

First Read

PG&E Corporation

Trimming the Outlook

Q: How did PCG's outlook/guidance change? Generally lower across the board

A: PG&E now expects to issue \$800Mn of equity in 2016 vs a \$600-\$800Mn range as of 1Q16 with the latest GT&S capital disallowance and the recordkeeping fine as two factors pushing the expected dilution incrementally higher. 2016 capex was maintained at ~\$5.6Bn with higher gas transmission spending offset by a reduction in electric distribution. 2016 weighted average rate base declined \$200Mn due to the GT&S disallowance. PCG has tightened its 2017-2019 weighted average ratebase CAGR to 5.5-6.5% from ~5-7% but off a ~\$150Mn lower base. 2017-2019 capex was trimmed \$100Mn at the high-end of the range to \$5.4-\$6.4Bn. Overall the midpoint for 2019 weighted average ratebase declined \$250Mn to \$38.25Bn from \$38.50Bn. Management's updated guidance is based on the assumption that the \$850Mn San Bruno penalty is split \$690Mn capital/\$160Mn expense but the final decision expected by mid-October could significantly differ, potentially impacting the capex disclosures depending on how the California Public Utilities Commission (CPUC) [seeks to address bill inflation](#). Specifically a split with additional expense rather than capital would be a positive for long-term earnings power. The FY16 operating EPS range was maintained at \$3.65-\$3.85; many investors had been concerned that PCG would lower guidance with results due in part to revenue recognition timing.

Q: How did 2Q16 results compare to expectations? Well below UBSe/Street

A: 2Q16 operating EPS of \$0.66 is down meaningfully YoY (\$0.91 in 2Q16) and represents a large miss versus UBSe (\$0.86) and Consensus (\$0.92). The two most significant wildcards are timing of taxes (-\$0.08 vs -\$0.03 UBSe) and miscellaneous (-\$0.08 vs +\$0.03 UBSe). The remaining -\$0.04 of the quarterly miss relates to -\$0.03 higher expenses for regulatory/legal and -\$0.01 higher refueling outage costs. On a GAAP basis PCG has reduced the expectations for net Butte fire costs due to insurance to -\$0.20 from -\$0.45. Management also expects a net ~+\$0.19 for GT&S impact with disallowances offsetting 55% of the revenue contribution.

Q: How do we expect investors to react? Negative outcome, but expected

A: The reduction in long-term weighted-average ratebase is a negative factor but was largely expected following the GT&S disallowance. PCG has solidly outperformed since mid-May and we have seen more reasons for optimism as the outlook has improved, but remain Neutral resolution on the [criminal case](#) expected in the upcoming weeks with a potential \$562Mn penalty. A settlement conference for the 2017 CPUC General Rate Case (GRC) is set for next Wednesday (August 3) where a potential settlement could be a positive catalyst.

Equities

Americas
Electric Utilities

12-month rating **Neutral**

12m price target **US\$67.00**

Price **US\$63.95**

RIC: PCG.N BBG: PCG US

Trading data and key metrics

52-wk range	US\$65.39-47.60
Market cap.	US\$30.1bn
Shares o/s	470m (COM)
Free float	100%
Avg. daily volume ('000)	869
Avg. daily value (m)	US\$53.7
Common s/h equity (12/16E)	US\$17.6bn
P/BV (12/16E)	1.8x
Net debt / EBITDA (12/16E)	2.8x

EPS (UBS, diluted) (US\$)

	12/16E	
	UBS	Cons.
Q1	0.82	0.82
Q2E	0.86	0.92
Q3E	0.99	1.08
Q4E	1.02	0.96
12/16E	3.70	3.72
12/17E	3.59	3.68
12/18E	3.76	3.86

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Highlights (US\$m)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Revenues	15,598	17,090	16,833	18,313	18,699	19,235	19,773	20,313
EBIT (UBS)	1,811	2,741	2,282	3,699	3,821	4,103	4,393	4,672
Net earnings (UBS)	1,210	1,648	1,522	1,843	1,826	1,944	2,067	2,197
EPS (UBS, diluted) (US\$)	2.72	3.50	3.12	3.70	3.59	3.76	3.96	4.21
DPS (US\$)	1.82	1.82	1.82	1.96	2.11	2.28	2.46	2.65
Net (debt) / cash	(14,736)	(15,784)	(17,338)	(17,995)	(19,938)	(21,659)	(23,589)	(25,327)
Profitability/valuation	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
EBIT margin %	11.6	16.0	13.6	20.2	20.4	21.3	22.2	23.0
ROIC (EBIT) %	3.9	5.5	4.2	6.5	6.5	6.6	6.7	6.9
EV/EBITDA (core) x	13.4	11.0	13.0	10.9	10.8	10.4	10.0	9.7
P/E (UBS, diluted) x	15.9	13.1	16.9	17.3	17.8	17.0	16.1	15.2
Equity FCF (UBS) yield %	5.9	13.4	10.6	14.6	11.3	13.0	15.2	17.1
Net dividend yield %	4.2	4.0	3.4	3.1	3.3	3.6	3.8	4.1

Source: Company accounts, Thomson Reuters, UBS estimates. UBS adjusted EPS is stated before goodwill-related charges and other adjustments for abnormal and economic items at the analysts' judgement. Valuations: based on an average share price that year, (E): based on a share price of US\$63.95 on 27 Jul 2016 19:37 EDT

Forecast returns

Forecast price appreciation	+4.8%
Forecast dividend yield	3.2%
Forecast stock return	+8.0%
Market return assumption	5.7%
Forecast excess return	+2.3%

Valuation Method and Risk Statement

Factors that could prevent PG&E Corp from achieving our earnings, cash flow and price target objectives include: adverse regulatory decisions by the California Public Utilities Commission (CPUC), including rate case decisions and cost of capital proceedings (CoC), or restrictions placed on the utility by the CPUC regarding the movement of funds between the utility and parent to meet its debt service and other financial obligations and to pay dividends on its common stock, as well as from the federal regulators, FERC. Additional risks include interest rate and capital markets risk; slowdown in the regional economy; various risks associated with operating nuclear units; more stringent environment regulation; adverse market performance requiring unplanned contributions to the pension plans and other postretirement benefit plans, and nuclear decommissioning trust are other significant risks, among other things.

Separately, the ultimate amount of loss, if any, the utility bears in conjunction with the San Bruno explosion could have a material adverse impact on the company's financial condition. The utility believes it will incur additional, unbudgeted costs for inspection and maintenance of its natural gas transmission system. If it is determined that the utility didn't comply with applicable statutes, regulation, rules, tariffs, or orders in connection with the San Bruno accident or if it is ordered to pay a material amount of refunds, penalties, or other amounts, the financial condition of the company could be materially and adversely affected.

Valuation is based on a P/E methodology.

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12-Month Rating	Definition	Coverage ¹	IB Services ²
Buy	FSR is > 6% above the MRA.	47%	32%
Neutral	FSR is between -6% and 6% of the MRA.	38%	25%
Sell	FSR is > 6% below the MRA.	15%	21%
Short-Term Rating	Definition	Coverage ³	IB Services ⁴
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 30 June 2016.

1:Percentage of companies under coverage globally within the 12-month rating category.

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UBS Securities LLC: Julien Dumoulin-Smith; Paul Zimbardo; Jeremiah Booream, CFA.

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Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
PG&E Corporation ¹⁶	PCG.N	Neutral	N/A	US\$63.95	27 Jul 2016

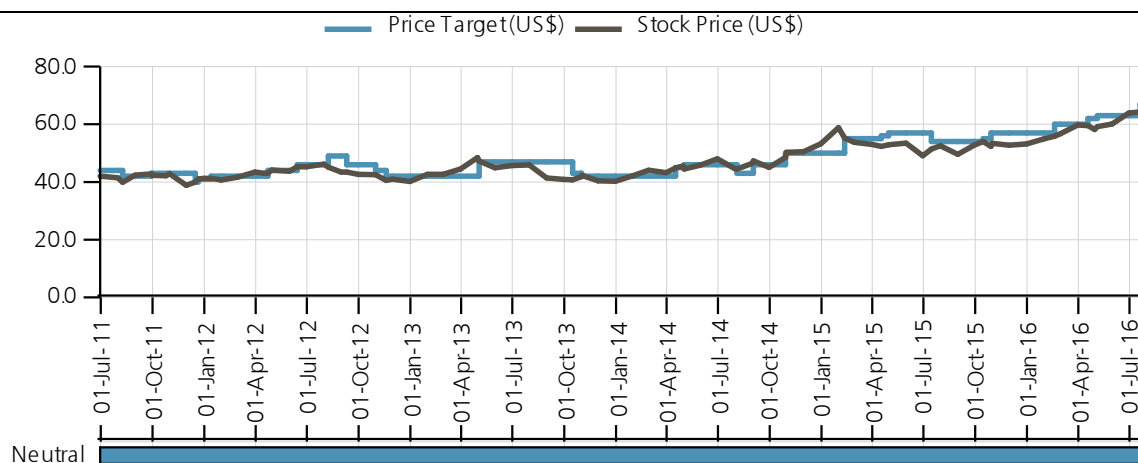
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PG&E Corporation (US\$)



Source: UBS; as of 27 Jul 2016

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