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July 9, 2013

PG&E Corp

(PCG US EQUITY–$45.37–OUTPERFORM)

San Bruno: Not easy, not over

- **CPSD asks to re-file reply testimony on San Bruno penalty cases; concerning**
  Yesterday, the CPSD (Consumer Protection and Safety Division ((enforcement Staff) filed a motion to file an amended reply brief in the penalty cases for San Bruno. CPSD says that due to the multiple lawyer and staff changes on its end it needs to correct certain inaccuracies in statements in its briefs. As a reminder, CPSD originally filed its reply briefs on June 5, 2013 and pushed for the penalty to be toward safety spending and pipeline improvements, potentially including rights of way spend. It is not clear what the new reply testimony (due July 15) will include. We find the recent development concerning and are watchful to see how it impacts recommendations and the schedule.

- **Bracketing a best case and a worst case**
  The CPSD's new reply testimony could keep its original recommendations the same, but write a more fulsome brief and correct technical language—we would view this positively. Conversely, the CPSD could change its entire recommendation and move towards a $2.25B fine that does not give PCG any credit for past expenditures towards safety. We believe the new reply briefs will be somewhere in between. Last week the City of San Bruno filed a motion to strike "credits" from the briefs saying that the CPSD proposal is wholly unsupported by evidence and violates due process. In its request to file an amended reply brief, the CPSD mentions that it will make some of the City of San Bruno motion moot.

- **CPSD likely to keep view that penalty go to safety spend, in our view**
  We believe the CPSD and the CPUC would prefer that penalties for San Bruno go towards safety spend and improving the pipeline system. However, it is not clear if the City of San Bruno will be successful in getting the concept of "credit" for past PCG spend stricken in the record. We believe PCG should be allowed to count safety improvements towards the penalty, and note that in the hearings on the Overland report, the penalty number recommended ($2.25B) was supposed to be all-inclusive.

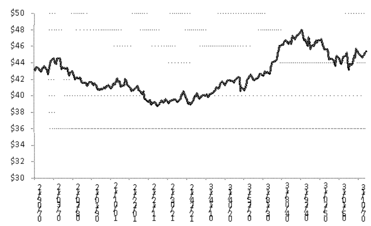
- **Could delay timeline for ALJ decision and resolution**
  Ultimately, we believe the amended CPSD reply brief raises uncertainty not only on the ultimate penalty recommendation but also on timing of a decision, which has dragged on for awhile. An ALJ decision is due 60 days after reply briefs are filed; it is possible that the clock could start again if the CPSD amends its reply briefs. That said, we believe the CPUC is anxious to have a decision in the San Bruno case and could stick to the original 8/7 timeline for an ALJ decision. **Next steps near-term: replies to the CPSD motion due 7/10. ALJ ruling due 7/12. CPSD amended reply filed 7/15. ALJ ruling on City of San Bruno motion 7/16.**

Trading and Fundamental Data	
Target Price	$ 51
Current Price	$ 45.37
52 Week Range	$ 39 - $ 49
Market Cap. ($MM)	$ 20,061
Share Out. (MM)	442.2
Dividend Yield	4.01%
Dividend Payout Ratio	95.7%
ROE	9.7%
Debt to Cap	50.2%
Avg Daily Vol (ooo)	2,232

Source: Bloomberg

Price Performance	YTD	LTM
PCG US Equity	13%	1%
Utility Index	7%	1%
S&P 500	16%	22%

Source: Bloomberg



Source: Bloomberg

Estimates / Valuation				
(US$)	**2013E**	**2014E**	**2015E**	**2016E**
EPS	$2.58	$3.07	$3.23	$3.29
Consensus	$2.64	$3.08	$3.28	$3.41
P/E	17.6x	14.8x	14.1x	13.8x
Dividend Per Share	$1.82	$1.86	$1.93	$2.01
Dividend Yield	4.0%	4.1%	4.3%	4.4%

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PG&E Corp Snapshot

Exhibit 1. Financial Summary

Financial Summary	2013E	2014E	2015E	2016E
Operating EPS	$2.58	$3.07	$3.23	$3.29
GAAP EPS	$1.46	$2.58	$3.10	$3.17
Diluted Shares Outstanding	448	476	498	518
Dividends Per Share	$1.82	$1.86	$1.93	$2.01
Dividend Yield	4.0%	4.1%	4.3%	4.4%
Dividend Payout Ratio	70%	60%	60%	61%
Equity Ratio	51%	51%	51%	51%
FFO/Net Debt	19%	23%	24%	23%
Valuation Metrics				
P/E	17.6x	14.8x	14.1x	13.8x
Price/Book	1.4x	1.3x	1.3x	1.2x
Segment EPS				
Utility	$2.60	$3.09	$3.25	$3.31
Parent	(0.02)	(0.02)	(0.02)	(0.02)
Total EPS	**$2.58**	**$3.07**	**$3.23**	**$3.29**
Utility				
Realized ROE	9.0%	10.3%	10.3%	10.4%
Average Rate Base (w/out CWIP)	$25,949	$28,505	$31,136	$33,192
Realized ROE	8.0%	9.2%	9.5%	9.5%
Average Rate Base (with CWIP)	$27,549	$30,105	$32,736	$35,192

Source: Wolfe Research, Utilities & Power

Exhibit 2. Modeling Assumptions

Assumptions	2013E	2014E	2015E	2016E
Total Capital Spending by Segment ($M)				
Electric Distribution	$1,850	$1,400	$1,500	$1,500
Gas Distribution	800	800	800	800
Generation	800	800	800	800
Common Plant	0	500	550	550
Electric Transmission	850	800	800	800
Gas Transmission	350	350	350	350
AMI & Other	0	0	0	0
Oakley	0	0	0	325
Pipeline Safety	450	367	400	400
Total Capex	**$5,100**	**$5,017**	**$5,200**	**$5,525**
Financings ($M)				
Total Equity Issued/(Repurchased)	$1,500	$1,000	$1,000	$800
Total Debt Issued/(Repurchased)	1,350	1,500	1,450	1,400
Sales Forecast				
Electric Customer Growth	0.0%	0.0%	0.0%	0.0%
Gas Customer Growth	1.8%	1.8%	1.8%	1.8%

Source: Wolfe Research, Utilities & Power

Company description

The Pacific Gas and Electric Company, a subsidiary of PG&E Corp, is one of the largest combination natural gas and electric utilities in the United States and one of the largest regulated utilities in our coverage universe. Based in San Francisco, California, the company provides natural gas and electric service to approximately 9.6 million people throughout a service area to most of the northern two-thirds of California. In Sept. 2010, there was an explosion on one of PG&E's gas pipelines in San Bruno, California which will result in penalties against PG&E and an overhaul of company operations, particularly in natural gas service.

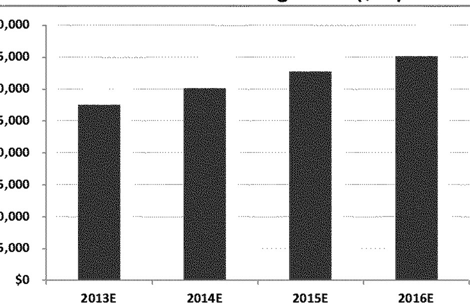
Investment Thesis

PCG offers a compelling regulated growth story that should return to a more normal operating state post the San Bruno aftermath. PCG benefits from very supportive state regulation in CA. We project earnings growth LT driven by an 8% growth in ratebase, through investments in transmission and distribution and generation. We expect PCG to increase the dividend as earnings grow LT.

Valuation

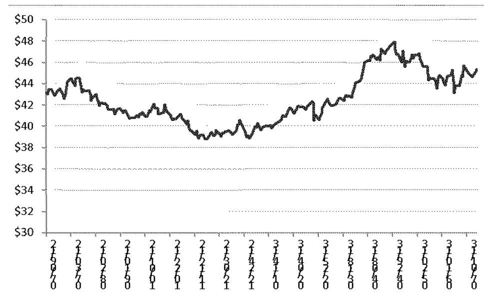
We value PCG at a P/E of 16x 2015E earnings in our $51 PT. Risks to our outlook are: 1) liability related to the San Bruno explosion, 2) lower than outcomes in rate cases and 3) Any unforeseen changes to California regulation.

Exhibit 3. Estimated base rate growth ($M)



Source: Wolfe Research, Utilities & Power

Exhibit 4. Performance Chart



Source: Bloomberg

Model highlights

Our 2013-2016 estimates are $2.58/$3.07/$3.23/$3.29.

Key assumptions are as follows:

- We target an overall equity ratio of 52% at the utility and by 2015, we target a consolidated equity ratio of 51%.
- We use an ROE of 10.4% at CPUC jurisdictional, 10.4% for PSEP spend, and 9.1% for FERC.
- We assume $300M annually of deferred taxes from 2013-2016. If deferred taxes are higher than what we have assumed, it would reduce our equity needs.
- We assume $21M in annual energy efficiency payments in 2013 and beyond
- We do not give any AFUDC earnings in 2013 and beyond
- We assume capex of $5.1 in 2013, $5.02B in 2014, $5.2B in 2015 and $5.53B in 2016. We do not assume any further capex write-offs beyond 2012.
- Our rate base from 2013-2016 excluding CWIP is $25.9B, $28.5B, $31.1B, and $33.2B. Our rate base with CWIP is $27.5B, $30.1B, $32.7B and $35.2B.
- We issue $1.5B of equity in 2013, $1B of equity in 2014, $1B of equity in 2015, and $800M of equity in 2016.
    - Our share price assumption is now $45/sh and was $44/sh
- We maintain PCG's 52% equity ratio at the utility. Our LT consolidated equity ratio is around 50-51%.
- We hold the dividend flat in 2013 and assume a 2% increase in 2014 and 4% increase after that.

Exhibits 5 and 6 below highlight our financial summary and modeling assumptions.

Exhibit 5: Financial Summary

Financial Summary	2013E	2014E	2015E	2016E
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Wolfe Research, LLC Fundamental Valuation Methodology:

Company:	Fundamental Valuation Methodology:
PCG US Equity	forward P/E

Wolfe Research, LLC Fundamental Target Price Risks:

Company:	Fundamental Target Price Risks:
PCG US Equity	liabilities associated with San Bruno, regulatory risk in California

Wolfe Research, LLC Research Disclosures:

Company:	Research Disclosures:
PCG US Equity	None

Other Disclosures:

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