

ATTACHMENT B

Equities

31 January 2012 | 7 pages

PG&E Corp (PCG)

Alert: Commission Staff Throws A Curveball First Pitch

On 1/27/12 CPUC Staff, under Resolution ALJ-274, levied a \$16.8 million fine on PG&E for failed pipeline leak surveys under a new citation program. The program was adopted on 12/1/11 and is the first such fine to be levied. This fine is procedurally separate from the three OILs discussed in our prior PCG notes. Under the new program (see http://docs.cpuc.ca.gov/word_pdf/FINAL_RESOLUTION/154782.pdf), violations by gas utilities can be assessed a penalty by CPUC Staff - more specifically, the Consumer Protection & Safety Division (CPSD). The program is meant to streamline the Order Instituting Investigation process for less severe/complex violations. PG&E has ten days to appeal the CPSD fine to an administrative law judge. If appealed, the ALJ then must reach a proposed decision within 60 days and the CPUC must place the ALJ's draft resolution on the first available agenda. Notably, the penalty is assessed on a "per violation" basis and Staff can define the frequency (per day/week/month) of what "per violation" means. Future penalty sizes will be based on penalty legislation found at http://www.leginfo.ca.gov/pub/11-12/bill/sen/sb_0851-0900/sb_879_bill_20111007_chaptered.pdf of either \$20,000/violation (retroactively) or \$50,000/violation (post 12/31/11).

In our view, the fine sets a negative regulatory precedent if ultimately adopted as-is by the CPUC. In the 12/1/11 resolution the CPUC agreed Staff should consider waived or reduced fines in cases of violations that are self-identified and self-corrected (as was the case in this instance). Yet, the magnitude of the Staff's recommended fine is high (we believe in the top 5 utility penalties in state history), and suggests Staff may be overly exuberant in its newfound authority. If the new fast-tracking citation program means record-level fine assessments for each violation, we would likely heavily consider a valuation discount for future gas pipeline infrastructure investment to reflect unforeseen heavy-handed penalties in the future, particularly in a San Bruno-charged environment.

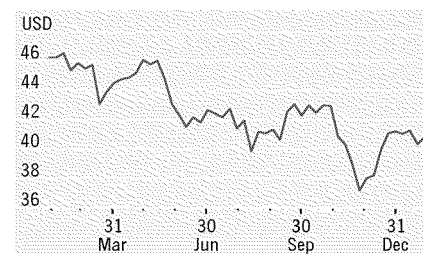
Next steps: We expect an appeal, and ultimately a CPUC decision or settlement.

In reaction to the fine, PG&E released a 1/27/12 statement indicating disappointment given the violation was a self-reported one and self-corrected; this signals an appeal is likely. We would not be surprised if additional violations were to arise near term under the program given PG&E is slated to report additional findings from its Gas & Electric Mapping System database review. Ironically, we believe the CPUC will ultimately have to adjudicate most penalties in this program if Staff remains overly exuberant, resulting in a cumbersome adjudication process – the very situation the program was intended to circumvent. For now, we are not changing our valuation on PCG shares, but future developments in this case could prompt us to revisit our California gas infrastructure stance.

Company Update

Buy	1
Price (30 Jan 12)	US\$40.40
Target price	US\$47.00
Expected share price return	16.3%
Expected dividend yield	4.6%
Expected total return	20.9%
Market Cap	US\$16,398M

Price Performance (RIC: PCG.N, BB: PCG US)



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PG&E Corp

Valuation

Our \$47/share target price is calculated by applying our 13.3x target multiple to our \$3.54/share earnings estimate for 2014.

We use a discounted 13.3x multiple on 2014 operating earnings to value PCG shares. Our PCG specific multiple is derived by first calculating the average electric utility multiple, which is based on our long term regression analysis between BBB bond yields and utility P/E multiples. This calculation results in a 15.0x average utility multiple based on yield expectations for 2014. We then apply a 1.0x, or 7% discount for PG&E to reflect risks and uncertainties associated with the resolution of San Bruno related items (the ongoing order instituting investigation (OII) and ruling on the PSEP). Finally, we discount this forward 14.0x multiple by one year to arrive at our 13.3x target multiple for PCG.

Risks

Risks to our target price include the following:

Growth in capital spending: Long-term spending on capital growth projects are contingent on approval of new projects by the CPUC. If the company fails to receive regulatory approval for increases in capital expenditures or fails to receive them in a timely manner, earnings trajectory may differ from our projection.

The future political and regulatory impact from the San Bruno accident & investigation carries a risk not only in financial penalties and fines, but more importantly, potentially damaging the standing of the company, in front of the CPUC and other statewide stakeholders. This is a risk that we are continually monitoring.

If any of these risk factors has a greater downside impact than we anticipate, the share price will likely have difficulty attaining our target price.

Appendix A-1

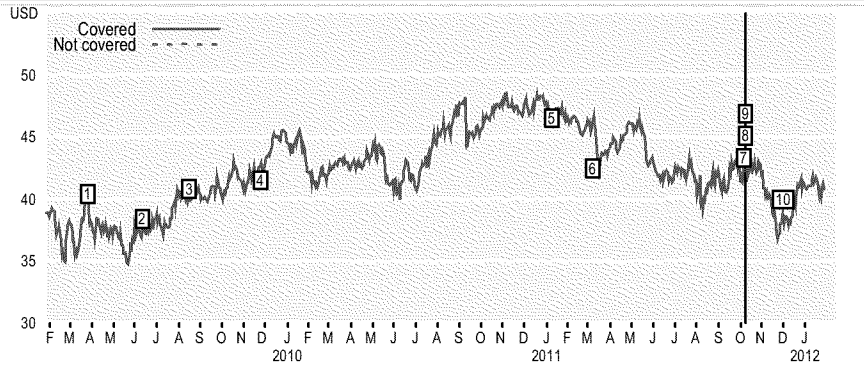
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PG&E Corp (PCG)
Ratings and Target Price History
Fundamental Research

Analyst: Brian Chin



	Date	Rating	Target Price	Closing Price
1	26-Mar-09	*2L	42.50	40.41
2	11-Jun-09	*1L	*43.20	37.76
3	17-Aug-09	1L	*48.00	39.98
4	25-Nov-09	1L	*50.00	42.94

	Date	Rating	Target Price	Closing Price
5	10-Jan-11	*2L	*48.00	46.52
6	8-Mar-11	2L	*46.00	46.27
7	6-Oct-11	*1L	*48.00	42.99
8	8-Oct-11	Stock rating system changed		

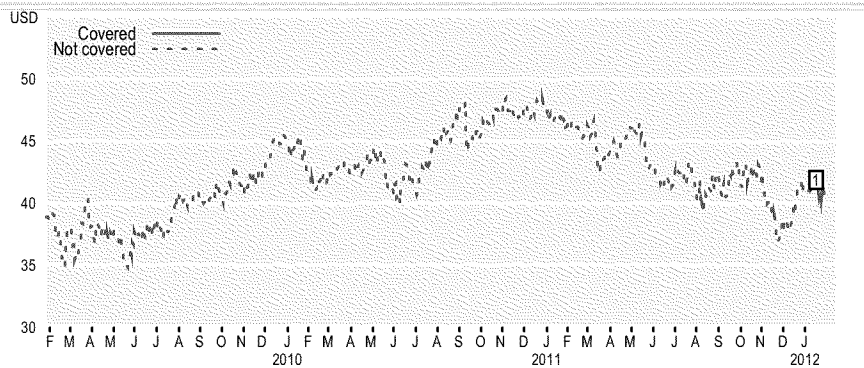
	Date	Rating	Target Price	Closing Price
9	8-Oct-11	*1	48.00	42.97
10	1-Dec-11	1	*47.00	38.52

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

PG&E Corp (PCG)
Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Brian Chin



	Date	Rating	Target Price	Closing Price
1	17-Jan-12	*ADD MP	-	41.74

* Indicates change

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Data current as of 31 Dec 2011

12 Month Rating			Relative Rating		
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