEC	55.21	A-1-7	6,454	14.8x	13.3x	12.3x	11.8x	2.9%	10.4%
Xcel Energy	XEL	21.86	A-2-7	10,533	13.5x	12.6x	12.0x	11.1x	4.6%	3.0%
Average					13.8x	12.7x	12.0x	11.6x	4.6%	3.7%

Source: BofAML Global Research

PCG has reached a settlement in its gas rate case which should be filed in the next few weeks

Gas Rate case settlement reached

PCG has reached a settlement with most parties in its gas storage and transmission rate case and is expected to file the settlement in the next few weeks. We view this as a positive indication that intervening parties and the DRA remain willing to negotiate a reasonable outcome for all participants. That said, we do not think a settlement of the 2011 GRC is likely, and will probably stretch into 2011 before a final decision is reached.

Recent regulatory outcomes for PCG and SRE indicate a reasonable CPUC

No major differences in regulatory environment

The regulatory environment in California appears to remain largely constructive, in our view. While the overall makeup of the Commission may change depending on the gubernatorial election, we do not see the constructive tone of the CPUC changing dramatically. As highlighted by the reasonable outcomes in the Solar PV case, Cornerstone for PCG and smart meters for SoCalGas and Sunrise Powerlink for Sempra, the CPUC seems to understand the need for the utilities to earn a reasonable return on necessary investments in renewables and energy efficiency.

Both gubernatorial candidates support current RPS goals; expect CPUC to be largely unchanged under Brown

New CA governor will not be an action hero

California has a gubernatorial election this year with current front runners Meg Whitman (R) and Jerry Brown (D). These candidates are both relatively even in the polls. If Meg Whitman wins the election, there could be changes to the Commission, including the replacement of President Peevey. If Jerry Brown wins, we expect the CPUC to remain largely unchanged. In addition, the new governor could impact state RPS goals (33% by 2020) by repealing an executive order signed by Gov. Schwarzenegger. That said, both candidates have declared support for 33% RPS goals.

If Prop 23 passes and AB 32 is suspended, the impact to utility growth should be minimal

Prop 23: impact to utilities less than expected

California Proposition 23 is an initiative to suspend AB 32. AB 32 requires greenhouse gas emissions be cut to 1990 levels by 2020 (about 15% from 2010 levels). AB 32 includes market based cap and trade regulations for CO2 but does not include an RPS provision. Currently Prop 23 is relatively even in the polls.

The 33% RPS goal by 2020 was signed as an executive order by Governor Schwarzenegger in 2009. California utilities have constructed growth plans to target compliance of the RPS goals by 2020. Hence, even if AB 32 is passed, utility growth plans remain on track.

That said, we do note that the executive order for RPS goals could get overruled by the next governor. We note that the Executive Order has broad legislative support and neither gubernatorial candidate has made statements opposing the renewable standard.

Community aggregation risk remains but costs keep probability low

Community aggregation: some concerns, some comfort

Leading up to and following the vote on Prop 16, there was much discussion of community aggregation and shopping risk in PCG's service territory. To date, some areas of Marin County have elected to go for a community aggregation pool and purchase power separately. These customers represent less than 1% of load and continue to pay T&D charges to PCG. San Francisco County also made

moves to aggregate (~6% of load), though did not follow through as community aggregation can be a costly process. In the near-term we do not see material earnings risk from community aggregation, though longer-term it could impact rate base growth.

In community aggregation, customers secure their own generation, but continue to use and pay PCG for T&D. During Prop 16, municipalization fears also surfaced. In municipalization, customers exit the PCG system and run their own utility. Customers must then pay PCG fair market value for transmission and distribution (poles and wires) assets. This is much more costly and we believe the risk of this is much less.

Financial summary and modeling assumptions

Our 2010-2013 estimates remain unchanged at \$3.41, \$3.73, \$3.90 and \$4.14 per share. Tables 3 and 4 highlight our financial summary and modeling assumptions for PCG.

PCG needs equity to fund rate base in 2011. Equity could come as early as late 2010.

As stated above, on its earnings call PCG reminded investors of its external equity needs in 2011 to fund rate base growth. We currently assume a \$300M equity offering in 2011. Though some of the rate base growth in 2011 is dependent on the outcome of the GRC, PCG could elect to pre-fund some of its equity issuance in late 2010.

Table 3: Financial Summary

<u>Financial Summary</u>	2010E	2011E	2012E	2013E
EPS	\$3.41	\$3.73	\$3.90	\$4.14
Diluted Shares Outstanding	392	398	415	415
Dividends Per Share	\$1.82	\$1.97	\$2.12	\$2.29
Dividend Yield	4.0%	4.4%	4.7%	5.1%
Dividend Payout Ratio	53%	53%	54%	55%
Equity Ratio	49%	49%	50%	49%
FFO/Net Debt	26%	27%	27%	24%
Valuation Metrics				
P/E	13.2x	12.1x	11.6x	10.9x
Price/Book	1.5x	1.4x	1.3x	1.3x
Segment EPS				
Utility	\$3.42	\$3.70	\$3.88	\$4.12
Parent	(0.01)	0.02	0.02	0.02
Total EPS	\$3.41	\$3.73	\$3.90	\$4.14
Utility				
Realized ROE	11.5%	11.4%	11.4%	11.4%
Average Rate Base	\$22,207	\$24,681	\$26,841	\$28,536

Source: BofAML Global Research

Table 4: Modeling Assumptions

<u>Assumptions</u>	2010E	2011E	2012E	2013E
Total Capital Spending by Segment (\$M)				
Electric Distribution	\$1,350	\$1,700	\$1,700	\$1,700
Generation	550	375	375	375
Common Plant	150	350	350	350
Electric Transmission	800	950	950	950
Gas Transmission	200	200	200	200
AMI & Other	420	200	0	0
Total Capex	\$3,470	\$3,775	\$3,575	\$3,575
Financings (\$M)				
Total Equity Issued/(Repurchased)	\$502	\$300	\$500	\$0
Total Debt Issued/(Repurchased)	1,048	1,000	1,100	700
Sales Forecast				
Electric Customer Growth	0.0%	0.0%	0.0%	0.0%
Gas Customer Growth	1.8%	1.8%	1.8%	1.8%

Source: BofAML Global Research

Price objective basis & risk

PG&E Corporation (PCG)

Our \$49 price objective assumes a premium P/E of 12.75x 2012E earnings to account for above average growth and high quality earnings. Risks to our outlook are: 1) outstanding 2011 general rate case and 2) Any unforeseen changes to California regulation.

Link to Definitions

Energy

Click [here](#) for definitions of commonly used terms.

Analyst Certification

I, Steve Fleishman, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Electric Utilities/Competitive Power Coverage Cluster

Investment rating	Company	BofAML ticker	Bloomberg symbol	Analyst
BUY	American Water Works	AWK	AWK US	Steve Fleishman
	CMS Energy	CMS	CMS US	Steve Fleishman
	Entergy	ETR	ETR US	Steve Fleishman
	NextEra Energy	NEE	NEE US	Steve Fleishman
	Northeast Utilities	NU	NU US	Steve Fleishman
	PG&E Corporation	PCG	PCG US	Steve Fleishman
	PPL Corporation	PPL	PPL US	Steve Fleishman
	Progress Energy	PGN	PGN US	Steve Fleishman
	Public Service Enterprise Group Inc.	PEG	PEG US	Steve Fleishman
	TECO Energy	TE	TE US	Steve Fleishman
	Wisconsin Energy	WEC	WEC US	Alex Kania
NEUTRAL	Alliant Energy	LNT	LNT US	Steve Fleishman
	Calpine	CPN	CPN US	Ameet I. Thakkar
	Consolidated Edison	ED	ED US	Steve Fleishman
	Dominion Resources	D	D US	Steve Fleishman
	Edison International	EIX	EIX US	Steve Fleishman
	FirstEnergy	FE	FE US	Steve Fleishman
	NRG Energy	NRG	NRG US	Ameet I. Thakkar
	NSTAR	NST	NST US	Steve Fleishman
	Pinnacle West	PNW	PNW US	Steve Fleishman
	Portland General Electric Company	POR	POR US	Steve Fleishman
	RRI Energy	RRI	RRI US	Ameet I. Thakkar
	SCANA Corp.	SCG	SCG US	Steve Fleishman
	Xcel Energy	XEL	XEL US	Steve Fleishman
UNDERPERFORM	DPL Inc.	DPL	DPL US	Steve Fleishman
	DTE Energy	DTE	DTE US	Steve Fleishman
	Duke Energy	DUK	DUK US	Steve Fleishman
	Dynegy	DYN	DYN US	Ameet I. Thakkar
	Exelon	EXC	EXC US	Steve Fleishman
	Hawaiian Electric Industries	HE	HE US	Steve Fleishman
	NV Energy	NVE	NVE US	Steve Fleishman
	Southern Company	SO	SO US	Steve Fleishman

04 August 2010

***iQmethod*SM Measures Definitions**

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Other LT Liabilities}$	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

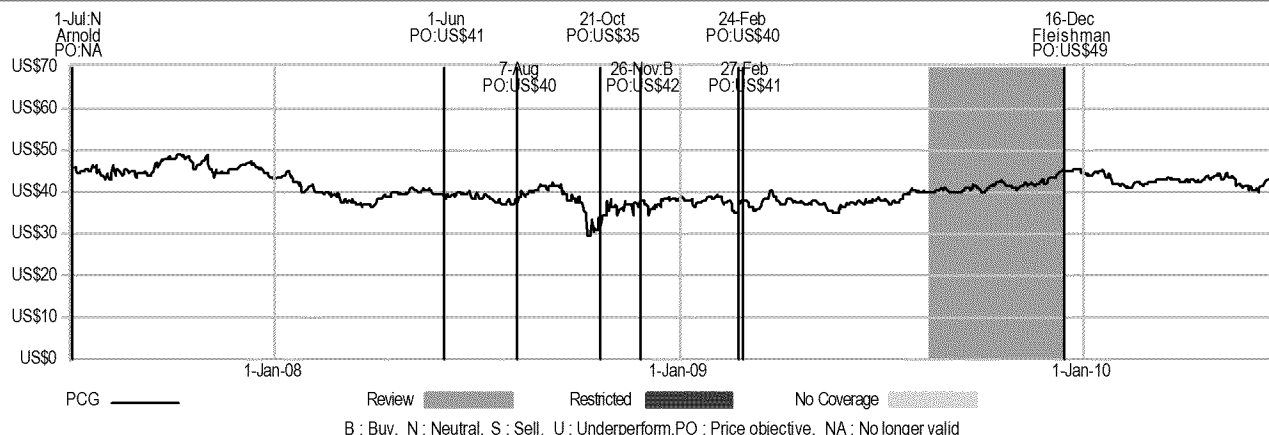
*iQmethod*SM is the set of BofA Merrill Lynch standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and valuations. The key features of *iQmethod* are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

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Important Disclosures

PCG Price Chart



Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of June 30, 2010 or such later date as indicated. BofAML price charts do not reflect analysts' coverage of the stock at prior firms. Historical price charts relating to companies covered as of December 31, 2008 by former Banc of America Securities LLC (BAS) analysts are available to BAS clients on the BAS website.

Investment Rating Distribution: Utilities Group (as of 01 Jul 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	74	42.77%	Buy	42	64.62%
Neutral	51	29.48%	Neutral	30	65.22%
Sell	48	27.75%	Sell	20	45.45%

Investment Rating Distribution: Global Group (as of 01 Jul 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1922	54.14%	Buy	1042	59.85%
Neutral	874	24.62%	Neutral	496	62.78%
Sell	754	21.24%	Sell	362	51.86%

* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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