From: Cherry, Brian K
Sent: 8/21/2013 7:24:55 AM
To: Paul Clanon (paul.clanon@cpuc.ca.gov)
Cc:
Bcc:
Subject: Fwd: PCG: Throwing in the towel; downgrade to Peer Perform

FYI.

Brian K. Cherry
PG&E Company
VP, Regulatory Relations
77 Beale Street
San Francisco, CA. 94105
(415) 973-4977

Begin forwarded message:

> **From:** "Cherry, Sara" <SACr@pge.com>
> **Date:** August 21, 2013, 7:22:27 AM PDT
> **To:** "Cherry, Brian K" <BKC7@pge.com>
> **Subject: Fwd: PCG: Throwing in the towel; downgrade to Peer Perform**
>
> Begin forwarded message:
>
>> **From:** Steve Fleishman <utilities@wolferesearch.com>
>> **Date:** August 20, 2013, 9:08:38 PM PDT
>> **To:** "invrel@pge-corp.com" <invrel@pge-corp.com>
>> **Subject: PCG: Throwing in the towel; downgrade to Peer Perform**
>> **Reply-To:** Steve Fleishman <utilities@wolferesearch.com>
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>> IPPs - Market

PG&E Corporation (PCG - $42.77 - Peer Perform)

Throwing in the towel; downgrade to Peer Perform

Click here to view our complete note [PDF]

Click here to view our PCG model [XLS]

Risk/reward not worth waiting for San Bruno order
A number of recent developments make us concerned that the final San Bruno outcome is more likely to be on the adverse end of the spectrum for shareholders. It is possible that the CPUC surprises to the upside in a final order, but they will face huge political pressure. PCG stock is trading at an average utility multiple on our 2015E of $2.99, which assumes the CPSD staff recommendation is adopted. We think the stock is fairly valued at this level given a lack of conviction the final order will be much better and the need for large amounts of equity without regulatory support and at a time when rates are rising and utility stocks are under pressure. Our new price target is $45 from $48.

What's new that worries us - are the tax benefits lost too?
While we thought the CPSD staff rec was extreme, the ALJ questions that came a few weeks after seemed to indicate even more issues, including a question of whether tax benefits from the billions of unrecovered costs should be passed back to customers. PCG will respond to the ALJ today, but in our discussions PCG indicated it has been saying all along that it is not fully clear that a penalty recommendation will be considered tax deductible by the IRS. We had not thought this was in question, but could possibly make the CPSD and other recommendations even worse than we assumed.

Calendar delayed with risk of more negative surprises
The ALJ filing made us more concerned that they could be just as bad as or worse than CPSD. Additionally, the ALJ filing also delayed the process to the point that a final order is now likely at the end of 2013 at best and possibly into 2014. In the meantime, PCG highlighted the ongoing criminal investigation on their Q2 call and the CA statute of limitations expires in September, which means a decision on criminal charges is likely coming soon with implications hard to predict. A recent show cause filed by the PUC on PCG related to pipeline testing data changes indicates a continued high pressure environment.

Still like rest of PCG, but San Bruno overwhelms all
Outside of SB we see constructive fundamentals, with strong rate base growth and favorable CA regulation. But SB and its lack of certainty, both on timing of resolution and magnitude, make PCG tough to own. In addition, PCG is currently also dealing with an electric rate case and will file a gas rate case next year. We expect a reasonable outcome, but expect some overhang. Our $45 PT is based on 15x P/E for 2015E earnings. Our 2013-2016 estimates are unchanged at $2.51, $2.91, $2.99 and $3.06 per share. We assume the CPSD rec in our estimates ($300M incremental fine, $1.5B disallowed costs).

Read more... [PDF]

Thanks,

Steve

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