November 28, 2018
Best Idea: Pacific Gas & Electric Corp. (PGC)
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Investment Strategy: Bank and Utility Total Return Strategy

Pacific Gas & Electric (PG&E Corp. – PCG) is the most attractive utility investment opportunity in the last 15 years. The company's stock price declined by approximately 50% in the wake of the devastating wildfires in northern California in early November 2018. PG&E's stock price is trading at 70% of tangible book value and 7x 2019 eps (utility group trades around 2.3x p/tbv and 20x p/e) as the market is pricing in various doomsday scenarios and does not appreciate the company's inevitable recovery path.

The market fears PG&E will face insurmountable liabilities (perhaps in excess of its current market cap of $12 billion) from the recent wildfires that could ultimately force the company to file for bankruptcy. There are several factors that clearly show why bankruptcy is not a realistic option for PG&E. Indeed, in all likelihood California will ensure that PG&E remains financially healthy. As these factors are better understood, PG&E's stock should experience a strong recovery and should rise above its pre-wildfire level ($48 per share).

Electric utilities provide a critical service to the communities they serve. If high-quality electric service is not maintained the community suffers greatly. Electric service is a very capital-intensive industry, and utilities have large capex budgets, which require favorable access to capital markets to finance. As a result, utility regulatory commissions typically set rates at levels that ensure utilities have good access to the capital markets, enabling appropriate service to be maintained. Not surprisingly, bankruptcies of electric utilities are very rare, and regulators seek to keep utilities sound financially. Importantly, the California Public Utility Commission President, Michael Picker, stressed after the most recent wildfire that he did not want PG&E to be forced into bankruptcy.

Utility access to capital markets is even more important in California than most states because the state has established an ambitious environmental policy to address climate change. The policy will require huge utility capex in the years ahead. PG&E is part of the solution. For example, California set a goal of 5 million zero-emission vehicles by 2030 (350,000 on the road now) which requires a significant development of the electric grid, including many more charging stations (15,000 now but expected to grow to 250,000 by 2025). Achieving California's environmental goals requires substantial increases in capex by the state's utilities which, in turn, requires that the utilities have access to the capital markets (something PG&E does not have at this time).

California addressed the wildfire liability issue earlier this year. In response to devastating wildfires in 2017, the California legislature overwhelmingly passed a bill (passed both houses by approximately 80% and was signed by the governor) that, among other things, provided a mechanism for PG&E to deal with wildfire liability from the 2017 wildfires – even if the company was negligent but the liabilities put the company under financial stress – by allowing the company to issue bonds secured by customer electric rates. Moreover, the legislation provided a mechanism for utilities to recover costs for future wildfires provided the utility acted reasonably beginning January 1, 2019. The legislation was passed on August 31, 2018 but left a gap for wildfires occurring in 2018. New legislation is already being considered to address 2018 wildfire liability and to ensure stable utilities in California.

While the market is concerned about massive potential liability facing PG&E – a determination of the exact amount of liability is likely years away. California Department of Forestry and Fire Protection ("CalFire") will initially investigate what caused the wildfire (likely to be PG&E electric equipment) which will at least take several months which will then be followed by litigation to ascertain liability over the coming years.

PG&E is currently financially healthy. As a result of the dividend suspension, PG&E is retaining approximately $1 billion more which further builds its equity base. Since California clearly wants PG&E to remain financially healthy, a positive resolution of the potential wildfire liability issue is highly likely over the coming months either through the legislature or by action of the utility commission. Providing a mechanism for PG&E to adequately deal with potential wildfire liabilities is in the best interests of all parties involved and would provide a pathway for a recovery in PG&E's stock price to a level from before the recent wildfires (almost double the current price) over the next 12 months.