Financial Analysis of PG&E Corporation

Submitted to:

California Public Utilities Commission
Consumer Protection and Safety Division

Submitted by:

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Background

PG&E Corporation ("PCG", or "the company") operates primarily through its regulated utility subsidiary Pacific Gas & Electric ("PG&E"). PG&E provides both electric and gas transmission and distribution services to roughly 5.1 million electric and 4.3 million gas customers in central and northern California.[1]

On September 9, 2010 a PG&E gas transmission pipeline ruptured in San Bruno, California killing eight people and destroying dozens of homes. While personally tragic to the families affected and the city of San Bruno, this accident also had an immediate financial impact on PCG's stock price dropping it from a closing price of $48.24 on September 9, 2010 to $44.21 on September 10, 2010, a decline of 8.35%.

Subsequent to this explosion, the California Public Utilities Commission's ("CPUC") opened numerous dockets to investigate the San Bruno incident and pipeline safety in California. It is our understanding that there are currently three open penalty proceedings under evaluation:

- I.12-01-007 - Order Instituting Investigation into PG&E's Operations and Practices in Connection with the San Bruno Explosion and Fire;
- I.11-02-016 - Gas Transmission System Records Order Instituting Investigation;
- I.11-11-009 - Class Location Designation Order Instituting Investigation.

The company's senior management has consistently stated that it plans to fund potential fines by issuing equity. As such, we have primarily focused our analysis on the company's ability to raise capital through the equity markets.[2]

Purpose of Analysis

This document contains the results of a financial analysis of PCG performed by Overland Consulting ("Overland") on behalf of the CPUC's Consumer Protection and Safety Division ("CPSD").[3]

In this report, we have provided the CPSD Staff with an objective examination, of PCG's financial health, as well as our estimate of its ability to raise equity capital sufficient to fund a CPUC imposed fine. While this analysis was conducted by Overland, it was based largely on the company's own financial projections. This analysis is organized as follows:

1. Overview of PCG's Financial Condition;
2. PCG's ability to raise equity capital;
3. Impact of penalty structure;
4. Conclusion.

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[1] Response to OC-359, Att. 201.

[2] While not the main focus of this analysis, we realize another area of concern for CPSD Staff is the company's proposed Pipeline Safety Enhancement Plan ("PSEP"). We have included a section on the potential financial impacts of recoverable/nonrecoverable costs.

[3] Although Pacific Gas & Electric is the utility subsidiary regulated by the CPUC, we mainly focused on the holding company, PCG, in our analysis because the financial strength of the holding company ultimately determines the amount of capital that can be raised.

Overview of PCG's Financial Condition

Comparable Company Analysis

In an effort to evaluate PCG's current financial position we evaluated PCG relative to 49 electric and 11 natural gas companies based on multiple valuation and financial metrics.[4] The results of this analysis are summarized below, and the full analysis is provided as Attachments 1 and 2 of this report.

Forward Price to Earnings and Price to Book Ratios:

- These are relative valuation metrics that evaluate a company's stock price relative to a measure of company value. A high relative valuation multiple indicates that the stock may be overvalued, while a low multiple indicates that the stock may be underpriced. As seen in Attachments 1 and 2, PCG's P/E ratio is 14.31 which is comparable to the industry median of 14.27 for electric and 14.76 for natural gas peers. The company's price to book ratio of 1.5 is also similar to the industry average for electric and gas companies of 1.54 and 1.64, respectively.

Debt to Equity and Current Ratios:

- These ratios evaluate the strength of a company's balance sheet. Specifically, debt to equity is a measurement of a firm's capital structure. A larger number indicates additional leverage, and, consequently more financial risk. PCG's current ratio of .84 was lower than its electric peers at .99, but nearly the same as the comparable natural gas companies at .89. The current ratio measures a company's current assets relative to its current liabilities. PCG's Debt to Equity ratio of 1.14 is in line with its electric and natural gas peers.

Dividend Yield

- The dividend yield ratio is calculated as the annual dividends per share of a company divided by its share price. This is essentially the cash component of the return on investment to a shareholder on a share of stock. As seen in our comparable company analysis, PCG's dividend yield of 4.1% is slightly higher than the median of its natural gas peers (3.8%) and roughly the same as the median of its electric company peers (4.2%)

Overall, our comparable company analysis indicated that PCG's growth prospects (as measured by the relative valuation metrics) and its current financial position are not significantly different than its peers in the electric and natural gas industries.

[4] The peer group Overland used is comprised of the electric and natural gas companies included in the 2011/2012 ValueLine investment survey.

Credit Rating Summary

As seen in the chart below, PCG currently has credit ratings above investment grade with stable outlooks from the two major rating agencies. These firms also note the risks that could lead to a potential downgrade. These concerns are largely focused on arriving at a constructive conclusion to the San Bruno incident and the company's efforts to regain credibility with its customers and regulators. It should be noted that while PCG's corporate and senior unsecured ratings are currently investment grade, its senior unsecured debt is the lowest possible investment grade rating (BBB-), as rated by S&P.

Table 1 – Credit Ratings

PCG Credit Rating Summary		
Description	Moody's	S&P
Corporate Credit Rating	Baa1	BBB
Senior Unsecured Debt	Baa1	BBB-
Outlook	Stable	Stable
Credit Strengths	*The stable rating outlook for PG&E and PCG reflects the expected predictability of cash flows over the next several years due to the credit supportive mechanisms currently in place with the California regulatory compact that reduces cash flow volatility. *PG&E's August 26th filing of a $2.2 billion Pipeline Safety Enhancement Plan (PSEP) incorporates 50% sharing of operating expense recovery among customers and shareholders. *The stable rating outlook also factors in the company's continued efforts to finance negative free cash flow with meaningful amounts of common equity sufficient equity to maintain a 52% equity ratio at the utility, which helps support overall credit quality.	* Supportive regulatory mechanisms approved by the CPUC that allow utility Pacific Gas and Electric Co. timely and certain recovery of costs. *An absence of any significant unregulated energy operations. *A large, economically diverse service territory that serves 5.2 million retail electric customers and 4.3 million natural gas distribution customers in northern California. *Decoupling mechanisms that have limited the utility's exposure to lost profits caused by lower electric and gas sales due to weak economic indicators.
Credit Risks	*The rating of PG&E and PCG could be downgraded if the company's credibility issues reach the point where the current regulatory compact is altered such there is meaningful cost recovery leakage over an multi-year period.	*The company has incurred substantial out-of-pocket costs, and may be subject to large fines and penalties for deficiencies in its gas transmission operations associated with the San Bruno accident. *The management team faces, in our view, a long-term process of rebuilding regulatory and customer credibility.
Source: Response to OC-350, Att. 4 and 8.		

The threat of a rating downgrade as a result of CPUC sanctions is unlikely within a large range of potential penalties (as discussed below) because the company's senior management has committed to issuing equity for these costs.[5] Credit rating agencies are solely focused on assessing the company's ability to make required debt payments (and sometimes preferred stock dividends). Therefore, from the perspective of the rating agencies, equity issuances are generally viewed positively because they increase capital available to the company without increasing the company's fixed debt obligations. S&P affirmed this view in its December 15, 2011 ratings report, stating: **[BEGIN CONFIDENTIAL]**

[5]**[BEGIN CONFIDENTIAL]**

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Potential Financial Impact of Pipeline Safety Enhancement Plan

Near the end of calendar year 2011 and the beginning of 2012, PCG developed forecasts that projected company financial results for two years through 2013. These results are presented below. The first table presents the projected financial results that were provided to PCG's board of directors in December 2011.

Table 2 – Financial Forecast assuming full PSEP recovery

[BEGIN CONFIDENTIAL]

Financial Forecast (assuming full PSEP recovery) Developed in December 2011		
	2012	2013
EPS from operations		
Earnings from operations		
Items impacting comparability earnings		
Earnings on a GAAP basis		
Average shares outstanding (millions)		
Dividends per share		
Common stock dividend payout		
Common stock issued		
Equity free cash flow		
Cash flow from operations		
Source: OC-357, Att. 1.		

These forecasts assumed full recovery in 2012-2013 of the projected PSEP costs seen in the next table.

Table 3 – PSEP Forecast Costs

PSEP Forecast Costs Assumed in the December 2011 Financial Forecasts				
	Expense		Capital	
	2012	2013	2012	2013
Hydrotesting				
MAOP Phase II & GTAM				
Valve Automation				
In Line Inspection				
Interim Safety				
PMO				
Contingency & Other				
Pipeline Replacement				
Gas Transmission Asset Management				
Total				
Source: OC-357, Att. 1.				

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Table 4 – Financial Forecast - assuming partial PSEP recovery

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Financial Forecast (assuming partial PSEP recovery) Revised in January 2012		
	2012	2013
EPS from operations		
Earnings from operations		
Items impacting comparability earnings		
Earnings on a GAAP basis		
Average shares outstanding (millions)		
Dividends per share		
Common stock dividend payout		
Common stock issued		
Equity free cash flow		
Cash flow from operations		
Source: OC-357, Att. 1.		

Table 5 – PSEP Forecast Costs

PSEP Forecast Costs Revised in January 2012				
	Expense		Capital	
	2012(1)	2013	2012	2013
Hydrotesting				
MAOP Phase II & GTAM				
Valve Automation				
In Line Inspection				
Interim Safety				
PMO				
Contingency & Other				
Pipeline Replacement				
Gas Transmission Asset Management				
Total				
Note1: Red font indicates items not assumed for recovery.				
Source: OC-357, Att. 1.				

[6] **[BEGIN CONFIDENTIAL]**
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While the purpose of our analysis is not to make qualitative judgments regarding whether, and the extent to which PSEP costs should be deemed recoverable by the CPUC, we note that the rating agencies have made clear that they expect **[BEGIN CONFIDENTIAL]**

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Third Party Litigation

In addition to the potential CPUC fines/penalties, PCG has also been the subject of third-party liability claims for personal injury and property damage. Some of these lawsuits have settled, while some are still pending. Overland did not separately analyze the potential impacts of third party litigation brought against PCG because we do not believe this pending litigation materially impacts our analysis. Through its various insurance policies, PCG has nearly one billion dollars of liability insurance coverage with a ten million dollar deductible.[10] The upper range for third party liabilities, as estimated by the company, is $600 million.[11]

PCG's Ability to Raise Capital

Estimate of Available Equity Capital Through Dividend Retention

The company has regularly stated to equity analysts that it plans to issue additional equity to fund fines imposed by the CPUC. We believe the decision to utilize equity capital to fund these penalties is a prudent decision by the company, as it maintains the company's current capital structure without

[7] Free cash flow to equity is generally calculated as: Free cash flow to equity = Cash flow from operations – Capital expenditures + Net borrowings.

[8] Response to OC-350, Att. 4.

[9] Response to OC-350, Att. 8.

[10] Response to OC-350, Att. 21.

[11] Obtained from: http://seekingalpha.com/article/551581-pg-e-s-ceo-discusses-q1-2012-results-earnings-call-transcript

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adding leverage that would increase the company's perceived financial risk. However, the company's remarks regarding the need to issue additional equity to fund these penalties is misleading. As Kent Harvey, PCG Chief Financial Officer, stated on PCG's 2011 fourth quarter earnings call when referring to the impact of CPUC penalties, "As we've indicated, our plans are to maintain a balanced capital structure consistent with our authorized capital structure. And that does require that we issue additional equity..." (emphasis added)[12]

Another alternative to raise capital available to the company is through internal equity, namely by reducing or temporarily eliminating its cash dividend to common stockholders. Dividends are paid from retained earnings, an owners' equity balance sheet account. Any cash retained from not paying out dividends would have the same effect (i.e. increasing equity and cash) that is achieved through issuing additional shares. This alternative has the added benefit of being the lowest cost option to raise capital, as the flotation costs incurred when issuing additional common shares (e.g. banker fees, registration fees) are avoided.

Using the company's conservative earnings assumptions regarding recovery of PSEP costs (Table 4 above), the company is projecting a total cash outflow of **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** in 2012 to pay dividends to its common shareholders.[13] This level of dividend represents a **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** dividend payout ratio.[14]

Theoretically, the company could temporarily cease paying a dividend in order to fund any penalties imposed by regulators. A less severe, though effective, option is to reduce the dividend amount to a seemingly more appropriate level, given the company's capital needs. As discussed in more detail below, the company's dividend policy targets a payout ratio of 50% to 70%, so the projected 2012 payout ratio of **[BEGIN CONFIDENTIAL]**

[END CONFIDENTIAL] In fact, by simply reducing the dividend payout ratio from **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** the company would decrease the 2012 cash outflow related to its dividends from **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** a saving of ███ million.[15] Using the same logic, we estimate the savings of reducing the 2013 dividend payout ratio to ███ would reduce the company's 2013 cash payout for dividends by ███ million, from **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]**

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[12] Obtained from: http://seekingalpha.com/article/372751-pg-e-s-ceo-discusses-q4-2011-results-earnings-call-transcript.

[13] **[BEGIN CONFIDENTIAL]**
[END CONFIDENTIAL]

[14] Dividend payout ratio is calculated as dividends divided by earnings from operations.

[15] **[BEGIN CONFIDENTIAL]**

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It should be noted that these are highly conservative estimates of internally available equity capital as we used the company's lower earnings estimates and we also assumed that the company stayed within the "target range" of its current dividend payout policy.

While we believe reducing the cash dividend is a viable option for the company to raise (i.e. retain) significant amounts of equity capital, we also acknowledge it appears to be the company's strong preference to obtain its funding from external equity issuances. The analysis provided below provides our estimate of the company's ability to raise external equity capital.

Relative Stock Price Performance

As seen in the charts below, over the time period from September 9, 2010 to April 30, 2012, PCG's stock price has continued to underperform its market peers as well as the overall stock market. PCG's stock price has dropped 8.42% ($48.24 on September 9, 2010; $44.18 on April 30, 2012). During the same time period the S&P 500 Index rose over 26% and the Dow Jones Utility Index increased approximately 18%.

Table 6 –Stock Price Performance

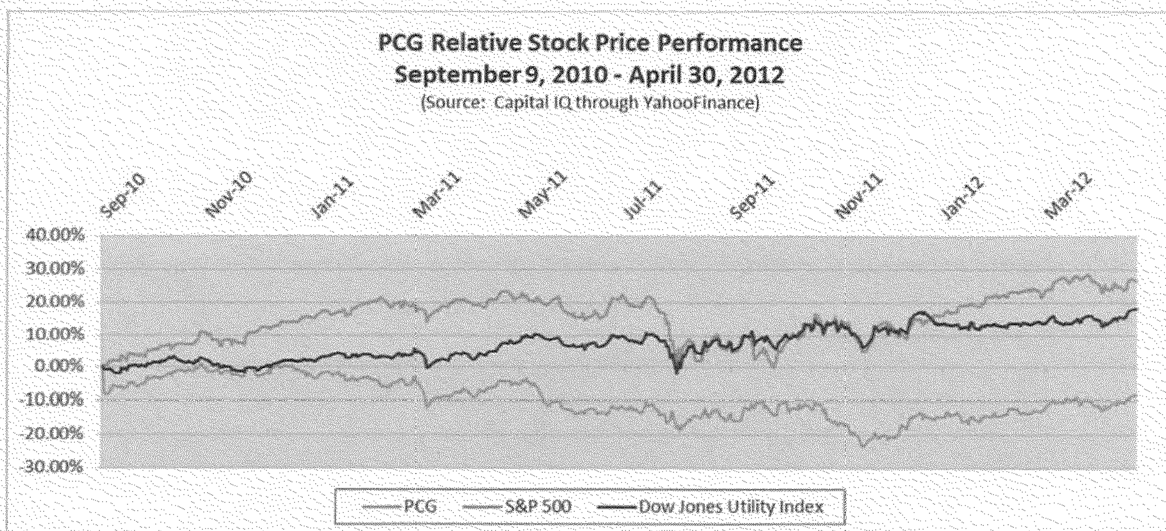

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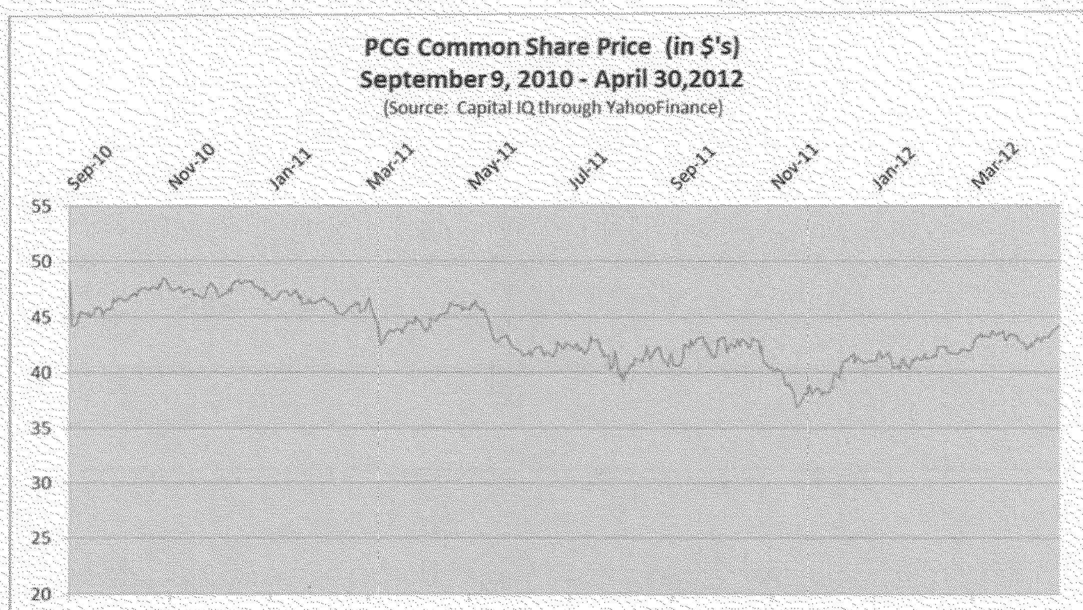
Table 7 –Share Price



It is our opinion that the primary reasons for PCG's underperformance since the time of San Bruno are the regulatory and financial uncertainties surrounding the San Bruno accident. While at first glance this would appear to support the company's position that raising additional equity capital will be difficult, this is not necessarily true.

Finance theory assumes that the value of equity investments are based on the present value of the stock's future cash flows.[18] When a major event occurs that could materially impact the company's future cash flows, the market adjusts the value of the stock based on its expectations of the consequences of this event on the company's future cash flows. Therefore, the impact of a fine on PCG would negatively impact PCG's stock price if that fine exceeded what the market is currently pricing into the stock. [REDACTED] noted in its December 14, 2011 report on PCG: **[BEGIN CONFIDENTIAL]**

[END CONFIDENTIAL](emphasis in the original) In its evaluation, [REDACTED] projected that a **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** would actually be levied on PCG. The range of fines estimated by PCG's equity analysts (including [REDACTED]) are listed in the chart below.

[18] Intrinsic value is not the same as price. Intrinsic value is the sum of all future cash flows of the security, discounted to present value. Price is what the stock is currently trading at on the market. Thus, "intrinsic value" could be thought of as the "justified price" of a stock. In an efficient market, the "value" and the "price" of a share of stock are assumed to be equal.

[19] Response to OC-359, Att. 195.

Table 8 -Estimate of Potential Fines

[BEGIN CONFIDENTIAL]

Analysts Reports	As of	Est. Fine ($MM)
BAML	3/12/2012	
JP Morgan	11/21/2011	
Goldman Sachs	2/21/2012	
Caris	3/13/2012	
ISI	2/16/2012	
Jefferies	2/17/2012	
Mean		
Median		
Source: OC 359		

[END CONFIDENTIAL]

Although counterintuitive, a CPUC imposed fine could actually make it easier for PCG to raise equity capital if that fine was below market expectations. In fact, all of the equity analyst reports we reviewed have either a **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** rating on the stock, indicating the analysts believe the market is **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]**

Table 9 -Equity Analyst Recommendations

[BEGIN CONFIDENTIAL]

Firm	Recommendation
RBC capital market	
Jefferies	
J.P. Morgan	
FBR	
Macquarie	
BAML	
Deutsche Bank	
UBS	
Citi	
ISI	
Goldman Sachs	
Credit Suisse	
Hold	
Buy	
Source:OC 359	

[END CONFIDENTIAL]

Estimate of Available Equity Capital Through Equity Issuance

It is important to note that our analysis reflects the impact of *incremental* equity issued by PCG. This is equity beyond the amount already embedded in PCG's forecasts. For the forecast period used in our analysis below, PCG was planning to issue $600 million in additional equity in 2012, including $300 million to fund gas-related penalties and unrecoverable pipeline related work.[20] This essentially means that PCG has already raised (or plans to raise during the course of 2012) $300 million to cover fines/disallowances imposed by the CPUC. Any penalties imposed at or below $300 million would presumably not require any additional funding, nor would it impact the company's earnings forecasts.

In order to evaluate the impact of raising incremental equity on PCG, we estimated the number of additional shares that would need to be issued to fund these equity issuances, and we also calculated the change in the company's price to book ratio and dividend payout ratio. We then used these ratios to estimate a maximum, or "threshold," level of available equity. Specifically, we sought to determine the level of equity that could be raised that would allow the company to maintain a premium of market value above its book equity value and allow the company to remain compliant with its dividend policy (which targets a payout ratio between 50 and 70 percent).[21] For purposes of this analysis, we assumed that dividends remained at the**[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** per share level currently projected by the company.

Also, as part of this analysis it is important to note that we assumed a direct linear relationship between the percentage of PCG's total market capital being sold and the company's stock price. This is generally a reasonable and logical assumption.[22] In the case of PCG this was a conservative estimate of the incremental equity that PCG could raise because the dilution impact on PCG's share price for forecasted equity issuances is already largely implicit in PCG's stock price. Stated another way, an announcement by PCG that it plans to issue $600 million worth of equity in 2012 would dilute PCG's stock price, even before the additional shares are actually issued.

Using the company's payout ratio and price to book ratio as a guide, we calculated a "Threshold level" amount of $2,250 million of equity capital that could be raised by the company.[23] Under this level of

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[20] Discussed by PCG CFO Kent Harvey on PCG's February 16, 2012 earnings call. Obtained from: http://seekingalpha.com/article/372751-pg-e-s-ceo-discusses-q4-2011-results-earnings-call-transcript.

[21] Corporate dividend policy is a well-established corporate governance practice that generally must be approved by a company's board of directors. It is instituted to provide assurance that reasonable dividend practices are being followed. In general, "reasonable" dividend policy implies that dividends are being distributed from earnings at a level that provides an adequate return to shareholders but also allows the company to retain some reasonable percentage of its earnings.

[22] For example, if a company with one share worth $100 issued one additional share, the two shares would be assumed to equal $50 each.

[23] While we use the term "threshold" we do not want to imply a false level of precision. The actual level of equity that the company could issue might be materially different than this amount. However, based on the information provided by the company we believe this amount is a reasonable estimate of external equity available

incremental equity, PCG's payout ratio would move from a base case of **[BEGIN CONFIDENTIAL] [END CONFIDENTIAL]** percent to a ██ percent dividend payout ratio,[24] and from a price to book ratio of 1.5 to 1.3. *The increase in the payout ratio is well within the company's payout ratio targets.* The drop in PCG's price to book ratio would still keep the company within the peer group range and would not be exceptionally low for the industry. In fact, a 1.3 price to book ratio would still be equal to or greater than fourteen of the sixty electric and natural gas companies we utilized in our comparable company analysis.

This level of equity issuance also appears reasonable compared to similar utility equity issuances in the recent past. Under our "Threshold" scenario, PCG would be selling 12% of its ownership stake as part of this equity sale, which is a comparable level to the sales performed in **[BEGIN CONFIDENTIAL]**
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Finally, in order to provide additional context to the impact of different levels of equity issuances, we performed our scenario analysis using a "Low Estimate" and a "High Estimate" of $500 million and $750 million, respectively. This range was derived from the **[BEGIN CONFIDENTIAL]**
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as noted in Table 8 above.

to the company that allows it to stay within its dividend payout policy as well as maintain a price to book ratio comparable to its utility peers.

[24] Although PCG's maximum payout ratio is 70 percent, we used a more conservative level of ██ percent.

[25] Response to OC-373, Att. 2.

Table 10 – Impacts of Equity Issuance

Level of Equity Issuance (1) (PARTIALLY REDACTED)				
	No Additional Equity Raise	Low Estimate	High Estimate	Threshold level
Additional Funding Required	0	500	750	2,250
Impact of Equity Issuance on PCG Price to Book and Payout Ratios				
	No Additional Equity Raise	Low Estimate	High Estimate	Threshold level
PCG Stock Price (as of 03/31/2012)	43.41	43.41	43.41	43.41
Outstanding Shares (pre equity raise)				
Implied Market Capitalization	18,328	18,328	18,328	18,328
Implied Book Equity(2)	12,218	12,718	12,968	14,468
Implied Price to Book Ratio	1.5	1.4	1.4	1.3
Equity Issuance Required (in dollars)	-	500	750	2,250
Percentage of Company Sold	0%	3%	4%	12%
Implied Stock Price	43.41			
Additional Shares Required to Fund Equity Issuance	-			
Outstanding Shares (post equity raise)				
Projected Dividend Per Share				
Projected Operating Earnings Per Share(3)				
Implied Payout Ratio	57%			

Note1: Amounts in table denoted in millions, except ratios and per share amounts.

Note2: "Implied Book Equity" was based on the company's Q1 2012 Price to Book Ratio of 1.5 obtained from Capital IQ (through YahooFinance).

Source: OC-357 (for company forecast data); Capital IQ (for stock price and price to book data).

As seen above, we believe a reasonable estimate of PG&E's ability to raise equity capital, is $2,250 million. **[BEGIN CONFIDENTIAL]**

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Cash Flow and Earnings Impact of Penalty Structure

While the analysis above focused on assessing the company's current financial position and the amount of equity capital that PCG would be able to raise, we have also considered the structure of the penalties and how this might impact the company.

Based upon responses received in discovery, the company confirmed that it would not seek to deduct payments made in relation to CPUC imposed fines. The guidance relied upon by the company for purposes of this statement was obtained from the Internal Revenue Code Section 162(f) which explicitly denies a deduction for fines paid to governments for the violation of any law.[26] Therefore, it appears that any fine imposed by the CPUC will immediately be expensed and impact PCG's bottom line, dollar-for-dollar.

[26] Response to OC-371.

Reducing the company's revenue requirement by disallowing portions of its PSEP expenses/capital expenditures will have a slightly different impact. Currently, the company is assuming recovery of these PSEP capital costs and the company is financing these costs with its existing capital structure. However, if these costs are disallowed, the company plans to write these capital expenditures off to expense and issue additional equity to fill the equity gap. This was explained by PCG CFO Kent Harvey in a response to Hugh Wynne, an equity analyst from Sanford Bernstein & Co.:[27]

> "Q. My question is around the PSEP CapEx and the OIR. If I understood correctly, you don't expect the OIR to be resolved until September, and you won't know, consequently, until then whether the full PSEP CapEx will be included in rate base or whether some portion will be disallowed. And my question in this are on the financing and the accounting for the PSEP CapEx. I assume until the OIR is decided that you're funding that as if it were included in rate base with the normal equity ratio. If that assumption turns out to be too optimistic and some portion of the CapEx is disallowed, you would then write off that CapEx and issue incremental equity that cover the write-down. Is that right or wrong?
>
> A. Hugh, this is Kent. I think, generally, that's directionally right. In other words, we are essentially financing that CapEx, which really is just beginning, because we've been in the winter months, but we are financing that with the weighted cost of -- weighted capital structure. And then we do -- in our guidance, we assume that essentially, the annual costs associated with that capital, the carrying costs essentially is part of our earnings guidance for the $450 million to $550 million. It's a small component of the overall expense."

Based on the information received in discovery and review of the Internal Revenue Code, it is not entirely clear whether these disallowances would be deemed "penalties" by the IRS for purposes of tax deduction. However, the CPUC should remain cognizant of the possibility that cost disallowances may have more favorable tax treatment for the company than fines. Structuring settlement terms that reflect optimal tax considerations may help the CPUC achieve additional consumer benefits, while maintaining the same net effect on the company.

Conclusion

As seen in the analysis above, Overland has estimated the incremental external equity capital available to PCG is approximately $2.25 billion. As explained previously, this is the *additional* equity capital we believe could be raised beyond the $600 million PCG assumed in 2012 (including $300 million to fund gas pipeline penalties). We have also shown that the company could raise (i.e. retain) significant amounts of equity internally through reducing its dividend.[28]

[27] Obtained from: http://seekingalpha.com/article/551581-pg-e-s-ceo-discusses-q1-2012-results-earnings-call-transcript

[28] Our analysis of PCG's ability to raise equity capital through internal and external sources should not be seen as cumulative. Decreasing the dividend would likely decrease PCG's stock price, making it more difficult to raise equity externally. However, these options are also not mutually exclusive. PCG could employ some combination of internal/external financing to meet its funding requirements.

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Ultimately, we agree with PCG CEO Anthony Earley that, "The company does need to be financially viable after [the PCG is] finished with all the issues related to San Bruno."[29,30] A financially healthy utility is in the best interests of all stakeholders, including the CPUC, PG&E customers, and the company's stockholders and creditors. As our analysis illustrates, PCG is currently in a stable financial position and has the ability to raise large amounts of capital (particularly equity capital), without seriously eroding the company's current credit quality.

[29] Quote from PG&E CEO Anthony Earley, obtained from http://www.bloomberg.com/news/2012-02-24/pg-e-ceo-says-big-blast-fine-would-threaten-financial-viability.html.

[30] Although the company is implying that it would not be able to sustain a large penalty, **[BEGIN CONFIDENTIAL]**

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PCG Comparable Company Analysis - Electric Company Peers						
Company	**Ticker**	**Forward P/E**	**Price/ Book**	**Debt/Equity**	**Current Ratio**	**Dividend Yield**
PG&E Corporation	PCG	14.31	1.50	1.14	0.84	4.10%
CH Energy Group	CHG	19.63	1.94	0.94	1.18	3.40%
Central Vermont Public Sevice	CV	N/A	1.75	0.88	1.32	2.60%
Consalidated Edison	ED	15.37	1.52	0.92	1.22	4.10%
Domoinion Resources Inc.	D	15.14	2.50	1.73	0.75	4.10%
Duke Energy Group	DUK	14.46	1.26	0.93	1.25	4.70%
Exelon Corp.	EXC	12.69	1.81	0.94	1.10	3.90%
FirstEnergy Corp.	FE	14.44	1.47	1.30	0.69	4.70%
NextEra Energy Inc.	NEE	12.87	1.74	1.57	0.64	3.70%
Northeast Utilities	NU	13.94	1.63	1.30	0.70	3.20%
PPL Corp	PPL	11.35	1.47	1.67	1.22	5.30%
Pepco Corp	POM	14.32	0.99	1.16	0.77	5.70%
Progress Energy	PGN	16.31	1.58	1.35	0.85	4.70%
Public Service Enterprise Group	PEG	12.86	1.55	0.79	1.32	4.60%
SCANA Corp	SCG	13.73	1.54	1.41	0.91	4.30%
Southern Co.	SO	16.08	2.23	1.14	N/A	4.30%
TECO Energy Inc.	TE	12.76	1.70	1.36	0.78	4.90%
UIL Holdings Corp	UIL	14.55	1.58	1.64	1.04	5.00%
ALLETE Inc	ALE	14.29	1.38	0.80	1.70	4.50%
Alliant Energy Corp	LNT	14.04	1.67	0.91	1.01	4.00%
Ameren Corp.	AEE	17.25	1.00	0.87	1.29	4.90%
American Electric Power	AEP	12.12	1.26	1.24	0.66	4.90%
CMS Energy Co.	CMS	13.77	1.91	2.33	1.25	4.20%
CenterPoint Energy	CNP	15.90	2.02	2.18	0.90	4.00%
Celeco Corp	CNL	15.62	1.72	0.96	1.42	3.10%
DTE Energy Co.	DTE	14.07	1.36	1.15	N/A	4.20%
Empire District Electric	EDE	13.59	1.22	1.02	1.79	4.90%
Entrgy Corp.	ETR	12.32	1.31	1.37	1.14	5.10%
Great Plains Energy Inc.	GXP	12.25	0.92	1.31	0.38	4.20%
ITC Holdings Corp	ITC	14.74	3.01	2.19	0.59	1.80%
Integrys Energy Group Inc	TEG	14.76	1.43	0.81	1.10	5.00%
MGE Energy Inc	MGEE	16.39	1.91	0.66	3.00	3.30%
OGE Energy Inc	OGE	14.79	2.04	1.07	0.65	2.90%
Otter Tail Corp	OTTR	15.44	1.38	0.81	2.13	5.40%
Vectren Corp	VVC	14.92	1.63	1.26	0.88	4.80%
Wester Energy	WR	13.61	1.30	1.10	0.77	4.60%
Wisconsin Energy	WEC	15.17	2.12	1.33	1.05	3.30%
Avista Corp	AVA	13.88	1.28	1.12	0.98	4.40%
Black Corp	BKH	14.31	1.18	1.45	0.86	4.50%
Edison Int'	EIX	17.35	1.42	1.30	1.03	3.00%
EL Paso Electric	EE	12.47	1.57	1.16	0.84	2.90%
IDACORP Inc	IDA	12.26	1.20	0.93	0.84	3.20%
NV Energy, Inc	NVE	13.31	1.14	1.51	0.87	3.10%
PNM Resources	PNM	13.25	0.95	1.05	1.24	3.10%
Pinnacle West Capital	PNW	13.53	1.37	0.89	0.71	4.40%
Portland General Electric	POR	12.99	1.16	1.06	1.17	4.10%
Sempra Energy	SRE	14.88	1.56	1.05	0.56	3.70%

PCG Comparable Company Analysis - Electric Company Peers						
Company	**Ticker**	**Forward P/E**	**Price/ Book**	**Debt/Equity**	**Current Ratio**	**Dividend Yield**
UniSource Energy	UNS	13.22	1.50	2.20	1.19	4.70%
Xcel Energy Inc	XEL	14.24	4.54	1.20	N/A	3.80%
HAWAIAN Electric	HE	15.12	1.67	1.05	0.99	4.70%
Mean		**14.30**	**1.62**	**1.23**	**1.06**	**4.12%**
Median		**14.24**	**1.54**	**1.15**	**0.99**	**4.20%**
Source: ValueLine Investment Survey; Capital IQ (obtained through YahooFinance).						

PCG Comparable Company Analysis - Gas Company Peers						
Company	**Ticker**	**Forward P/E**	**Price/ Book**	**Debt/Equity**	**Current Ratio**	**Dividend Yield**
PG&E Corporation	PCG	14.31	1.50	1.14	0.84	4.10%
AGL Resources Inc,	AGL	N/A	1.37	1.47	0.89	3.60%
Atmos Energy Corp.	ATO	13.15	1.29	1.14	1.07	4.30%
Laclede Group	LG	14.03	1.50	0.81	1.29	4.20%
New Jersey Resources	NJR	15.38	2.18	0.92	1.03	3.50%
NiSource Inc,	NI	16.19	1.41	1.59	0.62	3.80%
Northwest Natural Gas	NWN	16.72	1.71	1.15	0.84	3.90%
Piedmont Natural Gas	PNY	16.73	2.08	1.10	0.62	4.00%
South Jersey Industries, Inc	SJI	14.42	2.34	1.26	0.58	3.30%
Southwest gas	SWX	14.56	1.57	1.04	0.55	2.80%
UGI Corp	UGI	11.55	1.64	1.17	1.07	3.60%
WGL Holdings Inc	WGL	14.95	1.65	0.68	1.20	4.00%
Mean		**14.77**	**1.70**	**1.12**	**0.89**	**3.73%**
Median		**14.76**	**1.64**	**1.14**	**0.89**	**3.80%**
Source: ValueLine Investment Survey; Capital IQ (obtained through Yahoo Finance).						