

Market Flash: *Gas Pipelines*

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Enron [ENE] (Baa3/BBB- Hold): 10-Q Raises Further Concerns; Extent of Scheduled Near-Term Debt Maturities Exceeds Expectations

Opinion

We believe that Enron's third quarter 10-Q raises additional concerns regarding its financial stability and that the Dynegy merger could be at risk of being renegotiated or terminated if Enron proves unable to manage its near-term liabilities and to stabilize the core energy trading business. Factors that continue to erode investor confidence include: 1) Recent financial disclosures in the 10-Q, including the \$690 million note payable that, absent the posting of collateral, is facing repayment by November 26 as a result of a BBB-S&P ratings trigger (and apparently only recently having come to the attention of Enron); 2) significant debt maturities and other obligations of some \$9.3 billion over the next 12 months, and 3) the possibility of asset writedowns, including approximately \$700 million in the fourth quarter 2001 related to Osprey. On November 21, Enron announced that its lenders extended to mid-December the payment date on its \$690 million note payable. As a result, we expect Enron's stock price and bond spreads to continue to be volatile over the near term until uncertainties are resolved. In our opinion, the situation remains speculative. We also note that Enron's auditor, Arthur Andersen, has not finalized its review of Enron's third quarter financial statements that were filed on November 19, 2001.

Scheduled Debt Maturities and Other Obligations over the Next 12 Months Exceed Our Previous Expectations

Enron has disclosed debt maturities and other significant obligations over the next 12 months that total approximately \$9.3 billion. Enron's short-term debt increased to \$6.5 billion as of November 16, 2001 from \$3.5 billion at June 30. The increase in short-term debt appears to include close to \$2 billion of liabilities that were reclassified from long-term debt to short-term debt in the third quarter 2001.

Of the \$6.5 billion short-term debt, Enron has classified some \$2.14 billion as due in the fourth quarter 2001. Of these current maturities, some \$1,026 million is described as "demand notes payable to unconsolidated equity affiliates (including \$616 million due to Whitewing) under long-term revolving credit agreements for cash management purposes which can be requested as needed by the unconsolidated equity affiliates." The balance of the \$2.14 billion of debt obligations due in the current quarter include \$300 million of Enron senior notes that matured on November 15, \$94 million of current redemption value of Enron's zero coupon convertible senior notes due 2021, and the remainder, approximately \$700 million that is not specifically identified. Absent further clarification from Enron management, it is unclear whether Enron has the financial flexibility to meet these potential near-term debt maturities, depending on the timing of receipts of proceeds from previously announced and further anticipated asset sales.

A schedule of anticipated debt maturities and other significant obligations over the next 12 months is shown on the following page.

Enron Current Debt Maturities and Other Obligations
(\$ in millions)

PERIOD	AMOUNT	DESCRIPTION
Q4 2001	\$2,140	Debt (including \$1,026 million of demand notes to unconsolidated equity affiliates)
Q4 2001	\$890	Minority interest
Q1 2002	\$72	Debt
Q2 2002	\$2,125	Debt (includes \$1,750 million bank debt)
Q3 2002	\$1,600	Debt (including \$1,173 million related to zero coupon convertible bonds due 2021)
Q3 2002	\$1,819	Unconsolidated equity affiliates i.e. Osprey senior notes
Q4 2002	\$627	Debt
Q4 2002	\$74	Debt
Total	\$9,347	

Source: Company filings

Energy Trading Volumes May Be Negatively Impacted by Financial Disclosures

Enron's ability to stabilize its energy trading business by maintaining the support of key trading counterparties is critical. We caution that daily trading volumes can be highly volatile and can decline as a result of the disclosure of negative credit events related to Enron. We are concerned about news service reports and other anecdotal evidence indicating a decline in the number of counterparties willing to transact with Enron, even in the short-term markets. It is not yet clear whether such a decline in trading volumes is permanent.

Osprey and Marlin

In its 10-Q, Enron also reported a potential \$700 million write-down related to Osprey. We note that there is an apparent difference between the accounting treatment of Enron's contingent obligation in Osprey compared with Marlin. Unlike Marlin, the Osprey share trust contains an issued and outstanding series of preferred stock, the mandatorily convertible junior preferred stock, series B, and the contingent obligation to issue additional shares. This contingent obligation is in the form of a derivative instrument and is accounted for under SFAS 133 - Accounting for Derivative Instruments and Hedging Activities. Under SFAS 133, derivative instruments must be recorded at fair value. Therefore, as Enron's stock price has declined, the contingent obligations have increased, and, in the case of Osprey, are reported in Enron's earnings. Based on Enron's stock price decline from September 30 to November 16, 2001, Enron's contingent liability related to Osprey could result in a pre-tax \$700 million charge to earnings. In Marlin, convertible preferred stock is issued to the share trust but is not considered outstanding for accounting purposes. It is our understanding that Enron's contingent obligation that supports the Marlin senior notes, therefore, does not qualify for SFAS 133 treatment, and does not potentially generate reported losses in conjunction with Enron's stock price decline.

S&P Commentary

On November 20, S&P issued a comment on Enron's 10-Q filing and the disclosure of the ratings trigger related to the \$690 million Enron note payable. According to S&P, "At this time, the trigger event does not constitute an event of default. However, it does raise liquidity issues for Enron. Standard & Poor's believes, given the alignment of interests between Enron and the banks, that the company's efforts to renegotiate and extend the maturity of the obligation will be successful."

S&P also reported that they believe Enron's liquidity position is sufficient to carry the company through the period until the close of the merger with Dynegy, although, in our opinion, that view seems optimistic in light of the extent of reported current debt maturities noted above. We expect the rating agencies will continue to closely monitor the situation and that any material change in Enron's energy trading business or additional financial disclosures that are not in line with rating agency expectations could raise the risk of a credit rating downgrade. We think a downgrade from either S&P, Moody's or Fitch below current Baa3/BBB-/BBB- levels could potentially cripple Enron and could doom the Dynegy merger.

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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