

California Update

Alert: CPUC Issues Final Decision On CoC Proceeding and PSEP

Today, the CPUC issued a final decision on PG&E's pipeline safety enhancement proposal (PSEP) and the Cost of Capital proceeding for both EIX and PG&E. The Commission approved a 10.40% ROE and 52% equity layer for PG&E and a 10.45% ROE and 48% equity layer for SoCal Edison (EIX). The final decision was inline with the ALJ's proposed decision for PG&E, but slightly better for SoCal Edison, where the ALJ recommended a 10.40% ROE (5 bps of ROE on state regulated assets represents roughly \$0.01 of EPS for EIX). The new ROEs and capital structures will be effective on 1/1/13. For PG&E's PSEP, the Commission voted to approve the revised ALJ decision, which was released late yesterday.

Final PSEP decision a slight incremental positive. Late yesterday, a revised proposed decision was released and the Commission subsequently voted to approve it today. The primary revision to the initial PD (issued 10/12/12) is the higher allowed return on capital spending, which was lifted from the cost of debt (6.05%) to the cost of equity (10.40%). Compared to the initial PD, the final decision will result in higher EPS of approximately \$0.02 in 2013 and \$0.03 in 2014. There were also very minor adjustments to authorized expenses and capital expenditures. The revised authorized expenses are \$3 / 73 / 89 million in 2012-14, and the authorized capital expenditures are \$47 / 260 / 348 / 348 million in 2011-14. We view the final PSEP decision as a marginal positive and more consistent with the message the Commissioners have been communicating to the Street, where San Bruno related penalties would not seep into ratemaking policy, which would have been the case if the return on capital was set at the cost of debt. All else equal, today's decision would lift our PG&E EPS estimate in 2013 by \$0.02 and 2014 by \$0.03 given that our current model assumed the ALJ's initial PD would be approved as is.

Investigation settlement remains illusive. At this point, we still have not seen any sign of a potential settlement related to the San Bruno orders instituting investigation (OII) for PG&E. A status report on the settlement process was due 12/12/12, but only if the parties reached an agreement in principal by that date. The Commission indicated that they would not entertain another extension of the OII schedule to accommodate further settlement discussions and hearings are set to resume on 1/7/13 or soon thereafter. The next major event in the OII process is the consolidated penalty recommendation from the CPSD, which is due 45 days after conclusion of the hearings, which will put the recommendation sometime in March.

California still looks attractive. We continue to have a favorable view of PG&E, and today's resolution of the Cost of Capital proceeding and the PSEP removes some regulatory overhang. We currently rate PG&E Buy with a \$48 target price and rate EIX Neutral with a \$52 target price.

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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□ Industry Overview

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PG&E Corp

(PCG.N; US\$41.92; 1)

Valuation

For PCG, we start with the peer average target multiple of 16.0x that we assign to regulated utilities and then discount it by a 0.5x, or 3% to reflect risks and uncertainties associated with the resolution of San Bruno related items and the ongoing orders instituting investigation (OIs) and order instituting rulemaking (OIR) on gas pipeline safety. Multiplying our PCG specific target P/E multiple of 15.5x by our \$3.13 operating EPS estimate in 2014 gives us a target price of \$48/share.

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.

Edison International

(EIX.N; US\$46.05; 2)

Valuation

We currently view EMG, Edison's merchant generation business as an out of the option and do not assign any equity value. We derive the value for Edison International by taking our 2014 EPS estimate for SCE of \$3.39/share, and subtracting corporate drag of (\$0.13)/share to derive a net EPS for the Utility of \$3.26/share. We then apply a 16.0x P/E multiple to calculate a value of \$52/share. The 16.0x P/E multiple is the average regulated electric utility multiple we assign to companies under coverage and is based on a regression with BBB corporate bond yields.

Risks

Risks to our target price include the following:

Regulatory risk: Currently, Southern California Edison (SCE) is going through a cost of capital proceeding that will determine their allowed ROE and capital structure for the next 3 years. Additionally, SCE is awaiting a decision on their general rate case, which will set the capex and rate base for the company over the next 3 years. If either one of these proceedings results in an allowed ROE and rate base significantly below expectations, EIX shares could underperform.

Commodity risk at merchant unit: Given Forward natural gas prices can have a significant effect on the nuclear merchant financial outlook and per share value. This is because natural gas prices are the marginal fuel for deregulated power generation. We currently assume a long-term gas price based on the current forward curve. If natural gas and power prices were to rise significantly, this could have positive implications for EIX shares.

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.

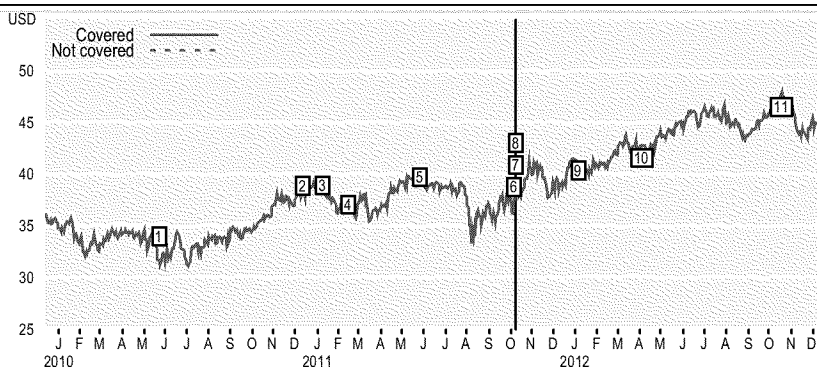
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Edison International (EIX) Ratings and Target Price History Fundamental Research

Analyst: Brian Chin



	Date	Rating	Target Price	Closing Price
1	23-May-10	2M	*33.00	31.71
2	13-Dec-10	2M	*38.00	38.36
3	10-Jan-11	*3M	*35.00	38.13
4	15-Feb-11	*2M	*36.00	37.05

	Date	Rating	Target Price	Closing Price
5	26-May-11	2M	*40.00	39.37
6	6-Oct-11	*1M	*45.00	37.46
7	8-Oct-11	Stock rating system changed		
8	8-Oct-11	*1	45.00	37.74

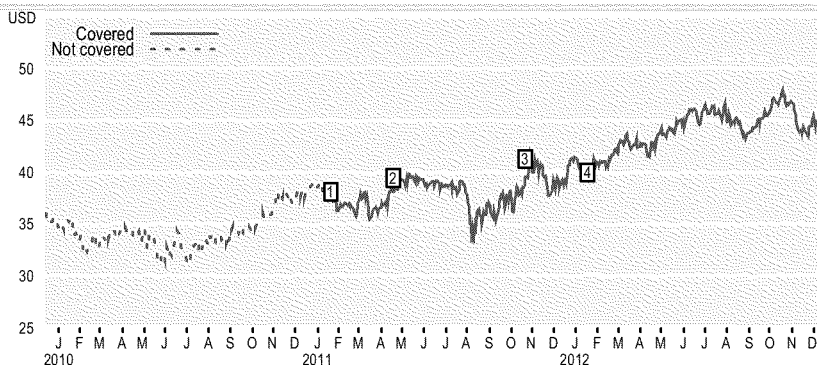
	Date	Rating	Target Price	Closing Price
9	5-Jan-12	1	*47.00	40.53
10	4-Apr-12	1	*48.00	42.82
11	18-Oct-12	*2	*52.00	47.96

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Edison International (EIX) Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Brian Chin



	Date	Rating	Target Price	Closing Price
1	20-Jan-11	*ADD LP	-	37.70
2	19-Apr-11	*REM LP	-	38.18

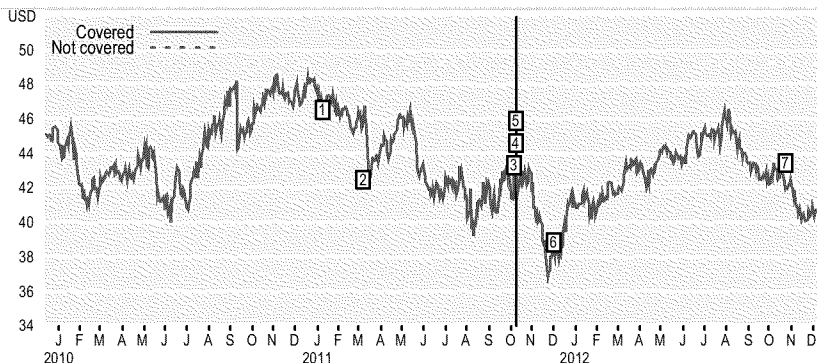
	Date	Rating	Target Price	Closing Price
3	21-Oct-11	*ADD MP	-	39.56
4	18-Jan-12	*REM MP	-	40.44

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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	10-Jan-11	*2L	*48.00	46.52
2	8-Mar-11	2L	*46.00	46.27
3	6-Oct-11	*1L	*48.00	42.99

	Date	Rating	Target Price	Closing Price
4	8-Oct-11	Stock rating system changed		
5	8-Oct-11	*1	48.00	42.97
6	1-Dec-11	1	*47.00	38.52

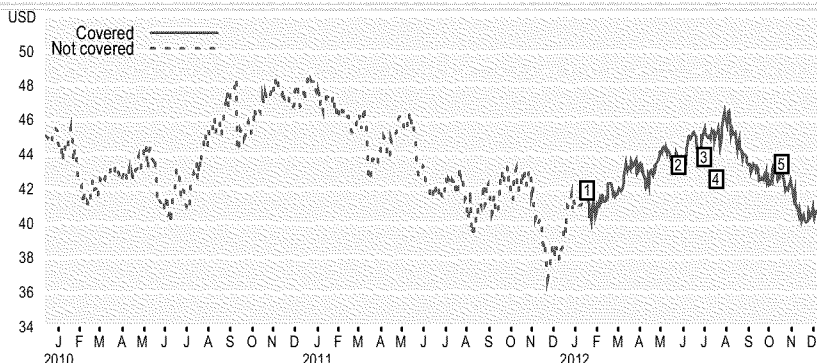
	Date	Rating	Target Price	Closing Price
7	24-Oct-12	1	*48.00	41.92

* 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	18-Jan-12	*ADD MP	-	41.44
2	25-May-12	*REM MP	-	43.74

	Date	Rating	Target Price	Closing Price
3	30-Jun-12	*N	-	45.27
4	18-Jul-12	*ADD MP	-	45.25

	Date	Rating	Target Price	Closing Price
5	18-Oct-12	*REM MP	-	43.21

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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<i>Data current as of 5 Oct 2012</i>	12 Month Rating			Relative Rating		
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