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Market Flash: Enron [ENE] (Baa1/BBB+) (Attractive)

Enron Third Quarter Earnings and Investor Call Update

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While Enron (Baa1/BBB+) (WL-Negative/Stable) [Attractive] still faces some near-term challenges to improve its financial flexibility and to restore investor confidence, we believe the core pipeline and wholesale energy businesses (which account for about 95% of total pre-tax earnings) are still stable. Enron remains a leading power and gas marketer in North America and Europe, and continues to demonstrate steady earnings growth. Enron's gas pipeline business contributes stable cash flows and modest growth.

Enron's long-term bonds and "share trust" bonds have widened to attractive levels given that we think the risk of a credit rating downgrade to low-BBB or below is low. We still feel comfortable with Enron's short-maturity "share trust" deals, specifically Marlin and Osprey. Importantly, Enron management reiterated its support for these deals during its recent investor conference call. Enron plans to meet its funding obligation with asset sale proceeds, but would issue equity, if necessary, as required under certain provisions of the indenture.

Enron Share Trust Notes

With regard to the trigger events related to Enron's share trust obligations, there is a low probability of a stock price/ credit downgrade trigger event, which would cause Enron to be required to issue a significant amount of equity. At ENE's current stock price, this trigger would only come into effect if Moody's, or Standard & Poor's, or Fitch downgrades to Enron below investment grade from its current Baa1/BBB+/BBB+ levels. Both S&P and Fitch have a stable outlook on Enron's credit ratings. While Moody's has Enron's long-term ratings on review for possible downgrade, they affirmed the P-2 short-term rating, which corresponds to a credit rating of at least mid-BBB.

Rating Agency Reaction

Enron reported earnings for the third quarter 2001 that showed consistent growth in its core pipeline and wholesale energy businesses, but also demonstrated the risk associated with some of its more recent diversification efforts. Following Enron's earnings announcement, Moody's placed Enron's credit ratings on review for downgrade due to concerns about the meaningful level of non-recurring charges and asset write-downs Enron reported for the third quarter. We expect Moody's to conclude its review around year-end. We think the probability of a one-notch downgrade at Moody's is slightly better than 50%. After the third quarter earnings announcement, Standard & Poor's affirmed Enron's credit ratings and stable outlook. We expect the rating agencies to continue to monitor the use of proceeds from planned asset sales and Enron's efforts to strengthen its balance sheet and capitalization ratios. Enron's management remains committed to its current credit ratings and to improving its balance sheet.

The primary performance targets to monitor over the near- to intermediate term are the sustainability of growth in Enron's wholesale services and energy services businesses and the implementation of Enron's planned asset optimization program. Although Enron has some $3.4 billion in contingent equity obligations related to the Marlin and Osprey transactions that mature in 2003, management expects asset sale proceeds to be the primary source of principal repayment. Also, management has stated that it does not have additional structured finance arrangements that are similar to the one that resulted in the $1.2 billion reduction in book equity recorded in the current quarter.

Enron Investor Call

On October 22, 2001, Enron held a conference call for investors to address some of the recent concerns that have had a negative impact on the price of Enron's common stock and fixed income obligations. In terms of near-term liquidity, Enron has some $3.35 billion of committed credit facilities that are used to back its commercial paper program. These committed credit facilities are not currently drawn. Enron has approximately $1.85 billion of commercial paper outstanding. According to Enron management, the committed credit facilities have no material adverse change clause and the only restrictive covenant is that Enron must maintain a debt to total capitalization ratio that does not exceed 65%. Enron has over $500 million of uncommitted lines of credit. Also, there is some $350 million outstanding under a $550 million loan facility.

In addition, Enron pledged its commitment to support the outstanding share trust deals, specifically, Marlin and Osprey, and to maintaining its current credit ratings. Management plans to hold subsequent conference calls as necessary to answer investor questions and to provide more answers to frequently asked questions via its web site.

Enron management also said that it is cooperating with an SEC inquiry into certain "related party transactions". For legal and confidentiality reasons, the company could not provide any specific details or expected duration of the SEC review. However, the information request appears to be related specifically to the LJM transaction, which Enron has terminated.

Third Quarter Results

For the quarter ended September 30, 2001, Enron announced non-recurring after-tax charge of $1.01 billion, including a $287 million asset impairment charge associated with Azurix, $180 million of restructuring costs associated with Broadband Services, and $544 million in investment losses primarily related to New Power Company, a retail energy marketing venture and early termination of certain structured transactions, called LJM. In addition, Enron will record a reduction to book equity of approximately $1.2 billion as a result of the termination of the LJM structured transactions. After the write-downs, Enron's net investment in broadband services is approximately $600 million. Enron continues to focus on cost reductions and strategic options for this business.

While the one-time charges and book equity adjustment will not have a negative impact on Enron's cash flow, the company's balance sheet will be weakened in the near term. For the third quarter 2001, total debt to total capitalization is expected to increase to approximately 50% from about 46% at June 30, 2001. By year-end, Enron plans to reduce debt through cash flow generated from operations and proceeds from asset sales. Pro forma 2001, debt leverage is expected to be approximately 47%. By 2002, Enron's debt leverage is expected to strengthen to the low-40% range with the proceeds from planned asset sales in 2002 used to strengthen the balance sheet. The planned $2.8 billion sale (including $1.0 billion of Portland General debt) of Portland General Electric is expected to close in the fourth quarter 2002.

	2000	LTM 6/30/01	9 mo. ended 9/30/01
EBITDA	2,808	3,424	2,605
Total Interest Obligations	915	971	663
Total Debt	10,229	12,812	*13,000
EBITDA/ Interest	3.07	3.53	3.93
EBITDA- Capex/ Interest	0.47	0.88	1.52
Total Debt/ LTM EBITDA	3.64	3.74	3.70
Total Debt/ Total Capitalization	41%	46%	50%

* = estimate

Source: Company Reports, CSFB

Segment Earnings

Enron reported recurring net income of $393 million and $1,203 million for the quarter and nine months ended September 30, 2001, respectively. Enron's income before interest, minority interests and taxes (IBIT) increased 16% to $773 million (see table below) driven primarily by growth in Enron's North American wholesale services, the consistent earnings contribution from the regulated gas pipeline business and growth in retail energy services. Natural gas volumes marketed increased 6% in North America to 26.7 Tbtu/d and by almost 3 times in Europe to 9.3 Tbtu/d. Power volumes increased 77% to 290 million Mwh in North America and to 104 million Mwh from 9.9 million Mwh in Europe.

Natural Gas Pipeline's IBIT increased by 2% to $85 million. System expansions to be online in 2002 are planned for Florida Gas Transmission and Transwestern Pipeline. Earnings at Portland General were negatively affected by increased purchased power costs. However, the utility received an approximately 36% rate increase effective October 2001. The rate order also included the implementation of a power cost adjustment mechanism that should allow for the more timely recovery of purchased power costs. Global Assets, Enron's newest reporting segment, mainly includes its international gas and power assets. Segment IBIT of $19 million was flat compared with the prior year and accounts for only 2% of Enron's total IBIT.

For the third quarter 2001, broadband services reported an IBIT loss of $80 million compared with a loss of $109 million in the prior quarter and a loss of $20 million in the third quarter 2000. Enron plans to continue to reduce costs for this business.

Income Before Interest, Minority Int. & Taxes ($ in millions)	**3Q 2001**	**3Q 2000**	**% chg.**	**% of total**
Transportation and Distribution				
Natural Gas Pipeline	85	83	2%	11%
Portland General	(17)	74	-123%	-2%
Global Assets	19	19	0%	2%
Wholesale Services				
Americas	701	536	31%	91%
Europe and Other Commodities	53	53	0%	7%
Retail Energy Services	71	27	163%	9%
Broadband Services	(80)	(20)	-300%	-10%
Corporate and Other	(59)	(106)	44%	-8%
Total	**773**	**666**	**16%**	**100%**

Source: Company reports

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AMSTERDAM	31 20 5754 890	JOHANNESBURG	27 11 884 67 41	SÃO PAULO	55 11 3841 6000
ATLANTA	1 404 656 9500	LONDON	44 20 7888 8888	SEOUL	82 2 3707 3700
AUCKLAND	64 9 302 5500	MADRID	34 91 423 16 00	SHANGHAI	86 21 6881 8418
BALTIMORE	1 410 223 3000	MELBOURNE	61 3 9280 1666	SINGAPORE	65 212 2000
BEIJING	86 10 6410 6611	MEXICO CITY	52 5 283 89 00	SYDNEY	61 2 8205 4400
BOSTON	1 617 556 5500	MILAN	39 02 7702 1	TAIPEI	886 2 2715 6388
BUDAPEST	36 1 202 2188	MOSCOW	7 501 967 8200	THAILAND	66 2 614 6000
BUENOS AIRES	54 11 4131 2700	MUMBAI	91 22 230 6333	TOKYO	81 3 5404 9000
CAIRO	202 567 7600	NEW YORK	1 212 325 2000	TORONTO	1 416 352 4500
CHICAGO	1 312 750 3000	PALO ALTO	1 650 614 5000	VIENNA	43 1 512 3023
FRANKFURT	49 69 75 38 0	PARIS	33 1 40 76 8888	WARSAW	48 22 695 0050
GENEVA	41 22 394 70 00	PASADENA	1 626 395 5100	WASHINGTON DC	1 202 354 2600
HOUSTON	1 713 220 6700	PHILADELPHIA	1 215 851 1000	WELLINGTON	64 4 474 4400
HONG KONG	852 2101 6000	PRAGUE	420 2 210 83111	ZUG	41 41 727 97 00
ISTANBUL	90 212 278 2500	SAN FRANCISCO	1 415 836 7600	ZURICH	41 1 333 55 55

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