BARCLAYS

Equity Research

Power & Utilities | North America Utilities

22 February 2013

PG&E Corp.

Still Awaiting the All Clear

Reiterating EW Rating, Lowering PT and EPS Forecast: We are reiterating our EW rating, lowering our eps forecast from $2.80/$3.20 to $2.65/$3.05 for '13/14 and introducing a '15 eps estimate of $3.25. We are lowering our price target to $44 premised upon the utility multiple of 14.4x our '14 eps estimate of $3.05. Our prior price target of $45 was premised upon the prior multiple of 14.5x our prior '14E eps of $3.20.

San Bruno Matters Still Have a Ways to Go: With settlement discussions souring at the end of last year, and intervening parties filing for rehearing of the pipeline safety enhancement program decision we see little prospect for settlement of the matters under investigation. As a result, we now view a fully litigated process as highly likely and do not see completion of that process happening before mid-year at the earliest.

2012 Results; 2013 Guidance: For the year the company reported ongoing eps of $3.22 vs. $3.58 last year and consensus estimates of $3.20. Results were driven by increased rate base earnings, lower storm/outage expenses, lower regulatory/litigation costs, and higher gas transmission revenues. These factors were more than offset by unrecoverable planned incremental work costs, employee performance incentives, and dilution related to the increase in shares outstanding. For 2013 management issued guidance of $2.55-$2.75 the drivers of which are detailed below.

San Bruno Matters Likely Overhang Performance: We struggle to see the shares performing in the near term as uncertainty over the ultimate outcome related to the ongoing San Bruno matters remains. These matters could be clarified around mid-year and investors could potentially see the "all-clear" signal to invest premised upon the perceived earnings power in 2015, although there will still be risk related to the two rate cases currently to be adjudicated by the commission prior to that year.

PCG: Quarterly and Annual EPS (USD)

	2012	2013			2014			Change y/y	
FY Dec	Actual	Old	New	Cons	Old	New	Cons	2013	2014
Q1	0.89A	N/A	N/A	0.68E	N/A	N/A	0.81E	N/A	N/A
Q2	0.81A	N/A	N/A	0.70E	N/A	N/A	0.85E	N/A	N/A
Q3	0.93A	N/A	N/A	0.82E	N/A	N/A	0.88E	N/A	N/A
Q4	0.59A	N/A	N/A	0.58E	N/A	N/A	0.58E	N/A	N/A
Year	3.22A	2.80E	2.65E	2.78E	N/A	3.05E	3.18E	-18%	15%
P/E	12.9		15.6			13.6			

Source: Barclays Research.

Consensus numbers are from Thomson Reuters

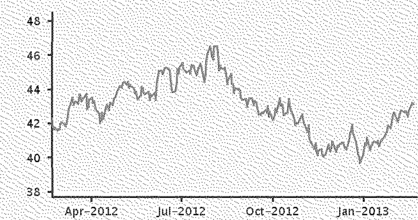
Stock Rating	EQUAL WEIGHT
	Unchanged
Industry View	POSITIVE
	Unchanged
Price Target	USD 44.00
	lowered -2% from USD 45.00

Price (21-Feb-2013)	USD 41.41
Potential Upside/Downside	+6%
Tickers	PCG

Market Cap (USD mn)	18541
Shares Outstanding (mn)	429.98
Free Float (%)	99.84
52 Wk Avg Daily Volume (mn)	2.4
Dividend Yield (%)	4.2
Return on Equity TTM (%)	7.24
Current BVPS (USD)	30.59

Source: FactSet Fundamentals

Price Performance	Exchange-NYSE
52 Week range	USD 47.03-39.40



Link to Barclays Live for interactive charting

North America Utilities

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North America Utilities | Industry View: POSITIVE

PG&E Corp (PCG)

Stock Rating: EQUAL WEIGHT

Income statement ($mn)	2012A	2013E	2014E	2015E	CAGR
EBITDA (adj)	3,525	4,441	5,080	6,280	21.2%
EBIT (adj)	1,176	1,946	2,435	3,485	43.6%
Pre-tax income (adj)	1,497	1,559	1,972	2,441	17.7%
Net income (adj)	1,352	1,184	1,452	1,609	6.0%
EPS (adj) ($)	3.22	2.65	3.05	3.25	0.3%
Diluted shares (mn)	420	446	476	496	5.6%
DPS ($)	1.82	1.82	1.93	2.05	4.0%

Margin and return data					Average
EBITDA (adj) margin (%)	22.7	28.3	31.2	37.4	29.9
EBIT (adj) margin (%)	7.6	12.4	15.0	20.8	13.9
Pre-tax (adj) margin (%)	9.7	9.9	12.1	14.6	11.6
Net (adj) margin (%)	8.7	7.5	8.9	9.6	8.7
ROIC (%)	4.2	6.3	7.2	9.6	6.8
ROA (%)	2.6	2.2	2.5	2.7	2.5
ROE (%)	11.0	8.5	9.6	9.8	9.7

Balance sheet and cash flow ($mn)					CAGR
Net PP&E	36,006	38,611	41,216	43,671	6.6%
Total net assets	52,022	54,708	57,415	60,135	4.9%
Capital employed	28,218	30,922	33,654	36,399	8.9%
Shareholders' equity	12,305	13,909	15,090	16,385	10.0%
Net debt/(funds)	15,825	16,801	18,370	19,551	7.3%
Cash flow from operations	2,312	3,285	3,549	4,431	24.2%
Capital expenditure	-4,700	-5,100	-5,250	-5,250	N/A
Free cash flow	-3,153	-2,627	-2,620	-1,832	N/A
Pre-dividend FCF	-2,388	-1,815	-1,701	-819	N/A

Valuation and leverage metrics					Average
P/E (adj) (x)	12.9	15.6	13.6	12.8	13.7
EV/EBITDA (adj) (x)	9.5	7.8	7.1	5.9	7.6
EV/EBIT (adj) (x)	28.6	17.8	14.9	10.7	18.0
P/BV (x)	1.4	1.3	1.3	1.3	1.3
Dividend yield (%)	4.4	4.4	4.7	4.9	4.6
Total debt/capital (%)	56.4	55.0	55.2	55.0	55.4
Net debt/EBITDA (adj) (x)	4.5	3.8	3.6	3.1	3.8

Selected operating metrics					
Payout ratio (%)	56.6	68.6	63.3	63.0	
Interest cover (x)	4.4	4.9	5.3	5.8	
Regulated (%)	N/A	N/A	N/A	N/A	

Price (21-Feb-2013)	USD 41.41
Price Target	USD 44.00

Why Equal Weight? We remain Equal Weight as we continue to see headwinds to the story related to resolution of regulatory matters related to the San Bruno accident. These regulatory matters could now potentially stretch beyond the end of the year, which delays any clarity around potential outcomes.

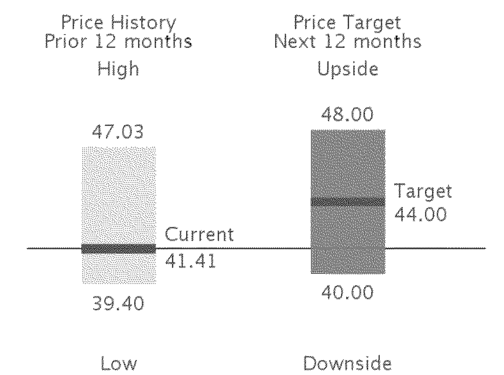
Upside case USD 48.00

A 10.75% ROE, 1.5% higher rate base growth, full returns earned on PSEP spending, $100m lower equity need in '13 related to lower pipeline spending, and a 50bp lower growth in base O&M lead to an indicative valuation of $48/share.

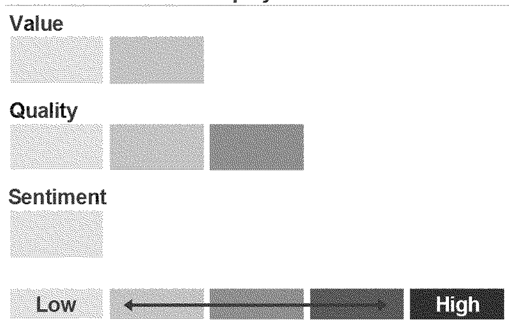
Downside case USD 40.00

A 10% ROE, 1.5% lower rate base growth, $100m higher equity need in '13 related to higher pipeline spending, and a 50bp higher rate of growth in base O&M lead to an indicative valuation of $40/share.

Upside/Downside scenarios



POINT® Quantitative Equity Scores



Source: POINT. The scores are valid as of the date of this report and are independent of the fundamental analysts' views. To view the latest scores, click here.

Source: Company data, Barclays Research
Note: FY End Dec

Outlook Varies Pending San Bruno Outcomes; Equity Needs; Rate Case Outcomes; Ultimate Amount of ROW Work

2013 Guidance and Outlook for '14/15/16

2013 Guidance

Management issued guidance of $2.55-$2.75 for 2013, in line with our update eps estimate of $2.65. The drivers of the lower results in 2013 vs. the $3.22 in operating earnings achieved in 2012 are:

- Lower returns on equity: Return on electric transmission was lowered from 11.35% to 9.1% on the latest FERC order and on California regulated assets to 10.4% based upon the cost of capital decision in December. This leads to a weighted average allowed ROE of approximately 10.18%. The company has filed for rehearing at the FERC over the transmission rate case and also filed litigation related to the FERC decision. While this could ultimately result in a higher allowed ROE, the conservative assumption remains 9.1% based upon the current order. The company is also engaged in settlement discussions with the FERC regarding the transmission rate case and that process could potentially lead to a "black box" settlement as in the past that could potentially lead to the ability to earn a higher ROE.
- Higher shares outstanding: The company embeds $1.0 - $1.2 Billion in equity needs in their 2013 earnings guidance although importantly this does not include any equity that may be needed should the penalty related to the ongoing San Bruno investigations be above the currently accrued $200 million. Our current estimate for the penalty is $600 million which would imply an additional equity need of $400 million. The equity need is also driven by higher capital expenditures in 2013 than allowed under the last general rate case and therefore unrecoverable through rates, and the capital charge taken in the fourth quarter of last year related to the final order related to capital costs for the pipeline safety enhancement program. We believe the consensus view of the equity need either did not incorporate a higher fine number, the PSEP capital charge, or some combination of both of those items and therefore the forecast equity need for 2013 was above the markets expectations.
- Capital Expenditures exceeding authorized amounts: Not only does this lead to an increase in equity needs as noted above, the expenses related to the deployment of this capital, such as property taxes and D&A expenses will not be recoverable until the completion of the next rate case cycles in 2014 and 2015 for electric (non-transmission) and gas, respectively.

Overall capital expenditure and average authorized rate base guidance for 2013, by segment is provided in the table below.

FIGURE 1

2013 Capital Expenditure and Average Rate Base Guidance by Segment

Segment	CapEx (US$M)	Avg. Rate Base (US$B)
Electric Distribution	1,850	11.9
Electric Transmission	850	4.5
Gas Transmission	350	1.8
Gas Distribution	800	3.0
Generation	800	4.5
Pipeline Safety Enhancement Program	450	0.3
Total	**5,100**	**26.0**

Source: Company Reports and Barclays Research

The company will not be able to earn the full allowed return on equity on the total rate base of $26.0 Billion in 2013. There will be incremental unrecoverable O&M spending of $250 million, financing and depreciation costs related to approximately $1.0 Billion in capital expenditures not recoverable through rates set by the last general rate case, CWIP earnings will be 100% offset (although the $26.0 Billion excludes CWIP), there will be lower gas storage revenues year over year, and energy efficiency revenues would be additive to base earnings levels.

Management also issued GAAP earnings per share guidance for the year of $1.66 - $2.22 with impacts of ($0.89)-($0.53) under items impacting comparability. ($0.04)-($0.00) of this total is related to further potential costs for environmental remediation of the Hinkley site. The remainder is related to $400 - $645 million in pre-tax costs related to ongoing natural gas matters. These are broken down in the table below.

FIGURE 2

2013 Natural Gas Matters under Items Impacting Comparability

US$M Pre-Tax	Amount
Unrecovered PSEP Expenses	150-200
Rights of Way (ROW) encroachment & integrity management	175-225
Legal and other costs	50-100
Total Pipeline Related Costs	400-500
Penalties	TBD
Third party liabilities	0- 145
Insurance recoveries	Follow 3rd party claims
Total	**400-645**

Source: Company Reports and Barclays Research

Our own estimate for the penalty remains $600 million and we assume that insurance recoveries ultimately fully offset third party liabilities.

Beyond 2013 – Triangulating Earnings

Management did provide some minimal guidance related to 2014 – 2016 with capital expenditures of $4.5-$5.5 Billion in 2014 and then ramping up to $4.5-$6.0 Billion in 2015 and 2016. The increase into 2015 and 2016 is presumed to relate to capital requirements filed for under the general rate cases for electric and gas assets under the jurisdiction of the California Public Utilities Commission. Average Rate Base is expected to be $28.5-$29 Billion in 2014 with a CAGR of 6%-10% going forward leading to an expected rate base range of $32-$35 Billion in 2016. These forecasts exclude the Oakley plant, the purchase price of which remains undisclosed under a confidentiality agreement. Oakley is a 586MW modern CCGT facility and will be purchased under a turn key contract from the vendor.

Pipeline related costs are expected to fall off into 2014 and 2015 although the right of way (ROW) encroachment work is expected to continue through 2017 and total $500 million over the five year period. This estimate is still uncertain as the company still needs to complete inspection work of the ROW and the risk could be that the work either costs more or is extended over a longer period of time, or both. The costs will require ongoing equity to fund but will be reported outside of ongoing earnings in items impacting comparability. PSEP costs are expected to continue in 2014 but recovery will be requested for recovery in 2015 in the next gas transmission rate case which is yet to be filed. Integrity management costs will also continue to be unrecoverable in 2014 but will be requested for recovery in 2015 in the next gas transmission rate case. Management also sees a significant decrease in legal and other costs in 2014. Management is also targeting completion of the third party liabilities, insurance recoveries and any penalties in 2013 with no earnings drag continuing in 2014.

By taking the rate base projected by management and then applying the 52% equity ratio and the 10.4% and 9.1% allowed returns on equity one can attempt to triangulate earnings levels. Earnings per share forecasts will ultimately also depend upon forecast number of shares and items impacting comparability and/or unrecoverable amounts reported in operating earnings going forward.

Several factors yet to be determined will impact earnings power, the most important of which are related to the ultimate amount of the San Bruno penalties, the equity need over the next two to three years, and the outcome of the gas transmission and electric general rate case filings. Variation in any one of these factors can influence the others and cause significant swings in the ultimate earnings power of the company in 2014 and 2015.

Our Model

Our model assumptions related to several of the as yet to be determined metrics are provided in the table below.

FIGURE 3

Key Model Assumptions 2013-2015

Item	Units	2013	2014	2015
Capital Expenditures	US$M	5.10	5.25	5.25
Average non-CWIP Rate Base	US$B	26.00	28.75	31.05
Equity Needs	US$B	1.7	1.1	0.7
Penalty Amount	US$B	0.6	0	0
Unrecoverable Expenses in Ongoing EPS	US$M, Pre-Tax	250	125	0
CapEx above authorized amount	US$B	1.0	0	0
Equity Ratio	%	52%	52%	52%
Allowed Return on FERC Assets	%	9.10%	9.10%	9.10%
Allowed Return on CPUC Assets	%	10.40%	10.40%	10.40%
Blended Allowed ROE	%	10.18%	10.18%	10.18%

Source: Company Reports and Barclays Research Estimates

These assumptions yield our earnings per share forecast of $2.65/$3.05/$3.25 for '13/14/15 respectively.

Still Waiting for the All Clear

We remain EW and our price target is now $44 premised upon the regulated utility multiple of 14.4x our 2014 estimated earnings per share of $3.05. We see upside of approximately 6% to our target price and a total shareholder return potential of over 10% when including the dividend yield of approximately 4.4%. Despite this upside potential we see several items remaining to be determined that could have impacts on our earnings per share estimates.

We struggle to see the shares performing in the near term as uncertainty over the ultimate outcome related to the ongoing San Bruno matters remains. These matters could be clarified around mid-year with the penalty determined and the equity need thus clarified, and investors could potentially see the "all-clear" signal to invest premised upon the perceived earnings power in 2015, although there will still be risk related to the two rate cases currently to be adjudicated by the commission prior to that year as well as the final determination related to costs and timing of the right of way encroachment work.

2012 Results

For the year the company reported ongoing earnings per share of $3.22 vs. $3.58 last year and consensus estimates of $3.20. For the quarter the company reported ongoing earnings per share of $0.59 vs. $0.89 last year and consensus estimates of $0.57.

Year over year annual results were driven by higher rate base earnings, non-recurring storm and outage expenses experienced in 2011, lower litigation and regulatory matters costs, and higher gas transmission revenues. These positive drivers were more than offset by increased unrecoverable costs from planned incremental work, higher costs related to employee operational performance incentives, lower energy efficiency revenues, several miscellaneous items, and the dilution resulting from the increase in shares outstanding.

Drivers for the year and the quarter are provided in the tables below.

FIGURE 4

Year over Year Operating Earnings per Share Drivers

Item	Amount
2011 Operating EPS	**3.58**
Increase in rate base earnings	0.19
Storm and outage expenses	0.06
Litigation and regulatory matters	0.06
Gas transmission revenues	0.04
Planned incremental work	-0.36
Employee operational performance incentive	-0.08
Energy Efficiency incentive revenue	-0.01
Increase in shares outstanding	-0.19
Miscellaneous	-0.07
2012 Operating EPS	**3.22**

Source: Company Reports and Barclays Research

FIGURE 5

Quarterly Earnings per Share Drivers 4Q '12 vs. 4Q '11

Item	Amount
Q4 11 Operating EPS	**0.89**
Increase in rate base earnings	0.05
Planned incremental work	-0.11
Employee operational performance incentive	-0.09
Storm and outage expenses	-0.02
Litigation and regulatory matters	-0.02
Energy Efficiency incentive revenue	-0.01
Increase in shares outstanding	-0.05
Miscellaneous	-0.05
Q4 12 Operating EPS	**0.59**

Source: Company Reports and Barclays Research

GAAP earnings in 2012 were $1.92 and were impacted by ($1.15) in natural gas matters impacting comparability and ($0.15) of environmental costs mostly related to environmental mitigation at the Hinkley site. Overall natural gas matters totalled $812 million for the year on a pre-tax basis. The breakdown of this amount is provided in the table below.

FIGURE 6

2012 Natural Gas Matters Impacting Comparability

US$M Pre-Tax	Amount
Pipeline related costs	(477)
Disallowed capital	(353)
Penalties	(17)
Contribution to City of San Bruno	(70)
Third party liability claims	(80)
Insurance recoveries	185
Total	**-812**

Source: Company Reports and Barclays Research

ANALYST(S) CERTIFICATION(S)

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Primary Stocks (Ticker, Date, Price)

PG&E Corp. (PCG, 21-Feb-2013, USD 41.41), Equal Weight/Positive

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Our coverage analysts use a relative rating system in which they rate stocks as Overweight, Equal Weight or Underweight (see definitions below) relative to other companies covered by the analyst or a team of analysts that are deemed to be in the same industry (the "industry coverage universe").

In addition to the stock rating, we provide industry views which rate the outlook for the industry coverage universe as Positive, Neutral or Negative (see definitions below). A rating system using terms such as buy, hold and sell is not the equivalent of our rating system. Investors should carefully read the entire research report including the definitions of all ratings and not infer its contents from ratings alone.

Stock Rating

Overweight - The stock is expected to outperform the unweighted expected total return of the industry coverage universe over a 12-month investment horizon.

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Positive - industry coverage universe fundamentals/valuations are improving.

Neutral - industry coverage universe fundamentals/valuations are steady, neither improving nor deteriorating.

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IMPORTANT DISCLOSURES CONTINUED

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Hawaiian Electric Inds (HE)	ITC Holdings (ITC)	National Grid Plc (NGG)
NiSource, Inc. (NI)	Northeast Utilities (NU)	NV Energy, Inc. (NVE)
OGE Energy Corp. (OGE)	Pepco Holdings (POM)	PG&E Corp. (PCG)
Pinnacle West Capital (PNW)	PNM Resources (PNM)	Portland General Electric Co. (POR)
SCANA Corp. (SCG)	Sempra Energy (SRE)	Southern Co. (SO)
TECO Energy (TE)	Westar Energy (WR)	Wisconsin Energy (WEC)
Xcel Energy (XEL)		

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Barclays Equity Research has 2506 companies under coverage.

43% have been assigned an Overweight rating which, for purposes of mandatory regulatory disclosures, is classified as a Buy rating; 53% of companies with this rating are investment banking clients of the Firm.

41% have been assigned an Equal Weight rating which, for purposes of mandatory regulatory disclosures, is classified as a Hold rating; 47% of companies with this rating are investment banking clients of the Firm.

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A high/low Sentiment score indicates bullish/bearish market sentiment. Measures of sentiment include price momentum and earnings revisions.

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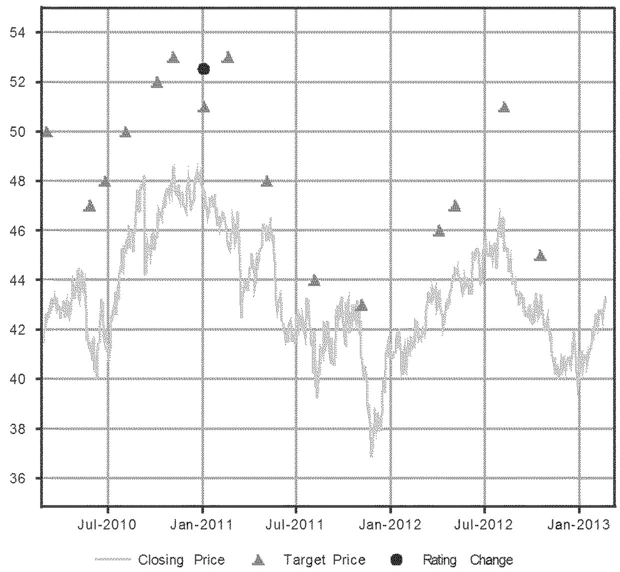
PG&E Corp. (PCG)

USD 41.41 (21-Feb-2013)

Stock Rating: **EQUAL WEIGHT**

Industry View: **POSITIVE**

Rating and Price Target Chart - USD (as of 21-Feb-2013)



Currency=USD

Date	Closing Price	Rating	Price Target
16-Oct-2012	42.63		45.00
07-Aug-2012	45.78		51.00
03-May-2012	44.37		47.00
03-Apr-2012	43.19		46.00
04-Nov-2011	40.86		43.00
05-Aug-2011	41.96		44.00
05-May-2011	45.91		48.00
18-Feb-2011	45.38		53.00
03-Jan-2011	47.39	Equal Weight	51.00
04-Nov-2010	48.51		53.00
04-Oct-2010	45.73		52.00
04-Aug-2010	45.30		50.00
25-Jun-2010	42.01		48.00
26-May-2010	41.21		47.00
03-Mar-2010	42.31		50.00

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