REGULATED UTILITIES

CA Update: Positive Regulatory Outcomes for EIX, PCG and SRE

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- **What Happened?** The California Public Utilities Commission (CPUC) held its last scheduled meeting of 2012 today (12/20/12). Final rulings were approved for 1) the cost of capital proceedings for all 3 investor owned utilities 2) PCG's pipeline safety enhancement plan and 3) 2010-2012 energy efficiency incentive awards. **We think all three rulings were constructive, and should demonstrate to investors that the CA continues be a positive environment for regulated utilities**.

- **Details of Rulings:** In the cost of capital proceeding, the CPUC increased the authorized ROE of SCE to 10.45% (vs. the Proposed decision to 10.40%), and increased the authorized equity ratio of SDGE to 52% (vs 50.5% in the PD). All other ROE and equity ratios were unchanged vs those recommended in the PD – (the table to the right shows the approved ROEs & equity ratios for each utility). The Commission approved the PD on PCG's pipeline safety enhancement plan, but overruled the ALJ's recommendation that the company receive a 6.05% debt return on equity capital deployed. All else equal, the authorized revenue increase through 2014 is now $43m higher than the PD. Finally, the CPUC awarded energy efficiency incentives to all three IOUs ($21m to PCG, $15m to SCE and $6m to SRE's utilities). The CPUC also approved a streamlined incentive mechanism for future periods: Utilities will earn a 5% management fee on actual energy efficiency portfolio expenditures, with the opportunity to earn an additional 1% performance based fee.

- **EIX Dividend Increase:** After the close, EIX announced a 3.8% increase to its annual dividend ($1.35 from $1.30). In a press release, CEO Ted Craver indicated that once the company's capex levels moderate (2013 is the peak spending year) the dividend should return to its target payout ratio of 45%-55% of utility earnings. By 2014, we expect the dividend could increase to $1.55- $1.90 (growth of 15-40% from current levels), bringing the yield more in line with its regulated peers.

- **Investment Thesis**: We continue to believe that EIX and PCG (both BUY rated) offer among the best total return prospects in our regulated utility universe. Both names should resolve company-specific overhangs early next year (San Bruno Settlement for PCG, SONGs Investigation for EIX) that should allow their valuation discounts to narrow. Today's decisions should help to bolster confidence that the regulatory outcomes in these proceedings should be fair.

CPUC Authorized ROEs & Equity Ratios

Utility	Authorized ROE's PD	Authorized ROE's Final	Authorized Equity Ratios PD	Authorized Equity Ratios Final
PCG	10.40%	10.40%	52.0%	52.0%
EIX (SCE)	10.40%	$\boxed{10.45\%}$	48.0%	48.0%
SRE				
SDGE	10.30%	10.30%	50.5%	$\boxed{52.0\%}$
SoCal Gas	10.10%	10.10%	52.0%	52.0%

Boxes #'s Indicate changes from the Proposed Decision

EIX EPS Summary

	ISI Est. EPS	ISI Est. PE	% Δ	Consensus EPS	Consensus PE
2011A	3.19	14.4x	-0.9%	3.22	14.3x
2012E	3.35	13.7x	39.4%	2.40	19.2x
2013E	3.30	14.0x	8.8%	3.03	15.2x
2014E	3.50	13.2x	4.9%	3.34	13.8x
2015E	3.75	12.3x	0.6%	3.73	12.4x

PCG EPS Summary

	ISI Est. EPS	ISI Est. PE	% Δ	Consensus EPS	Consensus PE
2011A	3.57	11.7x	-0.3%	3.58	11.7x
2012E	3.15	13.3x	-1.1%	3.19	13.2x
2013E	2.65	15.8x	-6.5%	2.83	14.8x
2014E	3.15	13.3x	-2.6%	3.23	13.0x
2015E	3.30	12.7x	-1.9%	3.37	12.4x

SRE EPS Summary

	ISI Est. EPS	ISI Est. PE	% Δ	Consensus EPS	Consensus PE
2011A	4.57	15.8x	2.1%	4.47	16.1x
2012E	4.00	18.0x	-3.9%	4.16	17.3x
2013E	4.60	15.6x	6.6%	4.31	16.7x
2014E	4.95	14.5x	5.8%	4.68	15.4x
2015E	5.25	13.7x	0.0%	5.25	13.7x

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Buy Low Risk ETR	**Buy Medium Risk ETR**	**Buy High Risk ETR**
>+10%	>+15%	>+20%
Hold Low Risk ETR	**Hold Medium Risk ETR**	**Hold High Risk ETR**
0% to +10%	-5% to +15%	-10% to +20%
Sell Low Risk ETR	**Sell Medium Risk ETR**	**Sell High Risk ETR**
<0%	<-5%	<-10%

ISI has assigned a rating of BUY to 47% of the securities rated as of 9/30/12.
ISI has assigned a rating of HOLD to 49% of the securities rated as of 9/30/12.
ISI has assigned a rating of SELL to 4% of the securities rated as of 9/30/12

RISK RATING
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