SANDERS MORRIS HARRIS

Enron Corp. (ENE/NYSE)

3735194

September 28, 200

Phoenix Rising

Recent Price:	$27.25
Price Target:	$42.00
52 Week Range:	$90.37 - $24.46
DJIA:	8,847

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Recommendation: ***Strong Buy***

Estimates	2000A	2001E	2002E
EPS (Diluted)	1.47	1.85	2.15
P/E:	18.5x	14.7x	12.7x
CFFOPS (Diluted)	1.34	2.42	3.25
P/CF:	20.3x	11.3x	8.4x
Dividend Rate:	0.50	0.50	0.50
Dividend Yield:	1.98%	1.98%	1.98%

Investment Profile:	(6/30/01)
Share Base (MM):	890
Market Value ($Bil):	$28.9
Expected 5 Year Growth Rate	18%
% ROE	12.4%
% Leverage	61.8%
Mgmt Ownership	6.9%
Inst'l Ownership	67.3%
Daily Trading Volume	5.9 mm

Company Profile:

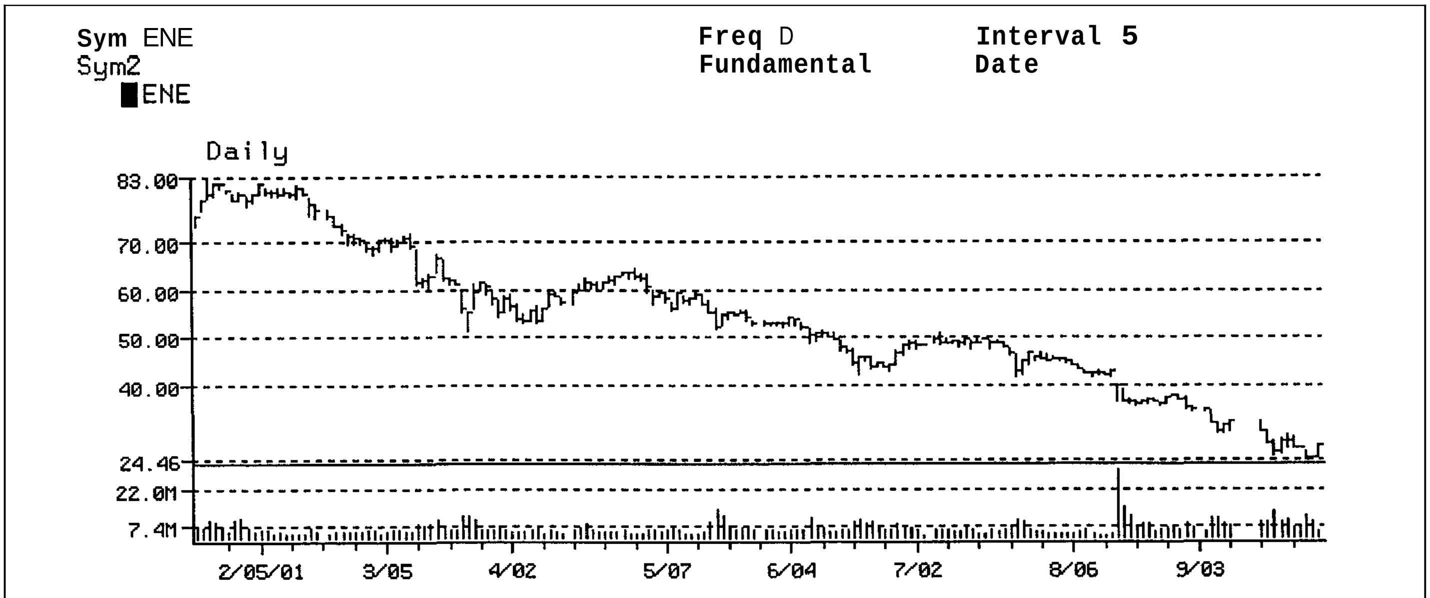
ENE is a $63 billion asset company with an exceptional marketing and trading agenda. It also has been weathering some exceptional issues. Its stock price is down 70% over the past year as the market continues to revalue high-flying stocks of all kinds. We expect ENE to grow EPS 15%-20% annually over the next five years, even while downsizing and streamlining its many moving parts. WEOS and RES, the marketing and energy outsourcing arms, should provide 80% of the 01E-05E growth. The company had 96 mm options outstanding (46.8 mm exercisable) at yearend 2000, 69% of the latter being still in the money. They represent about 12.7% of the primary share base, and will not be repriced.

Investment Logic:

Moving To A Strong Buy

- *We raised our ENE rating from Hold to Buy on September 5 at $32.25.* The September 11 tragedy changed everything. *We now move to a Strong Buy.* We have had the most conservative rating *(Hold)* on the Street for the past three years. Our twelve-month price target is $42.
- The stock has been undergoing massive distribution, and we are not smart enough to know where the bottom is. But it has become rationally priced again, at 12x forecasts for value investors. We think it is time to average into the stock.
- *The terrorism events of September 11 have made commodity markets even more volatile.* ENE's marketing and trading business (WEOS) does three times the dollar volume of the other trading platforms, and would be in a position to benefit.
- *The August management turnover may prove to be healthy in a Jeffersonian sense.* This was a company in need of a little revolution. We think it will turn into a good midcourse correction. The times are ideal for taking some $3 billion of asset write-downs, streamlining perhaps 1,500 jobs, etc., to get ENE back on a more profitable footing, ROE-wise.
- ENE would like to monetize $5 billion of International hard assets, and another $3 billion of Portland General (PGE) assets. Renewable Energy, Azurix, the Telecom network, and India all may come out of the portfolio.
- ENE intends to clarify its earnings reporting, stay out of exotic tax/ funding packages, and otherwise get back to basics. All of these issues had kept it increasingly out of step with a more conservative Wall Street.

RESEARCH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Source: ILX

Investing Rationale

ENE has traded down 70% in 2001 to date, in a 23% lower market and a 27% lower Energy Conglomerate group. It is also down 72% from its September 2000 high ($90.38). It is the prime Energy casualty of the pendulum shift in the market revaluation cycle so visible in the interim. The grouping below reflects Energy Conglomerates, and captures most of ENE's business mix.

Table One: 2001 Group Performance		
	28-Sep	***YTD***
Energy Conglomerates:	***Price***	***Delta***
CMS Energy	19.89	-37.2%
Dominion Resources	56.90	-15.1%
Duke Energy	36.29	-14.9%
Dynegy	31.27	-44.2%
El Paso	38.95	-45.6%
Enron	25.25	-69.6%
Kinder Morgan	47.14	7.3%
Williams	25.51	-36.1%
Average	35.15	-31.9%
Average ex Enron	36.56	-26.5%

The P/E and Average Annual Growth Rates (AAGRs) for this **group** are seen in Table Two.

Table Two: P/E Multiples & AAGRs:			%
	P/01E	***P/02E***	***AAGR***
CMS Energy	10.5	7.2	10.0
Dominion Resources	13.7	11.7	12.0
Duke Energy	15.1	13.5	10.0
Dynegy	15.3	12.3	20.0
El Paso	12.0	10.4	18.0
Enron	13.6	11.7	18.0
Kinder Morgan	25.2	19.4	20.0
Williams	11.9	11.1	15.0
Average	14.7	12.2	15.4

The market has been clearly revaluing ENE's growth, profitability, and business mix. Where has this led *so* far? A look at the PE-to-Growth and relative PE-to-S&P500 P/E is seen in Table Three:

Table Three: Relative P/Es	***02 PE/***	***02 PE/***
	AAGR	***Group***
CMS Energy	72%	59%
Dominion Resources	98%	96%
Duke Energy	135%	111%
Dynegy	61%	101%
El Paso	58%	85%
Enron	65%	97%
Kinder Morgan	97%	159%
Williams	74%	91%
Average	83%	100%
Average ex Enron	85%	100%

In looking at ENE's valuations relative to the S&P 500, first, we have Table Four:

Table Four: Earnings Data			
	2001E	***2002E***	***2003E***
S&P 500 (Operating)	47.00	56.00	61.00
AAGR (%)	-16.3%	19.1%	8.9%
Enron	1.82	2.15	2.47
AAGR (%)	23.8%	18.1%	14.9%

And second, we have the relative P/Es.

Table Five: Relative P/E Data			
	2001E	***2002E***	***2003E***
S&P 500 (Operating)	21.7	18.2	16.7
Enron	13.9	11.7	10.2
P/E Relative	64%	65%	61%

ENE's superior relative growth rates are obvious, but so are its deeper discounts to the S&P 500: 35%-40%. It is our argument that the revaluation **of** ENE has been overdone, and that the combination of better EPS growth and improving profitability should allow ENE to regain at least a market P/E. If it goes through a streamlining to get its ROE back to competitive levels (i.e., 17%-18% with a 50-50 total capital structure), it should command an even better premium. Simply recovering to a market P/E would take it back to the $39 area.

Table Six: ENE - Summary Investment Profile										
Diluted Per Share:	*1996*	*1997*	*1998*	*1999*	*2000*	*2001E*	*2002E*	*2003E*	*2004E*	*2005E*
Core Operating EPS	0.87	0.81	0.95	1.16	1.47	1.85	2.15	2.55	3.00	3.45
Recumng-Nonrecurring Items	0.21	-0.68	0.01	-0.08	-0.35	0.00	0.00	0.00	0.00	0.00
Reported EPS	**1.08**	**0.12**	**0.96**	**1.08**	**1.12**	**1.85**	**2.15**	**2.55**	**3.00**	**3.45**
DPS	0.43	0.45	0.48	0.50	0.50	0.50	0.52	0.54	0.56	0.60
CFFO	1.99	1.07	2.89	1.91	1.34	2.42	3.25	4.02	4.65	5.33
Book Value	6.78	8.81	11.38	11.80	13.76	15.10	16.74	18.74	21.18	24.03
Average Book Value	6.58	7.79	10.10	11.59	12.78	14.43	15.92	17.74	19.96	22.61
% Operating EPS Growth:	42%	-7%	18%	22%	27%	26%	17%	18%	18%	15%
% ROE	17.8%	10.3%	9.4%	10.0%	11.5%	12.8%	13.5%	14.4%	15.0%	15.3%
% Total Leverage	58.3%	60.9%	60.6%	58.1%	57.1%	58.6%	55.6%	52.1%	48.8%	45.5%
% Interest Rate	9.5%	8.4%	8.1%	8.5%	9.1%	7.5%	6.8%	6.6%	6.7%	7.0%
% Payout Ratio	39.8%	55.8%	49.7%	46.3%	44.6%	27.1%	24.2%	21.2%	18.7%	17.4%
% Taxes	-30.9%	-353.3%	20.9%	-9.1%	30.7%	24.0%	24.0%	25.0%	26.0%	27.0%
Share Bases (mm):										
Diluted Shares	540.2	554.6	695.3	769.0	842.9	889.4	920.0	940.0	960.0	980.0
Yearend Diluted Shares	510.3	656.0	718.2	783.2	845.8	890.0	920.0	940.0	960.0	980.0
% Growth		28.6%	9.5%	9.1%	8.0%	5.2%	3.4%	2.2%	2.1%	2.1%
Diluted Core Operating EPS:										
Q1	0.55	0.60	0.36	0.33	0.40	0.47	0.54	0.63	0.73	0.85
Q2	0.44	0.44	0.25	0.26	0.34	0.45	0.52	0.66	0.77	0.87
4 3	0.43	0.51	0.26	0.26	0.34	0.43	0.53	0.62	0.73	0.85
4 4	0.41	0.43	0.25	0.30	0.41	0.49	0.56	0.64	0.77	0.88
Year	1.82	1.98	1.12	1.16	1.47	1.85	2.15	2.55	3.00	3.45
				1.16	1.47	1.85	2.15	2.55	3.00	3.45
Diluted Core EPS: % Change										
Q1	9%	9%	-40%	-7%	19%	17%	16%	25%	16%	16%
Q2	24%	0%	-43%	5%	27%	35%	15%	19%	17%	13%
4 3	20%	19%	-49%	0%	29%	29%	23%	16%	18%	16%
4 4	-2%	5%	-42%	21%	37%	20%	13%	13%	20%	14%
Year	11%	9%	-43%	4%	27%	26%	15%	18%	18%	15%

Estimates: SMH, John E. Olson, (713) 220-5151

ENE's Valuation Matrix

On our particular investing guidelines, ENE still has some quite impressive investing credentials. The current investing arena appears unlikely to pay up for the Old Enron, but should be more interested in a New and Improved Enron. The more ENE streamlines itself, the easier the investing logic becomes. The current logic can best be considered via a glance at ENE's latest valuation matrix. First of all, we profile its overall investing credentials:

Table Seven: Investing Credentials

	2001E	2002E	2003E	2004E	2005E
Operating EPS	1.82	2.15	2.47	3.00	3.45
Unusual Items	0.00	0.00	0.00	0.00	0.00
Diluted Total EPS	1.82	2.15	2.47	3.00	3.45
DPS	0.50	0.52	0.54	0.56	0.60
CFFO	2.48	3.25	4.02	4.65	5.12
Book Value	15.10	16.74	18.74	21.18	24.03
Average Book	14.43	15.92	17.74	19.96	22.61
% Growth	25.6%	16.6%	18.4%	17.6%	15.1%
% ROE	12.8%	13.5%	14.4%	15.0%	15.3%
% Leverage	58.6%	55.6%	52.1%	48.8%	45.5%
% Yield	1.5%	1.6%	1.6%	1.7%	1.8%

Briefly, we expect ENE to grow its Operating EPS by 15%-20% annually, in spite of 2%-3% annual share base expansion. Its profitability has been unexciting since 1996 (a 17.8% ROE), but may recover from 13% to 15% in our model. A $3 billion asset write-down would push this from 14% to 17% and asset sales and streamlining could probably move this to the 18%-20% area. ENE's total leverage may drop steadily and naturally to the 45% area, although this is perhaps more due to our modeling than anything else. We presume all surplus CFFO goes to debt pay-downs. We count all debt, preferreds and "minority interests" (i.e., tax deductible, mandatory convertible preferreds) in our leverage calculation. Which brings us to Table Eight:

Table Eight: EBIT Profile (%)

	2001E	2002E	2003E	2004E	2005E
Gas Pipeline Group	12%	11%	9%	8%	7%
Portland General	9%	8%	7%	6%	5%
Wholesale (WEOS)	94%	88%	83%	81%	79%
Retail Energy Services	7%	9%	11%	11%	11%
Broadband Services	-7%	-5%	-2%	0%	1%
Corporate & Other	-15%	-11%	-8%	-6%	-4%
Total EBIT	100%	100%	100%	100%	100%

This profile simply reflects the changing importance of ENE's earnings contributions. Note the heavy negatives in the near term with *Broadband* and *Corporate*. The former reflects the Telecom implosion; the latter contains Azurix, EREC and various other leftovers.

This profile is also going to become moot in an accounting sense, because *Broadband Services* is likely to disappear into *Wholesale Energy Operations & Services* (WEOS), and into Corporate—the graveyard of several earlier initiatives. When ENE improves its reporting formats, the matrix will change in tandem. But for the moment, Table Eight should suffice.

Table Nine: Allocated EPS per EBIT Basis

	2001E	2002E	2003E	2004E	2005E
Gas Pipeline Group	0.23	0.24	0.23	0.25	0.26
Portland General	0.17	0.17	0.17	0.18	0.19
Wholesale (WEOS)	1.71	1.88	2.05	2.43	2.74
Retail Energy Services	0.12	0.19	0.27	0.34	0.39
Broadband Services	-0.13	-0.10	-0.05	-0.01	0.03
Corporate & Other	-0.28	-0.23	-0.20	-0.19	-0.15
Total EPS	1.82	2.15	2.47	3.00	3.45

Table Ten: Market Driven P/Es

	2001E	2002E	2003E	2004E	2005E
Gas Pipeline Group	15.0	15.0	15.0	15.0	15.0
Portland General	13.0	13.0	13.0	13.0	13.0
Wholesale (WEOS)	20.0	20.0	20.0	20.0	20.0
Retail Energy Services	20.0	20.0	20.0	20.0	20.0
Broadband Services	10.0	10.0	10.0	10.0	10.0
Corporate & Other	10.0	10.0	10.0	10.0	10.0
Composite P/E	20.9	20.4	20.1	19.8	19.6

A *Sidebar*

A digression is in order here, because ENE's multiples have been so variable over the 2000-01 boom and bust market cycle, The recently departed CEO had made some very aggressive valuation comments at the January 2001 Analyst conference, not the least of which was that WEOS was worth ***twice*** the market P/E (then 25x). This underlay a perceived $126 total valuation argument for the stock (nearly 70x), which included several fanciful DCF valuations. We mention this in passing, because that thesis appeared to create its own antithesis. It has been downhill ever since. No clear or new synthesis has emerged, and the market is still feeling its way to a sounder P/E level. If our particular logic is reasonable, ENE's normalized P/E valuations (from above) can be seen in Table 11. They are compared to the projected S&P 500 P/E and to ENE's forward P/E structure ("Actual P/E") using ENE's current stock price and projected EPS.

Table Eleven: ENE's Relative P/Es					
	2001E	*2002E*	*2003E*	*2004E*	*2005E*
ENE Normalized P/E	20.9	20.4	20.1	19.8	19.6
Actual ENE P/E	15.0	12.7	11.0	9.1	7.9
S&P 500 P/E	22.0	18.5		15.8	14.6
Relative P/Es:					
Normal To S&P 500	95%	110%	118%	126%	134%
Actual To S&P 500	68%	69%	65%	57%	54%
Actual to Normal P/E	71%	62%	55%	46%	40%

This table relates our sense of ENE's normalized P/Es to its actual P/Es, and then to the S&P 500 multiple. Yes, the comparisons are tilted by the lack of any implied present value discounting in the normalized P/E. But the growing gap between it and the other two multiples conveys a relative idea of how much upside ENE would have.

ENE's Central Value

If our sense of the market for ENE proves accurate then Table 12 is the consequence. This simply multiplies the matrixes of Tables Nine and Ten together, and defines the market value attributable to each business line. Investors may have trouble with the multiples of Table Ten, but hopefully not the methodology. This is perhaps the fairest way of valuing an Energy Conglomerate, even with the loss items taken into consideration. Our conclusions fall out of Table 12.

- ENE looks oversold by about 10-15 points. This comes from the shifting realities behind ENE's former New Economy premiums and that of the Old Economy's more prosaic valuations.
- The September 11 terrorist attacks were a national tragedy. Among other things, they should revive more anxieties about North American energy sufficiency. The near-term energy market effects will be increased price volatility, wider trading spreads and increased liquidity needs. Longer-term supply contracts appear inevitable. So do more aggressive hedging and longer storage positions. All of these should work well for the large energy marketers like ENE.
- The stock looks like it could be repriced to $38 (on 01Es) or **$44** (on 02Es), once the stock market proper normalizes.

Table Twelve: Imputed Market Values					
	2001E	*2002E*	*2003E*	*2004E*	*2005E*
Pipeline Group	3.38	3.53	3.52	3.76	3.85
Portland General	2.16	2.24	2.22	2.36	2.41
Wholesale (WEOS)	34.10	37.67	40.97	48.65	54.81
Retail Engy Svces	2.50	3.78	5.46	6.80	7.88
Broadband Svces	-1.26	-0.99	-0.55	-0.14	0.28
Corporate & Other	-2.76	-2.31	-2.02	-1.93	-1.55
Imputed Value	***38.13***	***43.92***	***49.60***	***59.51***	**67.68**
Current Price	27.25	27.25	27.25	27.25	21.25
% Upside	39.9%	61.2%	82.0%	118.4%	148.4%
% Yield	1.8%	1.9%	2.0%	2.1%	2.2%
%Total Return	41.7%	63.1%	84.0%	120.4%	150.6%

Enron's Outlook

Our five-year model suggests ENE can grow its earnings about 15%-20% annually and rebuild its ROEs from the 13% area to 15%, while deleveraging from 58% to **45%.**

- It would generate about $19 billion of cash flow (CFFO), pay out $3 billion of dividends and spend perhaps $18 billion in the process.
- The funding shortfall would be addressed by $5 billion of asset sales, **$4** billion of debt (90%) and equity (10%) issues. This would keep ENE's working capital and market-making positions quite liquid.
- ENE's earnings mix (ignoring its Corporate & Other losses) could stay around its current proportions: 76% Wholesale (WEOS); 10% Retail Energy (RES); 8% Pipelines; and 6% Electric Utility (PGE).
- Indeed, reducing or eliminating the losses in Azurix, EREC and Broadband Services can make a worthwhile difference. The Corporate & Other accounts already contain operating losses from them of about **$100** mm annually **($0.07** per share aftertax). The pending addition of the Broadband Network (EIN) would add to that.
- In our model, WEOS contributes 63% of the 2001-05 EPS growth. RES provides 17%; the pipelines and electric utility add only 3% combined; and the streamlining and loss reduction provides **17%** (i.e., Broadband and Corporate).

This is straight black box arithmetic. ENE has over 2000 subsidiaries and joint ventures, domestic **and** foreign. Modeling this becomes a black **art.** Indeed, the key macro issues behind any forecasts like these are just as important as the numbers. What are the key future drivers for ENE?

I. ***Electricity market reform look like the key driver for WEOS.***

- Gas has long been deregulated, but the power grid is only 25% there. The states and the government have oversight of the other **75%** (including munis, coops, TVA, etc). Indeed, there has been some backsliding in the aftermath of the California mishaps.

- The arrival of a new FERC Chairman with a background in Texas power market unbundling was part of the solution. The changeover was not pretty, in terms of the Federal Energy Bar, but the ends may justify the means.
- Forthcoming proposed unbundling legislation (Bingaman-Senate vs. Barton-House) would federalize the power grid, liberalize eminent domain and do away with the obsolete Public Utility Holding Company Act of 1935 (PUHCA). Some of these looked like longshots before September 11. Not any more.
- The FERC is already making legal moves towards gaining more grid jurisdiction. It is well into the process of creating four major regional transmission organizations (RTOs) to better synchronize open access power deliveries. These are intended to be in place by yearend, which may prove heroic.
- ENE's North American Power volumes have risen 82% in H1:01 and contributed about 37% of the volume growth. We expect these to be the main engine of WEOS' delivery growth over the coming five years.

II. Capital and Investment Spending for ENE looks like $18 billion over the next five years. Can they spend it better than over the past five years?

Table Thirteen: CapEx & Investments ($mm):	*1996-2000*	*2001E-2005E*	*1996-2000*	*2001E-2005E*
E&P	2082	0	15%	0%
Pipeline Group	881	853	6%	5%
Portland General	557	730	4%	4%
WEOS	7494	14000	54%	78%
Retail Energy Services	245	450	2%	3%
Broadband Services	436	600	3%	3%
Corporate & Other	2263	1250	16%	7%
Total	13958	17883	100%	100%

- E&P Spending ($2 billion) is in the past, and both Portland General and Broadband may not be much of the future.
- The Pipeline group easily comprises ENE's best hard assets. But it is difficult to spend significantly more on these systems and still make a dent on the parent company. Nonetheless, they have some big expansions underway
- ***WEOS*** is looking at about $14 billion of spending, including joint ventures. This is a major leap forward, and represents perhaps ENE's biggest challenge of all. Can it profitably reinvest all these funds in trading and systems assets? Not hardly. Can it buy other trading platforms and scale WEOS into other tradable commodities? Definitely. Will it need increasing amounts of working capital and margin balances to support its growth? Also a yes.
- *Retail Energy Services (RES)* should also have growing capital needs to support its own massive growth. It will still remain a good surplus CFFO generator.
- ENE has looked hard for the next wave beyond gas and power marketing. Broadband was the anointed product, except that the market was drowned in overcapacity and further afflicted by pauperism. Will this market ever meet its potential? We would not hold our breath waiting for it to happen over the next two-three years. If gas and are traded in pennies, broadband trading is done out to six decimals.

Are there any more tradable commodities? Yes, but nothing is in sight of the $100 billion-$400 billion sizes of the gas and power markets. ENE has jumped into Europe with both feet, and is rapidly scaling up its energy volumes there. Europe's share of ENE's total marketing volumes has risen from 10% last year to about 20% this year, and may rise to 22% or more next year. Japan and Latin America are still in their infancy.

Assets & *Profitability*

When analyzing Energy Conglomerates, we find it most useful to look at the assets first and then work back through to the intrinsic profitability of each sector. ENE tends to be a bit more complicated, but can be clarified by making some adjustments.

Table Fourteen – Total Assets ($mm):	*2001E*	*2005E*	*2001E*	*2005E*
Pipeline Group	3721	4076	5%	5%
Portland General	4563	4193	7%	5%
	53298	62393	78%	80%
Retail Energy Services	1238	1427	2%	2%
Broadband Services	1467	1517	2%	2%
Corporate & Other	3999	4249	6%	5%
Total	68286	77855	100%	100%

- First, Pipeline and Electric Utility (Portland General, or PGN) assets have to be disaggregated. PGB was acquired in late 1997, and nearly $1.6 billion of goodwill was created. This was pushed down to the hard assets, per SEC guidelines.
- WEOS carries huge offsetting trading/risk management positions. Over 40% (or $20 billion) of its 2000 asset base of $51 billion was risk management in nature. But when netted against risk management liabilities, the figure drops to only $1.1 billion
- The WEOS numbers seen in Table 20 are gross numbers. If WEOS were reported net of risk management positions the **$53** billion would become about $34 billion, and WEOS would be 70% of 2005E assets instead of 80%.

- Retail Energy Services has an understated asset base, because all of its risk management assets were moved over to WEOS. This was a $3 billion asset transfer.

In the last five years, ENE's asset base has risen from $16 billion to $65 billion. We look for a rise to at least $78 billion by 2005. Forecasting risk management assets is an exercise in futility, and we presume to err on the side of conservativism. We are more interested in the perceived asset mix.

We look at ENE's imputed profitability by allocating interest and preferred dividends on the basis of its expected average asset mix; then by allocating income taxes on the basis of its pretax earnings **mix.** Common equity is also allocated using the average asset mix. **As** discussed above, the latter is adjusted to eliminate largely offsetting risk management assets and liabilities.

Table Fifteen: Imputed ROEs	*2001E*	*2002E*	*2003E*	*2004E*	*2005E*
Pipeline Group	27%	24%	19%	15%	12%
Portland General	13%	12%	10%	8%	7%
WEOS	22%	20%	20%	19%	19%
Energy Svces	54%	67%	80%	75%	69%
Broadband Svces	-80%	-44%	-23%	-8%	1%
Corporate	-51%	-35%	-25%	-19%	-14%
Imputed ROEs	14%	15%	15%	15%	15%
Book ROEs	13%	14%	14%	15%	15%
% Total Leverage	59%	56%	52%	49%	45%

Table Fifteen basically derives functional ROEs by pro rating fixed charges proportionately over a similarly pro rated equity base. ENE **may** have very different internal measures. But from the outside looking in, this is the fairest way of appraising an Energy Conglomerate. It is also a snapshot in time. With all of the expected changes coming in ENE's asset profile, rest assured that the snapshot will change in tandem. For the moment, though, we have Table Fifteen.

- There is some obvious positive ROE impact from double leveraging of the *Pipeline Group.* This does not work as well with Portland General, because **of** the buried goodwill.
- *WEOS* looks like a sturdy 19%-22% kind of earner, even while carrying some hefty positions in marginal power and pipeline assets. **As** its $33 billion (net) asset base gets streamlined, its ROE is likely to jump.
- *Retail Energy Services* has splendid ROEs on its imputed equity. With expected 50%+ EBIT growth in 2001 and **2002,** and a tidier asset base, imputed ROEs of 55%-80% **look** likely.
- Corporate **&** Other comprises ENE's problem assets and its unallocated expenses. This item is to be negative, except not ***so*** massively as in the near term. It is pure fiscal drag. In our overall ENE model, streamlining these leftovers should provide about 10% of **EPS** growth through 2005.

Table Sixteen: Expected ROEs (%)	*2001E*	*2002E*	*2003E*	*2004E*	*2005E*
Enron	***14.4%***	***14.7%***	***15.2%***	***15.2%***	***14.9%***
Dynegy	16.7%	17.9%	18.0%	18.2%	18.2%
Duke Energy	17.1%	17.0%	17.3%	17.6%	17.1%
El Paso	24.3%	18.8%	19.4%	19.8%	20.0%
S&P 400	***16.4%***	***18.4%***	***17.8%***	***17.0%***	***16.2%***

- EOL is not a neutral exchange. It is capturing the specialist spread; and its customers run with margin positions, with over $2 billion over the past three quarters. EOL can tailor its trading to the markets. **As** long as EOL maintains the narrowest spreads and provides the deepest liquidity, its lead should be maintained.
- EOL has helped widen WEOS' unit margins nicely (12.0 cents/mmbtu in H1:01 versus 10.5 cents/mmbtu in 2000).
- Other on-line trading platforms (ICE, TradeSpark) are neutral (or open) third-market operations, and have begun to catch up somewhat, but they have a long way to go.

- Some of higher profile Internet exchanges are joint ventures, which can slow down decision making. EOL is wholly owned, and avoids the problems of multiple bureaucracies.

- There is no reason EOL can't be trading 3,000 or more contracts over the next five years. EOL particularly thrives on any commodity which is tradable, and which also needs a physical delivery. The new Enron tower rising in Houston will consolidate all its trading operations in Houston, and provide room for growth. The new trading floors will be phased-in from December into next July.

In the latest market share profiles, ENE has about 15% and 17.5% of the relevant (Top 20) gas and power trading markets in North America.

- It is quite strong in Europe, with about 15%-20% of the relevant market. Europe is expected to provide about 40% and 33% of WEOS volume growth in 2001 and 02.

In the overall scheme of things, WEOS will earn about a 1% after-tax margin on nearly $200 billion of revenues this year, up from $95 billion last year. These are very powerful numbers, and the ancillary benefit is that WEOS' trading networks allow it to control both the information and physical flows of the commodities.

- Our expectation is that WEOS' volumes could rise about 23% annually over 2001-05, driven primarily by power trading.

- This would further allow WEOS to reach perhaps $400 billion of revenues by 2005, albeit with expected lower EBIT margins (1.6% this year; 1.2%E in 2005).

There are two parts to WEOS: (1) ***Commodity*** Sales & Services, the marketing & trading arm; and (2) *Energy* Assets & Investments, comprising a host of unregulated or foreign pipeline and power assets, either wholly owned or in joint ventures. It also houses the longer-term structured power and gas contract portfolio. EA&I's hard asset base is being placed in the strong hands of Stan Horton, who should lead the downsizing effort.

- In the past five years (1996-2000), CS&S and EA&I were equal contributors to WEOS' EBIT. In the next five years, we would expect the earnings mix to move decisively from 50-50 to 85-15 in favor of CS&S.

The drivers will be more prosperity with EOL, and more asset sell-downs in EA&I. Mark-to-Market profits under FASB 133 are prone to show up in either segment, depending on the contract duration and the assets involved. For that matter, other parts of ENE (including Portland General and Northern Natural Gas) also have been showing M-to-M accounting profits. These also can occur

Table Seventeen: Marketing & Trading – Revenue Trends ($ Billions):

				Annualized 2001	
	1998	*1999*	*2000*	*Q1*	*Q2*
Duke Energy	8.7	11.6	33.6	48.1	46.0
Dynegy	10.7	10.5	21.5	44.6	30.0
El Paso	19.0	22.3	47.1	65.6	50.4
Enron (WEOS)	27.2	36.2	95.4	193.6	194.5
Reliant Resources	4.3	7.9	19.1	38.4	37.5
Total	70.1	88.5	216.8	390.2	358.3

forthcoming comparisons considerably over the next three quarters.

Table Eighteen: Marketing & Trading – Annual Growth Rates (%)				
			Annualized 2001	
	1999	***2000***	***Q1***	***Q2***
Duke Energy	33%	189%	43%	37%
Dynegy	-2%	104%	107%	40%
El Paso	17%	111%	39%	7%
Enron (WEOS)	33%	164%	103%	104%
Reliant Resources	81%	143%	100%	96%
Composite	26%	145%	80%	65%

What about earnings? Table 19 shows EBIT results over the same time frame.

- EBIT has also tripled over the past three years for this group, from $1.6 billion to $4.9 billion. It should annualize at perhaps $7 billion this year.

	2000

Table Twenty: Marketing & Trading				
			Annualized 2001	
Annual Growth Rates (%)	***1999***	***2000***	***Q1***	***Q2***
Duke Energy	57%	100%	234%	140%
Dynegy	20%	272%	-12%	41%
El Paso	-11%	258%	68%	13%
Enron (WEOS)	34%	73%	34%	42%
Reliant Resources	-53%	2453%	78%	69%
Composite	24%	144%	55%	49%

	2000

Table Twenty-Two: WEOS Forecasts					
Volume Growth (%)	***Q1***	***Q2***	***Q3***	***Q4***	***Year***
2005E	14%	14%	11%	9%	12%
2004E	16%	14%	14%	14%	15%
2003E	20%	20%	17%	18%	19%
2002E	27%	19%	21%	19%	21%
2001E	65%	60%	46%	30%	48%
2000A	43%	39%	64%	90%	59%

Essentially, we would anticipate 15%-20% volume growth in corning years, accompanied by gradually decreasing EBIT margins, as shown in Table 23.

Table Twenty-Three: WEOS Forecasts					
EBIT Margins (%):	***Q1***	***Q2***	***Q3***	***Q4***	***Year***
2005E	1.3%	1.3%	1.2%	1.2%	1.2%
2004E	1.4%	1.4%	1.3%	1.2%	1.3%
2003E	1.6%	1.5%	1.3%	1.2%	1.4%
2002E	1.6%	1.6%	1.5%	1.4%	1.5%
2001E	1.6%	1.6%	1.5%	1.5%	1.6%
2000A	3.5%	2.7%	2.2%	2.0%	2.4%
1999A	4.9%	4.2%	3.5%	2.3%	3.6%

If investors want to look at physical unit margins (on a Btu basis) for WEOS, **our** forecasts are shown in Table 24 (below).

Table Twenty-Four: Marketing & Trading					
WEOS Unit Margins ($/mmbtue)	***Q1***	***Q2***	***Q3***	***Q4***	***Year***
2005	0.094	0.096	0.093	0.095	0.095
2004	0.098	0.099	0.091	0.086	0.093
2003	0.102	0.101	0.091	0.082	0.093
2002	0.108	0.108	0.095	0.087	0.099
2001	0.121	0.118	0.103	0.101	0.110
2000	0.114	0.098	0.128	0.131	0.119
1999	0.124	0.118	0.125	0.074	0.110

WEOS' EBIT average annual growth rates **(AAGRs)** have run 42% annually over the past five years. We expect an AAGR of 17% annually over the coming five years.

- This would reflect more competition and market saturation, not to mention a diminishing influence from the EA&I side of the business.
- This means some breathing room for WEOS, since its smaller clone, Enron (or Retail) Energy Services' **AAGRs** are looking more like 50% for the next two-three years.
- The interim should allow WEOS (or the parent Enron) to develop another growth leg for the company.

To wrap up WEOS, a glance at our projections should summarize the argument. First, our volume projections are rolled into Table 25.

Table Twenty-Five: WEOS Volume Trends						
Cash & Physicals	*2000*	*2001E*	*2002E*	*2003E*	*2004E*	*2005E*
	28.3	35.1	40.5	45.5	49.1	52.5
	6.1	9.5	12.1	15.8	19.1	22.3

Table Twenty-Six: WEOS EBZT ($mm)						
		2001E	*2002E*	*2003E*	*2004E*	*2005E*
Com Sales & Svces	1622	3037	3100	3600	4100	4710
Energy A&I	889	433	670	635	820	910
Total EBIT	2511	3470	3770	4235	4920	5620
Unallocated Costs	-259	-398	-430	-485	-630	-750
Total EBIT	2252	3072	3340	3750	4290	4870
% AAGR	73%	36%	9%	12%	14%	14%

Lastly, WEOS' EPS contribution is seen in Table 26. If ENE were to continue business as usual, this would be our version of the result.

Table Twenty-Seven: WEOS Allocated EPS						
	2000	*2001E*	*2002E*	*2003E*	*2004E*	*2005E*
Com Sales&Svce	0.71	1.50	1.55	1.80	2.03	2.30
Energy A&I	0.39	0.21	0.34	0.32	0.41	0.44
WEOS EPS	1.10	1.72	1.89	2.11	2.43	2.74
Enron EPS	1.47	1.85	2.16	2.55	3.00	3.45
WEOS/ Total EPS	75%	93%	87%	83%	81%	79%
% AAGRs:						
WEOS	42%	56%	10%	12%	15%	13%
Enron	27%	26%	17%	18%	18%	15%

We think it is likely that the promised reporting changes may affect WEOS' reporting in particular. The asset mix is difficult to fathom, the M-to-Ms are often material, and the joint ventures are mostly unfathomable. ENE top management has always been adamant that WEOS enjoys various measurable advantages over Wall Street trading houses. In growth terms, this is obvious: the latter are highly cyclical. In profitability (ROE) terms, this is not apparent. In comprehension terms, WEOS remains opaque. This does not prevent us from recommending the stock, inasmuch as the reporting should be improving.

Enron's Businesses: Retail Energy Services

If there has been one truly successful growth clone of WEOS, it has been Retail Energy Services ***(RES)***.

RES is the leading energy outsourcer in the nation, having built up the franchise since 1996. RES carved out the commercial and small industrial markets in the USA, and markets energy efficiency, pure and simple. It is prepared to change out existing facilities, from meters to the full energy installation, with a soup-to-nuts service.

RES will earn its returns in several ways: (1) small markups on the commodities (1%-3% on gas & power); (2) a basic energy management fee; (3) lease income on energy assets changed out; and **(4)** some negotiated sharing of any postulated cost savings.

Over the 1997-1999 years, on the original accounting basis, RES spent $245 mm in CapEx to develop the business. It had accumulated losses of about $371 mm (on an NOI, not EBIT, basis) before moving into the black in Q4:99. Put another way, it cost ENE over $600 mm to develop the business. Since then, RES has been on a steady roll, helped in no small fashion by the California energy panic and by the sharply escalated energy price structure. RES has transplanted its domestic model, and has moved it into Europe.

- RES's contract awards have grown from $1 billion in 1997 to a projected $30 billion in 2001E, and to perhaps $38 billion in 2002E.
- It is on track to gross $2.5 billion **this** year, and earn an EBIT of $225 mm. These will be 42% and 103% higher than last year's restated figures.

- We expect RES revenues to grow another 31% to $3.3 billion next year, with EBIT rising 49% to $350 mm.
- Profit margins should be improving with scale. For 2000A—2003E, they should rise from 6.3%-9.0%-10.2%-11.9%.
- EBITDA should run $267mm-$385 mm, even while CapEx runs perhaps $40-$60 mm in the two years. RES is a major surplus CFFO generator.

It is also becoming a very profitable one. A glance back at ENE's imputed ROEs (Table 15) shows just how good the numbers are. By our reckoning, RES should be earning 50%-80% ROEs in the next five years. It also should be contributing about 11% of earnings.

Another Sidebar: New Power Company

For the past five years, ENE has been eyeing the progressive deregulation of the local retail (residential-small commercial) markets for electricity. It jumped into several markets (California, Vermont, Minnesota) quickly, and then backed off. The timing was too early. WEOS had successfully cloned RES into the middle markets during the mid-90s. New Power became the next apparent wedge into the local retail markets. The intent was to hit these markets with overwhelming force, scale the business over several years, and watch incremental volumes take razor-thin margins to something much better. **A** little history:

- ***New Power Co.*** **(NYSE-NPW-$2.57-NR)** was brought public by Enron on October 5, 2000. The IPO was priced at $21.00, opened for trading at $28.00, peaked that week at $29.00, but has slid downhill ever since. The IPO was marketed as a "New Economy" vehicle, with appeal to the more aggressive New Economy investors.
- NPW **was** initially conceived as a fusion of ENE's energy commodity knowhow, AOL-Time/Warner's 22 mm Internet customer list and a 10-year outsourcing deal with IBM.
- ENE owned 60% at the outset, which has been taken down to 45% post-IPO. Private equity investors own about 25%. The 58 mm share base **is** augmented by a 69 mm warrant position owned by ENE and the original investors. These are $0.05 ('nickel') warrants.
- ***New Power*** is reported as an equity earnings item in Retail Energy Services' EBIT. This **is** a major near term drag on RES' 2001 results, but should diminish to a breakeven contribution in 2004.

The original intent was to capitalize on the retail energy unbundling already done in 22 states. NPW has acquired some good customer lists and has marketed aggressively. It has also done necessary missionary work to maintain retail unbundling momentum where backsliding has occurred. Texas **is** an example of the latter. Incumbent power companies and sympathetic regulators have maintained tilted two-part rate designs, which effectively impede new entrants, notably in the Pennsylvania-New Jersey **(PJM)** arena. California has reversed itself on retail energy unbundling in the aftermath of its disastrous (and unique) efforts in wholesale power market unbundling in 1996. In a word, the unbundling climate has turned cautious.

- NPW has developed a 750,000-customer base in 25 local markets, and appears to be building momentum. With a look at the numbers, we would suggest that NPW would need perhaps 2.5 mm customers to reach that breakeven point (profit-wise) in 2004.
- The company has had some good success in local market penetration. It typically offers 10%-15% savings on monthly energy cost; and seeks to create a 10%-15% ***gross*** margin spread on the business.

But is the timing now better? When ENE IPOed NPW in October 2000, it was infused with $615 mm of cash. The aftermath has been this:

- NPW has been losing about $50-$60 mm per quarter since over the past five quarters. For 2001 as a whole, it should lose about $210 mm (non tax effected) on **$430** mm of revenues. The latter is a reduction from earlier hopes **of** $530 mm, owing to delayed market openings.
- The ENE (RES) share of these losses should be about $95 mm in 2001. This is about $0.06 per share (tax effected) net to ENE.

The customer count could reach **1** mm by yearend, with an energy book of business running nearly 300 mmbtu/day. This year could see average volumes **of** 190 mmbtu/day. The coming year would annualize at perhaps 240 mmbtu/day, before any more customer adds. What about liquidity?

- The initial cash (& equivalents) position has dropped from $615 mm to $431 mm at midyear, and is expected to close the year at $250 mm.
- The original equity of $655 mm has come down to $457 mm, and could hit $350 mm by yearend. The book value drops accordingly **from** $11.28 per share to about $6.00 by yearend. There is no debt.
- NPW looks like it needs CapEx and acquisition funding of about $10-$20 mm annually to grow the business.

It is perhaps early to look at 2002 and beyond, but we can sketch out our own rough expectations.

Table Twenty-Eight: NPW Financial

	Net Income		CapEx	NWC
2000	-170	-152	53	432
2001E	-216	-212	59	212
2002E	-130	-113	20	100
2003E	-75	-58	20	50
2004E	-5	18	20	20
2005E	30	58	20	0

It is likely that NPW will go into the factoring markets (inventories & receivables) to cover its funding deficits over the coming years. Presuming that NPW can both discount its energy services (to attract the needed 2.5 mm plus customer base) and earn 10%-15% gross margins on its service, the growth in the outer years should become self-funding.

The retail energy markets are measurably more difficult than the wholesale markets. They are not only farther down the food chain, they are more political and more complex. Hence, we would anticipate a longer payout than that seen in RES.

Insofar as the NPW contribution to RES is concerned, we would expect the $0.07 per share loss this year to disappear in the next several years.

A Walk On The Regulatory Side

ENE has over $8 billion invested in its so-called Transportation & Distribution (T&D) asset base. These include:

- Its regulated Oregon electric utility, Portland General Electric (PGE), with a $1.6 billion rate base. When disaggregated, the total electric assets are $4.6 billion, including $1.4 billion of goodwill.
- Its regulated pipeline portfolio, and various minority pipeline interests therein. These include Northern Natural Gas (NNG) and Transwestern Pipeline (TWPL), and a 50% interest in Florida Gas Transmission (FGT). The latter is held through a holding company, Citrus ***Corp.*** This carries about $1 billion of goodwill; the amortization of which has burdened FGT's otherwise good ROEs. Together, the pipelines have about $3.6 billion of assets, and a gross rate base of $2.9 billion ($2.3 billion net).
- In physical terms, NNG is the largest pipeline, with a throughput of 3.5 bcfld and a 4.1 bcf/d peak day (81% load factor). Its primary markets are the city gates (Omaha, Minneapolis) in the Great Plains. FGT has 95% of the Florida gas market, and moves 1.5 bcf/d there, with a 2 bcf/d peak day (78% load factor). TWPL has about 24% of the current pipeline capacity into California. It is moving 1.66 bcf/d there, with a 2.11 bcf/d peak day (79% load factor).
- Over the last five years, T&D generated nearly $3 billion of surplus EBITDA. This was during a time when ENE's aggressive spending in the rest of the company had created an EBITDA deficit of ***$5*** billion.
- Over the next five years, T&D could generate perhaps $3.7 billion of surplus EBITDA, even while the rest of the company may also be $7 billion in surplus.

But ENE has made its intentions clear about its ownership of PGE. It is a seller. The recent PGE life cycle is this:

- ENE had originally bought PGE for $3.1 billion in July 1996. It closed the deal July 1, 1997. ENE paid with $2 billion (102 mm shares) of common stock, and assumed $1.1 billion of total debt.
- In November 1999, ENE had cut a deal with *Sierra **Pacific** Resources* (NYSE-SRP-$16.45) to sell PGE for $2.1 billion cash and $1.0 billion of debt assumption. This transaction would have been a breakeven situation for ENE.
- The deal finally came unglued in April 2001, 18 months later, mainly due to the California energy panic.

PGE is still for sale. It has had a short shelf life with ENE, and was purchased primarily for its access to the California power market (North Path 15) and its early edge in power trading. On the other hand, the California market has proved to be a briar patch. This franchise is in fact still in place. Is it a good or better asset today?

ENE originally paid 14.8x and 213% of book value for PGE. This reflected a 45% premium for the company at the time. It was accounted for as a purchase, with about $1.6 billion of goodwill initially booked.

In the intervening years, PGE has been run pretty much as usual, with one exception. Earnings have ranged between $125-$140 mm after-tax. Then in 2000 and 2001, ENE has begun applying its risk management arsenal to PGE.

- In its basic retail electric business, PGE realized about $13 mm in 2000 and $4 mm in 2001 to-date in mark-to-market profits on natural gas swaps.
- In its power trading side, PGE has had a $16 mm after-tax mark-to-market gain in 2001 to date.

This year, PGE has also had some write-downs ($4 mm) in the value of its trust-owned life insurance portfolio ($85 mm). In H1:00, the portfolio had shown unrealized gains of $6 mm. The swing impacted the comparisons. A look at PGE's economics in H1:01 is seen below.

Table Twenty-Nine: Power Economics ($/mwh):			
Power Sales (000 mwh)	*HI-01*	*HI-00*	*%*
Retail Electric	9663	9886	-2%
Wholesale Power	5174	9190	-37%
Total Power Sales	15437	19076	-19%
Revenues ($/mwh):			
Retail Electric	52.88	52.60	1%
Wholesale Power	184.19	32.21	414%
Total Sales	102.22	42.78	139%
Other	1.30	0.63	106%
Operating Revenues	103.45	43.41	138%
Expenses ($/mwh):			
Purchased Power & Fuel	78.64	23.80	230%
O&M & Taxes	10.30	8.44	22%
DD&A	5.57	4.82	16%
Total Expenses	94.51	37.06	155%
Net Operating Income	8.94	6.34	41%
Interest Expense-Net:	4.28	3.41	25%
NIBT	4.66	2.94	59%
Income Taxes	3.04	2.25	35%
Net Income	1.62	0.68	138%

Table Thirty: PGE Rate Base ($mm)			
	Rate Base	*% ROE*	*% Leverage*
1997	1455	13.2%	53.3%
1998	1469	14.0%	49.6%
1999	1546	12.4%	49.7%
2000	1592	13.0%	44.9%
2001E	1650	12.1%	46.0%

PG&E runs about 2,000 mw of generating capacity: 600 mw **of** hydro, 750 mw of oil & gas, and 650 mw **of** coal. It is a net buyer of power for its retail markets in Oregon and Washington. In H1:01, it was 38% self-sufficient versus 27% last year. In the context of the probable overbuilding **of** power markets in the next **two** years, being a net buyer is not at all bad.

Table Thirty-One: PGE Earnings ($mm)			
	Net Income	*% Growth*	*Tax Rate*
	153	16.8%	41.6%
1991	124	-19.0%	35.1%
1998	133	7.3%	31.4%
1999	126	-5.3%	41.3%
2000	139	10.3%	40.8%

Could ENE still fetch $3.1 billion in today's market? Not very likely, given the current war footing and investor psychology. Our electric utility group index is **down** 14% in 2001 to date. The group is trading at **10x** year-ahead consensus estimates to yield 5.31% with a 61% payout ratio. We would think the market of the moment would be closer to $2.6-$2.7 billion.

The Pipelines

ENE's pipelines have been its core assets since the original merger. They have been exceptionally profitable, quite well managed and excellent surplus CFFO generators. The problem they have is slow growth: typically 3%-6% AAGRs.

The next few tables are a digest of the individual FERC Form 2 annual filings. We profile NNG, TWPL, and FGT. Please remember that FGT is 50% owned by El Paso Energy. We show the numbers as **if** it were 100% owned in order to simplify the profile.

First, we show the profitability profile of each system. This shows the nominal allowed ROEs and related capital structures from the latest settled rate cases. Suffice it to say that ENE typically does much better than these numbers.

Table Thirty-Two: Allowed Returns (%)			
	NNG	*TWPL*	*FGT*
ROE	12.89%	12.18%	13.49%
Equity Ratio	60.00%	60.00%	42.00%

In terms of rate case filings, NNG and FGT come back in 2003, (May and October). TWPL returns in 2005 and the 11%-owned Northern Border Pipeline (NBPL) refiles in 2006.

The next table shows the 4%-6% AAGRs for respective NNG and TWPL rate bases over the past five years. FGT's rate base has begun to grow again with the Phase III expansion booked in 2000, and Phases IV and V expected to boost the rate base nicely in '02 **and** '03.

Table Thirty-Three: Rate Base Trends ($mm)			
	NNG	*TWPL*	*FGT*
1995	794	363	1272
1996	845	408	1199
1997	1003	424	1154
1998	1128	422	1108
1999	1150	443	1119
2000	1108	453	1284
% Change: 95-00	28%	20%	1%

Table 32 shows the actual equity ratios in the balance sheets. The thicker the equity, the greater the overall returns on capital become.

Table Thirty-Four: Equity Ratios (%)			
	NNG	*TWPL*	*FGT*
1995	58.3%	73.2%	51.9%
1996	63.3%	16.7%	45.5%
1991	67.3%	78.6%	31.4%
1998	59.7%	80.8%	37.4%
1999	63.8%	82.6%	51.6%
2000	67.5%	81.9%	41.9%

Finally, the actual ROE experience on these systems is shown in Table 35 below.

Table Thirty-Five: Realized ROEs (%)	*NNG*	*TWPL*	*FGT*
1996	18.1%	23.4%	9.4%
1997	18.5%	13.6%	8.5%
1998	17.0%	14.4%	10.7%
1999	14.9%	11.7%	8.3%
2000	14.2%	14.2%	**12.2%**

Readers also should keep in mind that pipeline investor ROEs often are not the same as regulated ROEs. Why? Because of reporting differences between public books, the rate case books and the regulatory books.

Going forward, we would expect ENE's pipeline profiles to run thus:

- For NNG: realized ROEs in the range of 14%-17%, with a 40-60 capital structure.
- Rate base growth for NNG may be 3%-5% annually, thanks to Project MAX, with incremental spending flexed to meet market growth in the Omaha—Minneapolis pipeline corridor.

Over the last five years, NNG had CFFO of $1 billion, paid upstream dividends of $100 mm and had CapEx of $650 mm. In order to grow 4% annually, NNG needs to spend $90-$105 mm per year, and nearly $500 mm over the next five years.

- For TWPL, we would expect 14%-15% realized ROEs with a 25-75 capital structure. TWPL is working with a black box rate case into 2005 and will have to worry about a more normal capital structure (40-60) then.
- TWPL rate base growth should be much better over the near term. Owing to all of the power plant construction on Arizona "energy farms" (i.e., serving California), TWPL is in fine position to capture incremental markets.

TWPL has two expansions in motion: (1) the Red Rock lateral for 150 mmcfd, and due far June 2002 completion at a cost of about **$90** mm; and (2) the much bigger Sun Devil project, slated for a 2004 startup. The proposed **Sun** Devil system expansion could take mainline capacity from 1.7 bcf/d to 3.0 bcfld, and would have a 175-mile southern lateral via Flagstaff, Arizona, into Phoenix for the first time. The expected cost: $300-$400 mm

Now TWPL had total CFFO of $465 mm over the past five years, and had CapEx of $170 mm.

- If it simply grew the rate base at 5% AAGRs, its rate base would rise from $450 mm now to $580 mm. This implies CapEx needs of $210 mm, even while cumulative CFFO should exceed $500 mm.
- But Red Rock and **Sun** Devil together could cost at least $400 mm, meaning that TWPL's 2005E rate base could be 80% higher at $820 mm. This would create about 16% AAGRs if **Sun** Devil gets built.

Until mid-2002, FGT will be the only big mainline serving Florida. It is not coincidental that Florida has been the strongest gas market in the nation for 2001 to date. Its secular growth trends are good, the state needs another 10,000 mw of generating capacity over the next ten years and the Clean **Air** Act Amendments are forcing generators there off of residual fuel **oil.** FGT's only abiding problem has been its holding company, Citrus Corp.

- Citrus still carries over $1 billion in goodwill, the amortization of which has been sharply reduced in recent years as the pipeline life was stretched out.
- FGT's profitability is harder to come by because of the goodwill inclusion. We suspect the more normal ROEs are closer to 14%-16% than those seen in Table **32.**

FGT has had total CFFO of $640 mm over the past five years, and has paid out $285 mm in upstream dividends. Its CapEx has run $425 mm in the interim. This will be scaled up again for 2001—2005.

- The Phase IV expansion started up on May 1 and cost $270 mm.
- Phase V was approved by the FERC in mid July. This will cost another $452 mm, and will be in service in April 2002.
- Then Phase VI is planned for November 2003, at a cost of $150 mm.

These incremental adds to the rate base arithmetic suggest that FGT can grow about 40%, from $1.25 billion to about $1.75 billion **of** rate base by yearend 2005.

- Capacity will rise from 2.0 bcfld to 2.7 bcfld, with all of the incremental capacity subscribed on long-term contracts.
- The 40% rate base growth should translate into equivalent earnings growth ***to*** the partners (ENE-50%; El Paso-50%).

ENE has further permutations and combinations in its pipeline arena.

- An LNG (regas) plant on Grand Bahama Island with a related 90-mile (Calypso) pipeline **into** Florida is on the drawing board. **This** could cost over $350 mm.

- Its 11%-owned Northern Border system has become an aggressive acquirer and builder in the High Plains and Rockies gas markets, but its earnings impact is diluted by the small ownership.

On the other side of the argument, is the fact that ENE has disavowed hard asset growth strategies, and has visibly lost market turf in pipeline markets as a result. Whether this is turned around with the new management team will tell a lot about ENE's new game plans for the coming five years.

Issues And Answers

The investing arguments about ENE have become fairly clear cut:

- The stock is trading in the 12x-13x area. Investors can buy a good set of growth businesses (WEOS and RES), not to mention some impressive regulated pipelines.
- Indeed, ENE can even make some virtue out of adversity by downsizing and writing off its problem assets. This can only help the future.
- Better, ENE is trading at 60%-65% of the market multiple, which has not been seen in quite some time.

If our modeling is correct, then:

- ENE should both improve its ROEs and deleverage at the same time.
- The ROEs could rise to 15% naturally, perhaps to 17% with the help of some write-offs, and even higher if PGE and Azurix, etc., get monetized.
- Total leverage should ease from 58% to 46% over the next five years.

If our *summary* valuation matrix is decently reasoned (please see Table 12), we consider ENE's central value to be in the $38-$44 area. This is figured on ENE's expected earnings mix and our idea of normalized multiples. The upside in any market recovery may be 50% or better. Is this plausible? The rhetorical answer is yes, but perhaps with some market extemalities attached.

ENE has increasingly become a focus of controversy on Wall Street because of various issues (operating, financial, and accounting) that would not go away. After the stock price fall and the management changes, we think the leadership will reconstrue ENE's profile in a much healthier and humbler fashion.

- The accounting and reporting are expected to be simplified and made more understandable. The sooner the better.
- The exotic offshore and off balance sheet financings have been a riddle wrapped inside an enigma. These are expected to be cleaned up.

Then there have been the Hard Asset difficulties. The more obvious were Azurix, Dabhol, and the failure to close PGE. We have touched on the latter already, but what about the others?

- Azurix was about a $5 billion asset company, with nearly $1.5 billion of goodwill, before it was folded back into ENE after the misfiring of the M&A and other programs there. These assets are being steadily piecemealed to third parties, without too much financial pain in the process.

The original and main asset, Wessex Water, had been acquired for $2.4 billion (12x earnings in an 8x P/E U.K. market sector) in late 1998. It was then repackaged into AZX and resold in the U.S. market for 22x in June 1999. It remains intact, but with a character-building regulatory profile.

The 65%-owned Dabhol power project (2,924 mw) on the Bombay (Mumbai) coast was the showcase asset for the new Indian Government's economic initiatives. No more.

- The plants and infrastructure are 95% complete, with a cost of $2.9 billion. The plant also has a $220 mm LNG tanker under lease. It is 20% owned by ENE. After repeated breakdowns in negotiations, everything was shut down last May 29th.
- ENE and its partners have all of the facts, the law and even the science on their side. But this is India.

Despite the obvious looming violations of underlying sovereign credit guarantees, which would have wide ripple effects in the capital markets, the Indian Government has remained intransigent.

- ENE and its partners have offered to sell out at net book ($1.1 billion gross, $890 mm net to ENE), but this has not been favorably received so far.
- The Government apparently wants a substantial power price cut. They are going about it quite tenaciously.
- The first plant (740 mw, naphtha fed) was getting about $105/mwh when operating. This was going to drop to $85/mwh when the plant was boosted from 60% to 90% load factors.

When the bigger, LNG fed plant comes on line, the price was expected to fall further to $64/mwh. Various states in India have offered anywhere from $15/mwh-$53/mwh. The problem is that this would erase much of the expected profitability (18% or so ROEs with a 70-30 capital structure). The threshold of pain has not been reached by either side.

These are afflictions and, along with some of the $1.5 billion broadband assets, they will be dealt with as the opportunity arises. Their remedies will be of considerable benefit to ENE's earnings and profitability.

A final and important point about the company's investing climate: the frequent rumors of its trading demise, bad derivative deals on structured energy transactions and credit issues have appeared to be much exaggerated. WEOS, for instance, has faced more volatile markets in earlier years than the present, and has emerged unbruised while others have taken huge losses and then folded their tents. The company has a hard and fast policy of running matched books, with minimal trading risk. This is paired trading done right. This is not to say that a bad trade will never happen. But ENE has had a tremendous track record in playing defense as well as offense.

A 70% stock market decline has to be a huge catharsis for any major company. It is fair to say that ENE took many risks with its ventures, and in some notable cases it flew too close to the sun. Others, like RES, have worked fine.

The new management has an excellent chance of reconfiguring ENE into a much more profitable asset profile. Out of the ashes of the Old Enron, there **is** reason to expect a better and stronger New Enron to rise and fly. We recommend purchase.

Table Thirty-Six: ENE - 2001 Quarterly Earnings -- EBIT ($MM):

	Q1	Q2	H1	Q3	9 MOS	Q4	2001
Gas Pipeline Group	133	77	210	87	297	109	406
Portland General	60	65	12s	7s	200	100	300
Wholesale Operations & Services (WEOS)	755	802	1557	735	2292	780	3072
Enron Energy Services (Net)	40	60	100	60	160	65	22s
Enron Broadband Services	-35	-102	-137	-50	-187	-40	-227
Corporate & Other	-158	-109	-267	-110	-377	-120	-497
Core Operating EBIT	***795***	***793***	***1588***	***797***	***2385***	***894***	***3279***
Recurring Nonrecurring Items	0	0	0	0	0	0	0
Reported EBIT	79s	793	1588	797	2385	894	3279
Interest Expense--Net	201	21s	416	240	656	260	916
Pfd Divds--Subsidiaries	18	18	36	18	54	18	72
Minority Interests (Jr Prfd-1)	40	30	70	30	100	30	130
Total Interest & Other	259	263	522	288	810	308	1118
Net Income Before Taxes:							
Core Operating	536	530	1066	509	1575	586	2161
Unusual Items	0	0	0	0	0	0	0
Total	536	530	1066	509	1575	586	2161
Income Tares:							
Core Operating	130	126	256	122	378	141	519
Unusual Items	0	0	0	0	0	0	0
Total	130	126	256	122	378	141	519
Net Income:							
Core Operating	406	404	810	387	1197	44s	1642
Unusual Items	0	0	0	0	0	0	0
Total	406	404	810	387	1197	445	1642
Preferred Dividends:							
Second Preferred	4	4	8	4	12	4	16
Series B	16	17	33	17	50	17	67
Total Preferred Dividends	20	21	41	21	62	21	83
Net Income--Common	386	383	769	366	1135	424	1559
Extraordinary Items	19	0	19	0	19	0	19
Total Net Income	405	383	788	366	1154	424	1578
2001 Diluted EPS:							
Core Operating	***0.47***	***0.45***	***0.92***	***0.43***	***1.35***	***0.49***	***1.85***
Unusual Items	***0.00***	***0.00***	***0.00***	***0.00***	***0.00***	***0.00***	***0.00***
Reported EPS	***0.47***	***0.45***	***0.92***	***0.43***	***1.35***	***0.49***	***1.85***
Extraordinary Items	***0.02***	***0.00***	***0.02***	***0.00***	***0.02***	***0.00***	***0.02***
Total Net Income	***0.49***	***0.45***	***0.94***	***0.43***	***1.37***	***0.49***	***1.87***

Estimates: SMH, John E. Olson, (713) 220-5151

Table Thirty-Seven: ENE - 2002 Quarterly Earning – EBIT ($ Millions)

	Q1	Q2	H1	Q3	9 MOS	Q4	Year
Gas Pipeline Group	135	80	215	90	305	112	417
Portland General	61	66	127	77	204	102	306
Wholesale Operations & Services (WEOS)	900	830	1730	820	2550	790	3340
Enron Energy Services (Net)	65	90	155	80	235	100	335
Enron Broadband Services	-60	-40	-100	-40	-140	-35	-175
Corporate & Other	-150	-90	-240	-90	-330	-90	-420
Core Operating EBIT	951	936	1887	937	2824	979	3803
Recumng Nonrecumng Items	0	0	0	0	0	0	0
Reported EBIT	951	936	1887	937	2824	979	3803
Interest Expense – Net	250	255	505	240	745	245	990
Pfd Divds-Subsidiaries	18	18	36	18	54	18	72
Minority Interests (Jr Prfd-1)	35	35	70	35	105	35	140
Total Interest & Other	303	308	611	293	904	298	1202
Net Income Before Taxes:							
Core Operating	648	628	1276	644	1920	681	2601
Unusual Items	0	0	0	0	0	0	0
Total	648	628	1276	644	1920	681	2601
Income Taxes:							
Core Operating	152	148	298	151	449	160	611
Unusual Items	0	0	0	0	0	0	0
Total	152	148	298	151	449	160	611
Net Income:							
Core Operating	496	480	976	493	1469	521	1990
Unusual Items	0	0	0	0	0	0	0
Total	496	480	976	493	1469	521	1990
Preferred Dividends:							
Second Preferred	4	4	8	4	12	4	16
Series B	16	17	33	17	50	17	67
Total Preferred Dividends	20	21	41	21	62	21	83
Net Income – Common	476	459	935	472	1407	500	1907
Extraordinary Items	0	0	0	0	0	0	0
Total Net Income	476	459	935	472	1407	500	1907
2001 Diluted EPS:							
Core Operating	0.54	0.52	1.06	0.54	1.60	0.56	2.15
Unusual Items	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Reported EPS	0.54	0.52	1.06	0.54	1.60	0.56	2.15
Extraordinary Items	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Total Net Income	0.54	0.52	1.06	0.54	1.60	0.56	2.15

Estimates: SMH, John E. Olson, (713) 220-5151

Table Thirty-Eight: ENE -Earnings Forecast						
EBIT ($ MILLIONS):	***2000***	***2001E***	*2002E*	*2003E*	***2004E***	*2005E*
Exploration & Production	*0*	*0*	*0*	0	0	*0*
Gas Pipeline Group	*391*	*406*	417	430	442	456
Portland General	*341*	*300*	306	312	320	330
Wholesale Operations & Services (WEOS)	*2252*	*3072*	*3340*	*3750*	*4290*	*4870*
Enron Energy Services	*111*	*225*	335	*500*	*600*	*700*
Enron Broadband Services	-60	*-227*	-175	*-100*	*-25*	50
Corporate & Other **(Azurix)**	***-289***	***-497***		-370	**-340**	-275
Total Operating EBIT	2746	3279	3813	4522	5287	6131
Recurring Nonrecurring Items	***-264***	*0*	*0*	*0*	*0*	0
Total EBIT	2482	3279	3813	4522	5287	6131
Interest Expense—Net:	838	916	990	1030	1100	1200
Preferred Dividends--Subsidiaries	77	77	77	77	77	77
Minority Interests—EOG	0	0	0	0	0	0
Minority Interests—Junior Preferred (1)	*154*	*140*	*140*	*140*	*140*	*140*
Total Interest & Subs. Pfd Dividends	1069	1133	1207	1247	1317	1417
Net Income Before Taxes:						
Core Operating NIBT	1677	2146	2606	3275	3970	4714
Recurring Nonrecurring Items	**-264**	**0**	0	**0**	**0**	0
Total NIBT	1413	2146	2606	3275	3970	4714
Income Tares:						
Core Operating	*434*	*514*	*625*	*819*	*I032*	*1273*
Recurring Nonrecurring Items	*0*	**0**	*0*	*0*	**0**	*0*
Total Income Taxes	434	514	625	819	1032	1273
Net Income:						
Core Operating Earnings	1243	1632	1981	2456	2938	3441
Recurring Nonrecumng Items	-264	**0**	**0**	**0**	**0**	0
Total Net Income	979	1632	1981	2456	2938	**3441**
Preferred Dividends	***83***	***83***	*83*	*84*	*83*	*83*
Net Income—Common	896	1549	1898	2372	2855	3358
Extraordinary Items	**0**	0	**0**	**0**	**0**	**0**
Reported Net Income	896	1549	1898	2372	2855	3358
Normal Net Income to Common	1160	1549	1898	2372	2855	3358
Share Base (mm):						
Diluted Shares (mm)	*813.9*	*889.4*	*920.0*	*940.0*	*960.0*	980.0
% Growth	5.8%	9.3%	3.4%	2.2%	2.1%	2.1%
Diluted Earnings Per Share:						
Core Operating EPS	***1.47***	*1.83*	*2.15*	*2.55*	*3.00*	***3.45***
Recurring NonRecurring Items	*-0.35*	**0.00**	*0.00*	**0.00**	**0.00**	*0.00*
Total Reported EPS	*1.12*	*1.83*	*2.15*	*2.55*	*3.00*	*3.45*
Effective Growth Rates ***(%):***	*25%*	*25%*	*17%*	*18%*	*18%*	*15%*
Effective Income ***Tar*** *Rates (%):*						
Core Operating Earnings	25.9%	23.0%	24.0%	25.0%	26.0%	27.0%
Recurring Nonrecurring Items	**-35.0%**	**35.0%**	**35.0%**	**35.0%**	**35.0%**	**35.0%**
Effective ***Tax*** *Rate*	30.7%	24.0%	24.0%	25.0%	26.0%	27.0%
EBIT Profile (%):						
Gas Pipeline Group	16%	12%	11%	**9%**	8%	7%
Portland General	14%	9%	8%	7%	6%	5%
Wholesale Operations & Services (WEOS)	91%	94%	88%	83%	81%	79%
Retail Energy Services (net)	4%	7%	9%	11%	11%	11%
Broadband Services	-2%	-7%	-5%	-2%	0%	1%
Corporate & Other **(Azurix)**	-12%	**-15%**	-11%	**-8%**	**-6%**	-4%
Core Operating EBIT	111%	100%	100%	100%	**100%**	100%
Recurring Nonrecurring Items	-11%	0%	0%	0%	**0%**	**0%**
Total *EBIT*	100%	100%	100%	100%	100%	100%

Estimates: SMH, John E. Olson, (713) 220-5151

Table Thirty-Nine: ENE – CFFO ($ MM):

	2000	2001E	2002E	2003E	2004E	2005E	2001E--
Net Income	979	1661	1981	2456	2938	3441	12477
DD&A	854	930	1008	1092	1197	1304	5531
Deferred Taxes	207	300	120	150	150	170	890
Equity in Earnings of Affiliates	0	0	0	0	0	0	0
Subtotal	2040	2892	3108	3698	4285	4915	18897
Gain on Asset Sales	-146	-100	-20	-20	-20	-20	-180
Regulatory Reserves	0	0	0	0	0	0	0
Accounting Change	0	-19	0	0	0	0	-19
Asset Impairment	0	0	0	0	0	0	0
Amtzn--Production Payments	0	0	0	0	0	0	0
Subtotal	-146	-119	-20	-20	-20	-20	-199
CFFO	1894	2773	3088	3678	4265	4895	18698
Net Assets—Risk Management	-763	-618	-100	100	200	300	-118
CFFO—Net	1131	2155	2988	3778	4465	5195	18580
Merchant Assets & Investments:							
Realized Gains on Sales	-104	-154	0	0	0	0	-154
Proceeds From Sales	1838	879	0	0	0	0	879
Additions and Unrealized Gains	-1295	-325	0	0	0	0	-325
Unrealized Losses	0	21	0	0	0	0	21
Balance	439	421	0	0	0	0	400
Revised CFFO	1570	2576	2988	3778	4465	5195	15377
Per Share:							
Basic Shares	723.0	750.0	775.0	800.0	825.0	850.0	
Diluted Shares	813.9	889.4	920.0	940.0	960.0	975.0	
CFFO/Share	***1.39***	***2.42***	***3.25***	***4.02***	***4.65***	***5.33***	
Revised CFFO Per Share	***1.93***	***2.90***	***3.25***	***4.02***	***4.65***	***5.33***	
DPS	0.50	0.50	0.52	0.54	0.56	***0.60***	
Cash **Dividends (Common)**	362	375	403	432	462	510	

Estimates: SMH, John E. Olson, (713) 220-5151

Table Forty: ENE – Source/Use Forecasts ($ Millions)

	2000	2001E	2002E	2003E	2004E	2005E	2001E-
Adjusted CFFO	1570	2576	2988	3778	4465	5195	19001
Extraordinary Items	0	0	0	0	0	0	0
Reportable CFFO	1570	2576	2988	3778	4465	5195	19001
Less: Dividends							
Preferred	83	83	83	83	83	83	415
Preferred Dividends–Subsidiaries	77	77	71	77	77	77	385
Other	-5	0	0	0	0	0	0
Common	368	375	403	432	462	510	2182
Total Dividends	523	535	563	592	622	670	2982
CFFO–Net	1047	2041	2425	3186	3843	4525	16019
External Funding–Net (See Below):							
Long Term Debt	1657	2552	500	500	500	500	4552
Preferred Issues	404	0	0	0	0	0	0
Common Equity Issues	634	91	80	100	100	100	471
Grand Totals	2695	2643	580	600	600	600	5023
Funds Available	3742	4684	3005	3786	4443	5125	21042
Capital Spending	2381	2010	2020	2150	2300	2400	10880
Investments & Advances	933	1503	1200	1200	1300	1400	6603
Acquisition of Subsidiary Stock	0	0	0	0	0	0	0
Business Acquisitions	771	0	0	0	0	0	0
Total Spending	4091	3513	3220	3350	3600	3800	17483
Fund Balances	-349	1171	-215	436	843	1325	3559
Other Items:							
Asset Sales (Non Merchant)	494	1823	1000	500	500	500	4323
Miscellaneous	0	0	0	0	0	0	0
Operating--Net	1113	-639	-300	-300	-300	-300	-1839
Investing–Net	-182	-262	-250	-250	-250	-250	-1262
Financing–Net	-6	0	-20	-20	-20	-20	-80
Contra: Pfd Dividends–Subs	0	0	0	0	0	0	0
Total Other	1419	922	430	-70	-70	-70	1142
Fnnd Balances	1070	2093	215	366	713	1255	
Adjustments	409	-2068	285	-866	-273	-255	
NWC Change	1479	25	500	-500	500	1000	
NWC--Open	496	1975	2000	2500	2000	2000	
NWC--Close	1975	2000	2500	2000	2000	2000	

Estimates: SMH, John E. Olson, (713) 220-5151

Table Forty-One: ENE – Balance Sheet Forecast

$Millions:	2000	2001E	2002E	2003E	2004E	2005E
Cash & Equivalents	1374	1000	1200	1500	2000	2500
Short Term Debt	1679	3000	3500	3800	4200	4500
Current Long Term Debt	0	0	0	0	0	0
Total Current Debt	1679	3000	3500	3800	4200	4500
Current Assets	30381	30000	34000	38000	40000	43000
Current Liabilities	28406		31500			41000
Net Working Capital	1975	2000	2500	2000	2000	2000
PPE–Net	11743	12523	13235	13993	14796	15592
Investments & Advances	5294	6797	7997	9197	10497	11897
Risk Management Assets	8988	9500	10500	12000	13000	15000
Goodwill	3638	1710	1650	1590	1500	1400
Other	5459	7900	8200	8500	9000	9500
Subtotal	23379	25907	28347	31287	33997	37797
Total Assets	65503	68430	75582	83280	88793	96389
Liabilities ($mm):						
Deferred Taxes	1644	1758	0	0	0	0
Risk Management Liabilities	9423	9600	10600	12100	13100	15100
Other	2692	2866	0	0	0	0
Subtotal	13759	14224	10600	12100	13100	15100
Total Capital Structure ($mm):						
Short Term Debt	1679	3000	3500	3800	4200	4500
Long Term Debt	8550	11102	11602	12102	12602	13102
Total Debt	10229	14102	15102	15902	16802	17602
Preferreds	1133	1133	1133	1133	1134	1135
Minority Interests	2414	2143	2143	2143	2143	2143
Total Leverage	13776	17378	18378	19178	20079	20880
Common Equity	10346	12269	14673	17600	21041	25032
Total Capital	24122	29647	33051	36778	41120	45912
Total Capital Structure (%):						
Short Term Debt	7.0%	10.1%	10.6%	10.3%	10.2%	9.8%
Long Term Debt	35.4%	37.4%	35.1%	32.9%	30.6%	28.5%
Total Debt	42.4%	47.6%	45.7%	43.2%	40.9%	38.3%
Preferreds	4.7%	3.8%	3.4%	3.1%	2.8%	2.5%
Minority Interests	10.0%	7.2%	6.5%	5.8%	5.2%	4.7%
Leverage	57.1%	58.6%	55.6%	52.1%	48.8%	45.5%
Common Equity	42.9%	41.4%	44.4%	47.9%	51.2%	54.5%
Total Capital	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Shares Issued	0.00	0.00	0.00	0.00	0.00	0.00
Treasury Stock	0.00	0.00	0.00	0.00	0.00	0.00
Share Base	0.00	0.00	0.00	0.00	0.00	0.00
Shares Outstanding	783.20	824.50	920.00	940.00	960.00	980.00
Book Value	13.21	14.88	15.95	18.72	21.92	25.54

Estimates: *SMH*, John E. Olson, (713) 220-5151

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