From: Stephen Byrd
Sent: 10/15/2012 2:15:16 AM
To: Togneri, Gabriel (/O=PG&E/OU=CORPORATE/CN=RECIPIENTS/CN=GBT1)
Cc:
Bcc:
Subject: PG&E Corp(PCG.N): Harsh Treatment in Pipeline Safety Proposed Decision

OCTOBER 15, 2012 GMT

PG&E Corp (PCG.N)

Morgan Stanley Research
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PG&E Corp
Stock Rating: Equal-weight
Share Price: USD 42.50
Target Price: USD 48.00

Market Cap (mm): USD 18,189

Industry View: Attractive

Harsh Treatment in Pipeline Safety Proposed Decision

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Friday's Proposed Decision on pipeline safety cost recovery was harsher than expected. If approved, it may lead to weaker EPS and additional equity needs, potentially lowering the relative valuation discount. Accordingly, we remain comfortable with our EW-rating and prefer OW-rated EIX and SRE.

The Proposed Decision (PD) filed by the California Commission late Friday cut return levels on capital items by almost half and reduced expense recovery in all years for the pipeline safety plan PG&E filed following an explosion in the city of San Bruno. The PD reflected: 1) Reduced ROE levels on capital outlays associated with the plan to 6.05% for 5 years; 2) An authorized spending plan of ~$1bn through 2014 despite a request of ~$1.4bn that may still be needed; 3) Operating expense recovery on about a quarter of the original request (~$1.1bn) versus the 50% PCG offered. We broadly assumed a full return level on the filed amount and modestly higher expense recovery.

The potential impact to estimates and equity is meaningful. In aggregate, the Commission is providing the company 36% of its requested revenue requirement increase. In terms of the impact to EPS, we estimate that in each 2013 and 2014 the negative effect is ~$0.15 per share. In addition, net of tax benefits we estimate equity needs as a result of this decision to likely be higher by $200-300mn based on unrecovered costs.

Despite upside to our PT, we remain comfortable with our Equal-weight rating. Although San Bruno issues are close to being resolved, we believe the upcoming rate case uncertainty and considerable equity needs (~$1bn per year) may limit upside. In addition, we believe there is downside potential to consensus estimates, which are not fully factoring in equity needs, under-earning from the prior rate agreement, and the recent Proposed Decision. Our valuation is based on 2014 EPS but we now note that there may be downward pressure given these recent developments.

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