

PG&E Corporation (PCG)

FORECAST REDUCTION

Rating	NEUTRAL
Price (21 Feb 13, US\$)	41.41
Target price (US\$)	45.00 ¹
52-week price range	46.51 - 39.71
Market cap. (US\$ m)	17,806
Enterprise value (US\$ m)	31,690

^{*}Stock ratings are relative to the coverage universe in each analyst's or each team's respective sector.

¹Target price is for 12 months.

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Hits Keep Coming; Not Time Yet

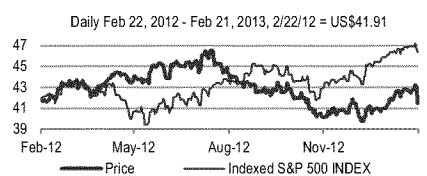
Our take: PCG shares feel potentially set up to have a good overall 2013, but we still believe a push into the stock at this point is early. We think (a) the overhang of big equity needs (we're at \$2.6 BN for '13 -'14), (b) the surprisingly big but still not fully sized encroachment costs that feel like they could go higher than \$500 MM, and (c) limited clarity on size and duration of non-recoverable operating costs as PCG improves from bottom to upper quartiles will all limit market confidence in the stock. We appreciate the 'PCG looks cheap on '15 P/E' argument but doubts about the '15 estimate make this case harder to embrace.

We maintain our Neutral rating and are updating our '13-'15 estimates to \$2.68, \$3.07 and \$3.29 to incorporate the lower FERC ROE on transmission, greater share dilution and some higher costs.

PCG's ongoing 4Q12 EPS was \$0.59, in-line with the Street. Mgmt issued '13 guidance of \$2.55 -2.75 (Street was at \$2 .78) along with expected equity issuance of \$1 -1.2BN before including a fine above the previously accrued \$200M.

- **Another Wave of Costs.** PCG provided a preliminary estimate for remediation of encroachment costs at \$500 MM over 5 years that will be borne by shareholders with a final estimate expected in late 2013. We appreciate market frustration over this announcement both for the absolute cost (the hits like these to shareholders have been large and frequent) but also treatment as a non-recurring earnings hit even though it spans 5 years and relates to costs for deficiencies not related to San Bruno (it feels selective as to what is recurring vs event specific?).

Share price performance



On 02/21/13 the S&P 500 INDEX closed at 1502.42

Quarterly EPS	Q1	Q2	Q3	Q4
2012A	0.89	0.81	0.93	0.59
2013E	0.79	0.75	0.78	0.37
2014E	—	—	—	—

Financial and valuation metrics

Year	12/12A	12/13E	12/14E	12/15E
EPS (CS adj.) (US\$)	3.22	2.68	3.07	3.29
Prev. EPS (US\$)	—	2.85	3.19	3.46
P/E (x)	12.9	15.4	13.5	12.6
P/E rel. (%)	87.2	112.4	109.5	114.2
EBITDA (US\$ m)	4,883	4,112	4,697	5,136
EV/EBITDA (current)	6.1	7.3	6.4	5.8
Net debt (US\$ m)	12,178	13,884	15,835	17,563
FFO/Interest	5.2	3.5	3.6	3.6
FFO/Total Debt	0.28	0.18	0.18	0.18
Number of shares (m)	430			31
Net debt (Next Qtr., US\$ m)	12,586			1.8
Net debt/tot cap (Next Qtr., %)	91.4			1.1
		BV/share (Next Qtr., US\$)		
		Dividend (current, US\$)		
		Dividend yield (%)		

Source: Company data, Credit Suisse estimates.

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- **FERC ROE:** PCG requested a FERC rehearing on the 9.1% electric transmission ROE, but this will take a while to resolve with the only other recourse being federal appeals court if FERC does not change. The ROE drop to 9.1% costs about \$0.10 of EPS.
- **Big investment, equity:** PCG plans to spend \$4.5 -6.0 BN of capex a year through 2016 (6-10% annual rate base growth) with the range dependent upon how much the CPUC approves in the pending general rate case (GRC) which realistically is a 2014 resolution. To fund capex, losses from the encroachment repairs, and assumed San Bruno fine (we use \$600 MM) we see PCG needing \$2.6 BN of equity in '13/'14 and about \$800 MM a year thereafter.
- **Cost questions.** While hard to quantify until GRC is resolved, we worry PCG could underearn for longer than just 2013 as mgmt incurs O&M at higher than approved levels as they work to raise operating metrics from 3rd / 4th quartile in most categories to 1st / 2nd which will likely take several years to realize. As hard as it is to accept underearning especially with supportive CA regulatory mechanisms, we think the concerted efforts to improve performance is the right long -term strategy for the utility, customers, and ultimately investors.

Exhibit 1: PCG Income Statement

Income Statement	Q112A	Q212A	Q312A	Q412A	2012A	Q113E	Q213E	Q313E	Q413E	2013E	2014E	2015E
GrossMargin	2,439	2,499	2,575	2,504	10,017	2,291	2,366	2,428	2,370	9,455	9,842	10,384
Operation & Maintenance Expense	1,116 [¶]	1,201 [¶]	1,220 [¶]	1,432 [¶]	4,968 [¶]	1,144	1,231	1,250	1,468	5,092	5,194	5,298
Additional San Bruno Related O&M	38 [¶]	59 [¶]	66 [¶]	73 [¶]	236 [¶]	75	75	75	75	300 [¶]	0	0
Public Purposed Programs	0	0	0	0	0	0	0	0	0	0	0	0
O&M Related to Pension Funding	0	0	0	0	0	0	0	0	0	0	0	0
Taxes Other Than Income Taxes	0	0	0	0	0	0	0	0	0	0	0	0
Other Income	26	32	26	(14)	70	13	13	13	13	50	50	50
Energy Efficiency Incentives	0	0	0	0	0	0	0	0	0	0	0	0
EBITDA	1,311	1,271	1,315	985	4,883	1,085	1,072	1,115	840	4,112	4,697	5,136
Depreciation & Amortization	480	506	502	353	1,841	355	358	360	362	1,435	1,523	1,613
Securitization Amortization	102	98	113	110	423	0	0	0	0	0	0	0
Pension Funding Amortization	2	2	2	2	8	2	2	2	2	8	8	8
Operating Income	727	665	698	520	2,611	727	713	753	475	2,669	3,167	3,514
Net Interest Expense	171	172	175	174	692	180	186	192	198	755	839	922
Incremental cost of debt					0.0%	5.5%	5.5%	5.5%	5.5%	5.5%	5.5%	5.5%
Weighted Avg. Cost of Debt	5.4%	5.3%	5.3%	5.4%	5.4%	5.4%	5.5%	5.6%	5.6%	5.6%	5.5%	5.4%
Securitization Interest Expense	2	1	1	0	4	-	-	-	-	-	-	-
Earnings Before Taxes	554	492	522	346	1,915	548	527	562	278	1,914	2,328	2,592
Income Tax Expense/(Benefit)	179	145	120	89	534	195	187	199	99	680	826	920
Effective Tax Rate	32.3%	29.5%	23.1%	25.8%	27.9%	35.5%	35.5%	35.5%	35.5%	35.5%	35.5%	35.5%
Net Income	375	347	402	257	1,381	353	340	362	179	1,235	1,501	1,672
Preferred Securities	3	4	3	4	14	3	4	3	4	14	14	14
Recurring Net Income	372	343	399	253	1,367	350	336	359	175	1,221	1,487	1,658
Extraordinary Items	(139)	(108)	(38)	(266)	(551)	(99)	(99)	(99)	(499) [¶]	(795) [¶]	(169) [¶]	
Reported Net Income	233	235	361	(13)	816	252	237	260	(324)	426	1,319	1,658
Recurring Earnings per Share	0.89	0.81	0.93	0.59	3.22	0.79	0.75	0.78	0.37	2.68	3.07	3.29
Growth					-10.1%					-16.6%	14.5%	7.2%
Reported EPS	0.56	0.55	0.84	(0.03)	1.92	0.57	0.53	0.57	(0.69)	0.94 [¶]	2.72	3.29
Fully Diluted Shares Outstanding	416	425	429	430	425	443	450	458	469	455	484	504
9.5% Convertible	0	0	0	0	0	0	0	0	0	0	0	0
Stated Diluted Shares Outstanding	416	425	429	430	425	443	450	458	469	455	484	504
Share Price	41.88	43.88	44.41	41.42	42.90	42.00	42.63	43.27	43.92	42.95	46.55	49.35
Common Shares	416	425	429	430	425	442	449	458	469	455	484	503
Dividends Per Share	0.46	0.46	0.46	0.46	1.82	0.46	0.46	0.46	0.46	1.84	1.93	2.07

Source: Company data, Credit Suisse estimates

Exhibit 2: PCG Cash Flow Statement

CashFlow Statement	Q112A	Q212A	Q312A	Q412A	2012A	Q113E	Q213E	Q313E	Q413E	2013E	2014E	2015E
Net Income	236	239	364	(9)	830	353	340	362	179	1,235	1,319	1,558
D&A	582	604	615	463	2,264	355	358	360	362	1,435	1,523	1,615
Other D&A	2	2	2	2	8	0	0	0	0	0	0	0
Extraordinary Items / San Bruno	(163) ^W	(183) ^W	(40) ^W	(426) ^W	(812)	0	0	0	0	0	0	0
Deferred Income Taxes	146	88	390	24	648	125	117	129	(160)	211	450	350
Changes in Working Capital	17	(12)	26	565	596	0	0	0	0	0	0	0
Energy Efficiency cash levdization	0	0	0	0	0	0	0	0	0	0	0	0
Other	111	505 ^W	(79) ^W	811 ^W	1,348	(55) ^W	(55) ^W	(55) ^W	(55) ^W	(220)	(158) ^W	(108) ^W
CashFlow From Operations	931	1,243	1,278	1,430	4,882	778	760	796	326	2,661	3,134	3,514
Capital Expenditures	(1,094)	(1,125)	(1,142)	(1,263)	(4,624)	(1,283)	(1,283)	(1,283)	(1,283)	(5,130)	(5,150)	(5,050)
Acquisitions of Assets & Sec.	0	0	0	0	0	0	0	0	0	0	0	0
Divestitures of Assets & Sec.	0	0	0	0	0	0	0	0	0	0	0	0
Other Investments	1	12	(11)	96	98	0	0	0	0	0	0	0
CashFlow From Investing	(1,093)	(1,113)	(1,153)	(1,167)	(4,526)	(1,283)	(1,283)	(1,283)	(1,283)	(5,130)	(5,150)	(5,050)
Issuance/(Redemption) of Debt	(245)	23	65	93	(64)	408	429	297	572	1,706	1,951	1,728
Securitization Issuance / (Redempti	(102)	(98)	(113)	(110)	(423)	0	0	0	0	0	0	0
Issuance/(Rep.) of Pref. Equity	0	0	0	0	0	0	0	0	0	0	0	0
Issuance/(Rep.) of Common Equity	387 ^W	174	141 ^W	49	751	300	300	400	600	1,600	1,000	850
Common Stock Dividends	(182)	(186)	(188)	(190)	(746)	(203)	(207)	(211)	(216)	(837)	(935)	(1,042)
Convnt pass thru dividends	0	0	0	0	0	0	0	0	0	0	0	0
Other Financing	48	(8)	(26)	0	14	0	0	0	0	0	0	0
CashFlow From Financing	(94)	(95)	(121)	(158)	(468)	504	522	486	956	2,469	2,016	1,536
Increase/(Decrease) in Cash	(256)	35	4	105	(112)	0	0	0	0	0	0	0
Cash at Beginning of Period	513	257	292	296	513	401	401	401	401	401	401	401
Cash at End of Period	257	292	296	401	401	401	401	401	401	401	401	401

Source: Company data, Credit Suisse estimates

Exhibit 3: PCG Balance Sheet

Balance Sheet	Q112A	Q212A	Q312A	Q412A	2012A	Q113E	Q213E	Q313E	Q413E	2013E	2014E	2015E
Cash & Cash Equivalents	257	292	296	401	401	401	401	401	401	401	401	401
Restricted Cash	385	381	418	330	330	330	330	330	330	330	330	330
Accounts Receivable	1,540	1,684	1,964	1,698	1,698	1,698	1,698	1,698	1,698	1,698	1,698	1,698
Regulatory Balancing Accts.	1,425	1,351	1,475	936	936	936	936	936	936	936	936	936
Inventories	370	415	454	444	444	444	444	444	444	444	444	444
Prepaid Expenses and Other	2,189	1,417	986	1,312	1,312	1,312	1,312	1,312	1,312	1,312	1,312	1,312
Total Current Assets	6,166	5,540	5,593	5,121	5,121	5,121	5,121	5,121	5,121	5,121	5,121	5,121
Gross PP&E	50,356	51,348	52,011	54,167	54,167	55,450	56,732	58,015	59,297	59,297	64,447	69,497
Less Accum. Depreciation	(16,107)	(16,446)	(16,361)	(16,644)	(16,644)	(16,999)	(17,357)	(17,717)	(18,079)	(18,079)	(19,602)	(21,216)
Total PP&E	34,249	34,902	35,650	37,523	37,523	38,450	39,375	40,298	41,218	41,218	44,845	48,282
Other Noncurrent Assets												
Regulatory Assets	6,565	6,534	6,527	6,809	6,809	6,864	6,919	6,974	7,029	7,029	7,187	7,294
Nuclear Decommissioning Funds	2,134	2,106	2,155	2,161	2,161	2,161	2,161	2,161	2,161	2,161	2,161	2,161
Other/Restricted Cash	1,074	1,033	943	835	835	835	835	835	835	835	835	835
Total Other Assets	9,773	9,673	9,625	9,805	9,805	9,860	9,915	9,970	10,025	10,025	10,183	10,290
Total Assets	50,188	50,115	50,868	52,449	52,449	53,431	54,411	55,389	56,364	56,364	60,148	63,693
Short Term Debt	1,401	1,079	397	492	492	492	492	492	492	492	492	492
Short Term Securitized Debt	321	223	110	0	0	0	0	0	0	0	0	0
Accounts Payable	2,666	2,194	2,100	2,476	2,476	2,476	2,476	2,476	2,476	2,476	2,476	2,476
Accrued Taxes	110	112	15	6	6	6	6	6	6	6	6	6
Other	2,777	2,749	2,814	3,282	3,282	3,282	3,282	3,282	3,282	3,282	3,282	3,282
Total Current Liabilities	7,275	6,357	5,436	6,256	6,256	6,256	6,256	6,256	6,256	6,256	6,256	6,256
Long Term Debt	11,767	12,166	12,915	12,417	12,417	12,825	13,254	13,551	14,123	14,123	16,074	17,802
Convertible	0	0	0	0	0	0	0	0	0	0	0	0
Long Term Securitized Debt	0	0	0	0	0	0	0	0	0	0	0	0
Deferred income taxes	6,190	6,272	6,724	6,748	6,748	6,873	6,990	7,119	6,959	6,959	7,409	7,759
Regulatory Liabilities	4,927	5,008	5,107	5,088	5,088	5,088	5,088	5,088	5,088	5,088	5,088	5,088
Other	7,217	7,258	7,301	8,614	8,614	8,614	8,614	8,614	8,614	8,614	8,614	8,614
Total Long Term Liabilities	30,101	30,704	32,047	32,867	32,867	33,399	33,946	34,372	34,784	34,784	37,185	39,263
Pref. Stock of Subsidiaries	252	252	252	252	252	252	252	252	252	252	252	252
Stockholders' Equity												
Common Stock	8,011	8,204	8,362	8,428	8,428	8,728	9,028	9,428	10,028	10,028	11,028	11,878
Retained Earnings	4,752	4,793	4,957	4,747	4,747	4,897	5,030	5,182	5,145	5,145	5,529	6,144
Other Comprehensive Income	(203)	(195)	(186)	(101)	(101)	(101)	(101)	(101)	(101)	(101)	(101)	(101)
Total Stockholders' Equity	12,560	12,802	13,133	13,074	13,074	13,524	13,957	14,509	15,072	15,072	16,456	17,921
Total Liab. & Share. Equity	50,188	50,115	50,868	52,449	52,449	53,431	54,411	55,389	56,364	56,364	60,148	63,693

Source: Company data, Credit Suisse estimates

Companies Mentioned (Price as of 21-Feb-2013)

PG&E Corporation (PCG.N, \$41.41, NEUTRAL, TP \$45.0)

Disclosure Appendix

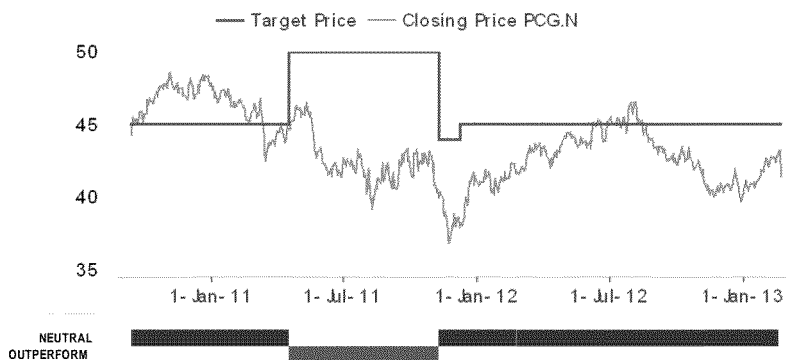
Important Global Disclosures

I, Dan Eggers, CFA, certify that (1) the views expressed in this report accurately reflect my personal views about all of the subject companies and securities and (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

Price and Rating History for PG&E Corporation (PCG.N)

PCG.N	Closing Price	Target Price	
Date	(US\$)	(US\$)	Rating
13-Sep-10	44.26	45.00	N
18-Apr-11	44.65	50.00	O
10-Nov-11	40.09	44.00	N
09-Dec-11	38.24	45.00	

* Asterisk signifies initiation or assumption of coverage.



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Neutral/Hold*	38%	(46% banking clients)
Underperform/Sell*	16%	(40% banking clients)
Restricted	3%	

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Price Target: (12 months) for PG&E Corporation (PCG.N)

Method: We reach our \$45 target price on PG&E Corp. using a zero premium to group traditional multiples - currently we are using discounted 2013 group multiples of 15x Price to Earnings (P/E).

Risk: Risks to our \$45 target price on PG&E Corp include: (1) negative regulatory decisions that disallow PCG's planned capital spending, ROE degradation, or non-recoverable O&M (2) unknown liability of San Bruno gas pipe explosion (3) a significant increase in natural gas prices that raises the cost of electricity that is passed through to end use customers in PCG's northern California service territory, (4) Nuclear risk.

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See the *Companies Mentioned* section for full company names

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