PG&E Corporation

Pipeline costs could moderate 2011 earnings

Estimate Change **BUY**

Equity | United States | Electric Utilities
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Bank of America Merrill Lynch

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Ongoing San Bruno investigations could be headwind

PCG continues to face ongoing NTSB and CPUC investigations into the San Bruno pipeline disaster. While neither investigation has been conclusive, PCG has faced increased scrutiny on its record-keeping and ongoing pipeline operations. We believe PCG could see some additional one-time cost increases related to San Bruno in 2011, pressuring 2011 earnings.

Bonus depreciation (D&A) could lessen equity needs

We estimate PCG will see material cash benefits (up to ~$800M in 2011) from bonus D&A extension. Given this additional cash and the cancellation of the Manzana Wind project, we believe PCG may not need the majority of its $400M of external equity in 2011. We note, however, that the CPUC has a proposed resolution outstanding that would give back bonus D&A cash benefits to CA ratepayers immediately. If this is passed, we would expect a moderate increase in equity issuance for 2011, but likely less than $400M given the loss of Manzana.

Adjusting EPS for San Bruno costs in 2011, ROE in 2013

We have adjusted our estimates to reflect our estimate of San Bruno in 2011. Our new '11 estimate is $3.65 vs our prior estimate of $3.71. PCG narrowed its '11 guidance to $3.65-$3.80 from $3.65-$3.85 to reflect San Bruno costs and the GRC settlement in Nov. 2010. We also reduced our expected CPUC jurisdictional ROE for '13 to 10.85% from 11.35% given our expectation for a lower future ROE. Our new '11-'14 estimates are $3.65/$3.89/$3.95/$4.13 from $3.71/$3.91/$4.11.

Reiterate Buy, $50 price objective

PCG continues to trade at a discount to the large cap regulateds, despite its above-average 6-8% EPS growth rate. Our PO is based on an industry average of 12.5x 2013E earnings. Risks are liability related to the explosion, approval of the settlement, regulatory changes.

Stock Data

Price	US$46.21
Price Objective	US$50.00
Date Established	21-Oct-2010
Investment Opinion	A-1-7
Volatility Risk	LOW
52-Week Range	US$34.95-48.63
Mrkt Val / Shares Out (mn)	US$17,975 / 389.0
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%

Key Changes

(US$)	Previous	Current
2010E Rev (m)	15,212.0	14,425.9
2011E Rev (m)	15,655.0	14,810.0
2012E Rev (m)	16,221.4	15,337.1
2011E EPS	3.71	3.65
2012E EPS	3.91	3.89

Estimates (Dec)

(US$)	2008A	2009A	2010E	2011E	2012E
EPS	3.02	3.20	3.44	3.65	3.89
GAAP EPS	3.02	3.20	3.44	3.65	3.89
EPS Change (YoY)	8.6%	6.0%	7.5%	6.1%	6.6%
Consensus EPS (Bloomberg)			3.43	3.71	3.89
DPS	1.56	0	1.82	1.97	2.12

Valuation (Dec)

	2008A	2009A	2010E	2011E	2012E
P/E	15.3x	14.4x	13.4x	12.7x	11.9x
GAAP P/E	15.3x	14.4x	13.4x	12.7x	11.9x
Dividend Yield	3.4%	0%	3.9%	4.3%	4.6%
EV / EBITDA*	11.9x	10.9x	9.4x	9.1x	8.4x
Free Cash Flow Yield*	-4.9%	-5.1%	-1.9%	0.8%	1.4%

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

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.

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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%	4.9%	5.2%
Return on Equity	12.1%	12.5%	12.3%	12.1%	12.1%
Operating Margin	14.6%	17.7%	21.3%	21.9%	23.0%
Free Cash Flow	(879)	(919)	(345)	150	250

iQmethod SM – Quality of Earnings*

(US$ Millions)	2008A	2009A	2010E	2011E	2012E
Cash Realization Ratio	2.5x	2.5x	2.7x	2.9x	2.6x
Asset Replacement Ratio	2.2x	2.3x	2.3x	2.3x	2.1x
Tax Rate	28.2%	27.2%	39.4%	39.0%	39.0%
Net Debt-to-Equity Ratio	106.8%	109.7%	103.8%	105.9%	103.2%
Interest Cover	2.9x	3.4x	3.5x	3.6x	3.5x

Income Statement Data (Dec)

(US$ Millions)	2008A	2009A	2010E	2011E	2012E
Sales	14,628	13,399	14,426	14,810	15,337
% Change	10.5%	-8.4%	7.7%	2.7%	3.6%
Gross Profit	8,113	8,397	9,641	10,003	10,509
% Change	4.5%	3.5%	14.8%	3.8%	5.1%
EBITDA	3,791	4,118	4,791	4,957	5,340
% Change	-3.1%	8.6%	16.3%	3.5%	7.7%
Net Interest & Other Income	(634)	(672)	(872)	(895)	(985)
Net Income (Adjusted)	**1,081**	**1,234**	**1,336**	**1,435**	**1,556**
% Change	**7.5%**	**14.2%**	**8.3%**	**7.4%**	**8.4%**

Free Cash Flow Data (Dec)

(US$ Millions)	2008A	2009A	2010E	2011E	2012E
Net Income from Cont Operations (GAAP)	1,081	1,234	1,336	1,435	1,556
Depreciation & Amortization	1,651	1,752	1,712	1,709	1,805
Change in Working Capital	(739)	(814)	0	0	0
Deferred Taxation Charge	590	809	300	(100)	(50)
Other Adjustments, Net	166	58	206	1,104	773
Capital Expenditure	(3,628)	(3,958)	(3,900)	(3,999)	(3,834)
Free Cash Flow	**-879**	**-919**	**-345**	**150**	**250**
% Change	**-292.4%**	**-4.6%**	**62.4%**	**NM**	**66.9%**

Balance Sheet Data (Dec)

(US$ Millions)	2008A	2009A	2010E	2011E	2012E
Cash & Equivalents	1,509	1,160	1,271	560	538
Trade Receivables	2,436	2,280	2,280	2,280	2,280
Other Current Assets	2,458	2,217	2,397	1,697	1,347
Property, Plant & Equipment	26,261	28,892	30,694	32,580	34,185
Other Non-Current Assets	8,196	8,396	8,396	8,396	8,996
Total Assets	**40,860**	**42,945**	**45,037**	**45,512**	**47,346**
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	12,652	13,429
Other Non-Current Liabilities	13,071	14,339	14,639	14,539	14,489
Total Liabilities	**31,231**	**32,360**	**33,322**	**32,985**	**33,712**
Total Equity	**9,629**	**10,585**	**11,715**	**12,527**	**13,634**
Total Equity & Liabilities	**40,860**	**42,945**	**45,037**	**45,512**	**47,346**

* 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	2,267,767

Quarterly Earnings Estimates

	2009	2010
Q1	0.65A	0.79A
Q2	0.83A	0.91A
Q3	0.93A	1.02A
Q4	0.79A	0.72E

PCG earnings preview

We believe PCG could see some additional cost increases related to San Bruno, pressuring 2011 earnings. PCG is scheduled to report earnings on February 17, 2011 at 11:30am EST.

PCG continues to face ongoing NTSB and CPUC investigations into the San Bruno pipeline disaster. While neither investigation has been conclusive, PCG has faced increased scrutiny on its record-keeping and ongoing pipeline operations. We believe PCG could see some additional one-time cost increases related to San Bruno in 2011, pressuring 2011 earnings. PCG is scheduled to report earnings on February 17, 2011. It will hold its conference call at 11:30am EST.

San Bruno investigations

We have assumed some additional O&M costs in 2011, and our new 2011 estimate is $3.65, the low end of PCG's 2011 guidance range

San Bruno continues to be an overhang on PCG's regulatory and political relationships. Given some of the increased need for inspections of pipeline pressure, record-keeping and possible leak assesments under the CPUC and NTSB investigations, we are taking a more conservative approach on pipeline O&M. Thus, we have assumed some additional O&M costs in 2011, and our new 2011 estimate is $3.65, the low end of PCG's 2011 guidance range of $3.65-$3.80/sh.

GRC settlement still outstanding

We are still waiting for a proposed decision from the ALJ on PCG's Gas Storage & Transmission GRC and Electric & Gas GRC. There is a 30-day wait period post an ALJ decision before the CPUC can issue a final decision. We believe it is likely both settlements will be approved given the largely unanimous support of the settlement by major parties.

In addition, we believe it is likely that newly appointed Commissioner, Mike Florio, will recuse himself from the PCG GRC, given his involvement with them in his prior role as an attorney with TURN (a major intervenor).

Bonus D&A could lessen equity needs

We estimate PCG will see cash benefits from the bonus D&A extension. Given this additional cash and the cancellation of Manzana , we believe PCG may not need the majority of its $400M of external equity in 2011.

We expect PCG to benefit from bonus D&A in 2011 and 2012. We expect cash benefits of ~$800M in 2011 and ~$400M in 2012. PCG had previously announced that it would issue up to $400M in external equity in 2011 (starting in late 2010) under a DRIBBLE program to fund rate base and the Manzana Wind project. Given the cancellation of Manzana and the influx of bonus D&A, we expect PCG to fund its external equity needs through cash on hand.

We note, however, that the CPUC has a proposed resolution outstanding that would give back bonus D&A cash benefits to CA ratepayers immediately. If this is passed, we would expect a moderate increase in equity issuance for 2011, but likely less than the $400M given the loss of Manzana. This resolution is currently on the CPUC agenda for 2/24/2011.

Additionally, while bonus D&A does lower rate base through an increase in deferred taxes, this impact for PCG could be pushed out. Currently, PCG's rate base for the 2011-2013 timeframe is set through its GRC settlement. It is possible that PCG could not see the impact on rate base until its next GRC in 2014.

We believe there could be some downward ROE and equity layer pressure in 2013

ROE, capital structure could get cut

As part of the California regulatory construct, equity ratios and ROEs are decided outside of the GRC and are set for three year periods. California currently has higher ROEs than the national average. We believe there could be some downward pressure on this, and that these ROEs are likely to come down modestly when they are reviewed in 2012 to be effective in 2013.

That said, given the large renewable energy focus in California, and the 33% RPS, CA utilities generally have a large amount of PPAs. As rating agencies treat PPAs as debt, we believe relatively strong ROEs and equity ratios are necessary to avoid credit downgrades.

To be conservative, we are cutting our 2013 and forward CPUC jurisdictional ROE by 50bps to 10.85% from 11.35%. As a result in 2013, our earnings have come down to \$3.95 from our previous estimate of \$4.11/sh.

To be conservative, we are cutting our 2013 and forward CPUC jurisdictional ROE by 50bps to 10.85% from 11.35%. We did not reduce the FERC ROE, and maintain it at 12%. This gives a weighted average allowed ROE of ~11% down from PCG's current weighted average allowed ROE of 11.45%. As a result in 2013, our earnings have come down to \$3.95 from our previous estimate of \$4.11/sh.

As stated above, capital structure will also likely be reviewed in 2012 to be effective in 2013. PCG currently has a 52% equity ratio, above its peer CA utilities (SCE at 48%, SDG&E at 49%). While we do believe there is a possibility that PCG's equity layer is reduced, we expect that PCG will use the extra equity on hand to reduce future equity needs until its equity layer is lessened, or do a stock buyback.

Reducing PCG's equity ratio to 48% from the current 52% will impact our earnings by roughly \$0.07/sh

We have run sensitivities on our model. Under a case where we reduce PCG's equity ratio to 48% from the current 52%, it will impact our earnings by roughly \$0.07/sh, net of cash used for buybacks and debt paydown. This would not move our valuation meaningfully.

Valuation

We have updated our model to reflect a reduced ROE in 2013, and have taken our 2013 estimate to \$3.95/sh. We now value PCG on 2013 earnings to fully account for a new ROE. Our \$50 price objective is based on applying an industry average of 12.5x multiple to 2013E earnings. In other words, PCG stock is already reflecting an ROE cut at the current depressed valuations.

Our 2011-2014 estimates are now \$3.65, \$3.89, \$3.95, and \$4.05 per share

Model Updates

We have updated our 2011-2014 estimates for San Bruno and a potentially lower ROE post 2012. Our 2011-2014 estimates are now \$3.65, \$3.89, \$3.95, and \$4.05 per share. Our prior 2011-2013 estimates were \$3.71, \$3.91 and \$4.11 per share. Tables 1 and 2 highlight our financial summary and modeling assumptions for PCG. We made the following adjustments to our model:

- Assume \$50M (pre-tax) of one-time operational costs in 2011 related to San Bruno.
- Remove energy efficiency earnings from 2011-2014 estimates. We had previously estimated this at \$15M, or \$0.02/sh. While PCG was awarded ~\$40M in energy efficiency payments in 2010, we conservatively do not expect this to continue given the scrutiny under which the energy effiency programs are currently. PCG has included a range of \$0-\$30M in its 2011 guidance.

- Adjusted 2011 and 2012 cash flow for bonus depreciation. We conservatively model in $700M in cash in 2011 and $350M of cash in 2012. We believe this number could be as high as $800M in 2011 and $400M in 2012.
- Assume only $150M of equity in 2011 under PCG's DRIP. In addition we assume incremental equity needs of $250M/year from 2012-2014 to fund rate base growth and maintain a 52% equity ratio and ~49-50% consolidated equity ratio.
- We reduce our 2014 rate base by $1,050M, assuming a reset rate base due to bonus depreciation gains in 2011 and 2012.

Table 1: Financial Summary

Financial Summary	2010E	2011E	2012E	2013E	2014E
EPS	$3.44	$3.65	$3.89	$3.95	$4.05
Diluted Shares Outstanding	389	394	400	409	418
Dividends Per Share	$1.82	$1.97	$2.12	$2.29	$2.48
DividendYield	4.0%	4.3%	4.6%	5.0%	5.4%
Dividend Payout Ratio	53%	54%	55%	58%	61%
Equity Ratio	49%	49%	49%	50%	50%
FFO/Net Debt	29%	32%	29%	23%	23%
Valuation Metrics					
P/E	13.4x	12.6x	11.8x	11.6x	11.3x
Price/Book	1.5x	1.4x	1.3x	1.3x	1.2x
Segment EPS					
Utility	$3.51	$3.65	$3.89	$3.95	$4.05
Parent	(0.01)	(0.00)	(0.00)	0.00	0.01
Total EPS	**$3.50**	**$3.65**	**$3.89**	**$3.95**	**$4.05**
Utility					
Realized ROE	11.6%	11.5%	11.5%	11.0%	11.0%
Average Rate Base	$22,030	$24,119	$26,053	$28,084	$29,436

Source: BofA Merrill Lynch Global Research

Table 2: Modeling Assumptions

Assumptions	2010E	2011E	2012E	2013E	2014E
Total Capital Spending by Segment ($M)					
Electric Distribution	$1,300	$1,550	$1,550	$1,550	$1,550
Generation	750	375	375	375	375
Common Plant	265	350	350	350	350
Electric Transmission	800	950	950	950	950
Gas Transmission	250	200	200	200	200
AMI & Other	535	165	0	0	0
Total Capex	**$3,900**	**$3,590**	**$3,425**	**$3,425**	**$3,425**
Financings ($M)					
Total Equity Issued/(Repurchased)	$502	$150	$400	$400	$400
Total Debt Issued/(Repurchased)	1,048	800	1,200	900	900
Sales Forecast					
Electric Customer Growth	0.0%	0.0%	0.0%	0.0%	0.0%
Gas Customer Growth	1.8%	1.8%	1.8%	1.8%	1.8%

Source: BofA Merrill Lynch Global Research

Price objective basis & risk

PG&E Corporation (PCG)

Our $50 price objective assumes an average P/E of 12.5x 2013E earnings, in line with the regulated utility average. Risks to our outlook are: 1) approval of the settlement in the 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	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
BUY				
	American Water Works	AWK	AWK US	Steve Fleishman
	CenterPoint Energy, Inc.	CNP	CNP US	Steve Fleishman
	GenOn Energy, Inc.	GEN	GEN US	Ameet I. Thakkar
	NextEra Energy	NEE	NEE US	Steve Fleishman
	NV Energy	NVE	NVE US	Steve Fleishman
	PG&E Corporation	PCG	PCG US	Steve Fleishman
	Public Service Enterprise Group Inc.	PEG	PEG US	Steve Fleishman
	Southern Company	SO	SO US	Steve Fleishman
	Westar Energy	WR	WR US	Steve Fleishman
	Wisconsin Energy	WEC	WEC US	Alex Kania
	Xcel Energy	XEL	XEL US	Steve Fleishman
NEUTRAL				
	Alliant Energy	LNT	LNT US	Steve Fleishman
	American Electric Power	AEP	AEP US	Steve Fleishman
	Calpine	CPN	CPN US	Ameet I. Thakkar
	CMS Energy	CMS	CMS US	Steve Fleishman
	Consolidated Edison	ED	ED US	Steve Fleishman
	Constellation Energy Group	CEG	CEG US	Ameet I. Thakkar
	Dominion Resources	D	D US	Steve Fleishman
	Edison International	EIX	EIX US	Steve Fleishman
	Entergy	ETR	ETR US	Steve Fleishman
	Northeast Utilities	NU	NU 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
	PPL Corporation	PPL	PPL US	Steve Fleishman
	SCANA Corp.	SCG	SCG US	Steve Fleishman
	TECO Energy	TE	TE US	Steve Fleishman
	UIL Holdings	UIL	UIL US	Steve Fleishman

US - Electric Utilities/Competitive Power Coverage Cluster

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
UNDERPERFORM				
	Ameren Corp	AEE	AEE US	Steve Fleishman
	DPL Inc.	DPL	DPL US	Steve Fleishman
	DTE Energy	DTE	DTE US	Steve Fleishman
	Duke Energy	DUK	DUK US	Steve Fleishman
	Exelon	EXC	EXC US	Steve Fleishman
	FirstEnergy	FE	FE US	Steve Fleishman
	Hawaiian Electric Industries	HE	HE US	Steve Fleishman

*iQmethod*SM Measures Definitions

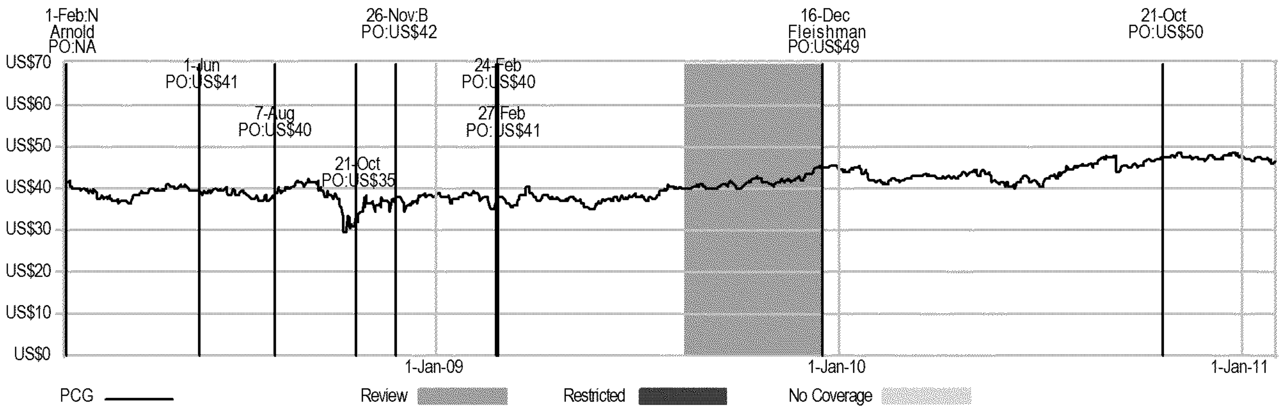
Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating 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	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + 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 validations. 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.

iQdatabase® is our real-time global research database that is sourced directly from our equity analysts' earnings models and includes forecasted as well as historical data for income statements, balance sheets, and cash flow statements for companies covered by BofA Merrill Lynch.

Important Disclosures

PCG Price Chart



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

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 January 31, 2011 or such later date as indicated.

Investment Rating Distribution: Utilities Group (as of 01 Jan 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	74	39.57%	Buy	30	46.15%
Neutral	56	29.95%	Neutral	33	63.46%
Sell	57	30.48%	Sell	17	33.33%

Investment Rating Distribution: Global Group (as of 01 Jan 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	2011	53.86%	Buy	874	48.31%
Neutral	925	24.77%	Neutral	444	52.30%
Sell	798	21.37%	Sell	276	36.75%

* Companies in respect of which BofA Merrill Lynch or one of its affiliates 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*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

* Ratings dispersions may vary from time to time where BofA Merrill Lynch Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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