

Enron: California Utility Settlement and Indian Asset Sale are Catalysts for restoring Confidence. Outperform.

Duane Grubert 212-756-4206 GrubertDM@bernstern.com, David Wideman 212-756-4139 WidemanDL@bernstern.com

Stock	Price	SCB Rating	YTD Perf.	EPS			P/E		Yield
				2000A	2001E	2002E	2001E	2002E	
Enron	\$33.37	O	-58%	\$1.12	\$1.80	\$2.40	18.5x	13.9x	1.63%
SPX	1075		-18%	\$56.25	49.75	53.75	21.6	20.0	1.3%

O – Outperform, M – Market-Perform, U – Underperform

- Investor confidence in Enron has improved with material progress on legacy issues in California and India.
- With California regulators crafting a settlement to restore Edison's creditworthiness, Enron is likely to be paid back a large part of its undisclosed exposure, likely hundreds of millions of dollars, likely by the end of this year.
- Enron's announced sale of its Indian oil and gas assets to BG for \$338 million is a tangible symbol of CEO Ken Lay's ability to accelerate asset sales and refocus the company on core merchant activity.
- Enron's billion dollar stake in India's Dabhol plant is likely to be sold, at a discount, in 2002, perhaps to Tata, an Indian power developer.
- Additional asset sales within the next two years could include Portland General, South American assets, and remaining upstream assets. This will enhance Enron's merchant energy focus and return on assets.

Details

With progress on Enron's two main headaches (California and India) within weeks of CEO Lay taking back the reins as operating head, we believe Enron will be able to focus and execute on our \$2.40 eps estimate for 2002 (Exhibit 1). We reiterate the Outperform rating we've assigned to the stock since September 10 with a \$42 target in twelve months.

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Exhibit 1**Enron Corp and Subsidiaries
Selected Financial Data, in million \$**

	1998	1999	2000	2001E	2002E	2003E	2004E	2005E
Revenues, Net of Intercompany								
Transportation and Distribution								
Gas Pipeline Group	794	768	776	793	793	797	797	797
Portland General	1,196	1,379	2,256	2,991	3,171	3,361	3,563	3,777
Wholesale Energy Operations and Services	27,220	35,501	93,296	177,262	239,304	299,130	373,913	467,391
Retail Energy Services	1,072	1,518	1,766	2,296	2,755	3,306	3,967	4,761
Broadband Services			495	198	248	297	356	428
Exploration and Production	750	429						
Corporate and other	385	651	400	400	400	400	400	401
Total	31,417	40,246	98,989	183,940	246,670	307,292	382,996	477,554
EBIT								
Transportation and Distribution								
Gas Pipeline Group	351	380	391	406	401	410	405	405
Portland General	286	305	341	298	342	391	444	502
Wholesale Energy Operations and Services	968	1,317	2,252	2,895	3,039	3,582	4,298	5,158
Retail Energy Services	-119	-68	111	230	275	331	397	476
Broadband Services	0		-48	-158	27	53	107	128
Exploration and Production	128	65						
Corporate and other	7	-17	-615	-450	-250	-250	-250	-250
EBIT - Recurring	1,621	1,982	2,432	3,219	3,835	4,517	5,401	6,419
Non-recurring items	-39	13						
Total EBIT	1,582	1,995	2,432	3,219	3,835	4,517	5,401	6,419
Interest and Related charges, net	550	656	838	879	884	928	975	1,023
Pre Tax Income	1,032	1,339	1,594	2,340	2,951	3,589	4,426	5,396
Income Tax Provision (Benefit)	175	104	434	483	575	678	810	963
Dividends	77	76	77	78	78	78	78	78
Minority Interests	77	135	154	150	150	150	150	150
Net Income before cumulative changes	703	1024	929	1629	2148	2683	3388	4205
Cumulative effect of accounting changes, net of tax		-131						
Net Income	703	893	929	1629	2148	2683	3388	4205
Preferred stock dividend	17	66	83	85	85	85	85	85
Earnings	686	827	846	1544	2063	2598	3303	4120
Earning per share								
Diluted	\$ 1.01	\$ 1.10	\$ 1.12	\$ 1.77	\$ 2.40	\$ 3.02	\$ 3.83	\$ 4.78
EPS with low margins and revenues in wholesale					\$ 2.12	\$ 2.42	\$ 2.73	\$ 2.98

Source: Company reports, Bernstein estimates

California settlement with Edison

A surprise settlement plan was announced October 3 by California power regulators to work to restore Edison's creditworthiness. Edison has \$3.3 Billion of obligations unpaid as a result of this year's California power market debacle. The settlement intends to have Edison apply its cash on hand plus any future refunds from wholesalers to pay off back debt to power providers including Enron. Under the plan, Edison will reportedly be able to make good on \$3 Billion of current obligations.

Enron has repeatedly reported that it has fully reserved against credit risk in California. This proposed settlement then has the potential to free up cash on the order of several hundred million dollars. The exact figure has never been disclosed by the company.

Indian oil and gas fields sold off

Enron will sell its oil and gas fields in India to BG for \$388 million according to BG. This upstream asset sale is consistent with Enron's desire to ultimately exit the upstream completely. The company still retains upstream assets in China, and an interest in Mariner Energy, a US upstream business active in Gulf of Mexico deepwater development.

The sale is consistent with Enron's focus on sales of non-core assets, as well as a move away from investing in international physical assets. The Indian fields had been retained when EOG was split from Enron, as an option to link Indian oil and gas production to now-troubled Indian power infrastructure projects.

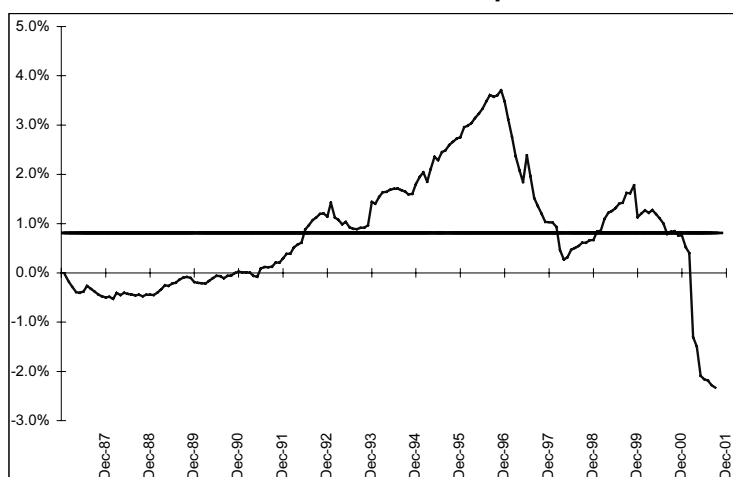
Enron's interest in the Indian Dabhol plant is around \$1 billion, and recent press reports indicate that Tata, an Indian power developer, may be interested in buying the stake at some discount.

Asset Sales are the right thing for Enron

With recently low relative return on capital employed (Exhibit 2) and large assets deemed as non-core, ENE trades at a historically low price to book relative to peer companies (Exhibit 3). Further asset sales while the merchant business grows suggests future improvements on both metrics.

Exhibit 2

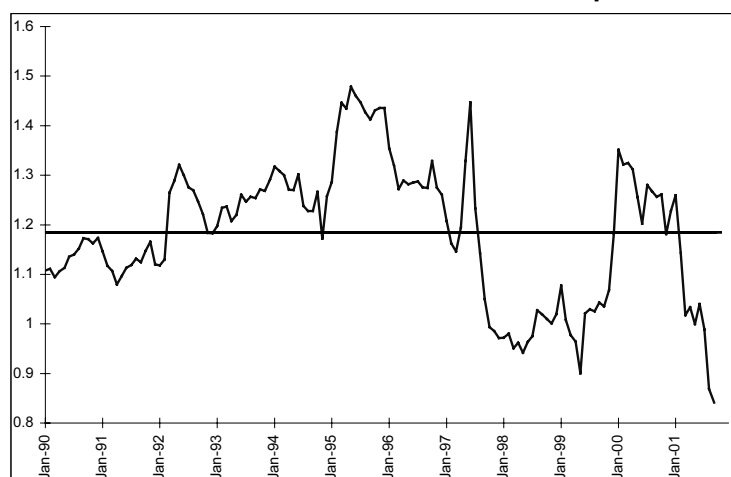
ENE Relative ROCE to Merchant Group



Source: Company reports, Factset, Bernstein estimate

Exhibit 3

ENE Relative Price to Book to Merchant Group



Source: Company reports, Factset, Bernstein estimate

Investor implication

Enron has collected a laundry list of legacy issues and problems requiring workout along the lines of the utility settlement and Indian asset sale. With Ken Lay back as COO, execution of asset sales is likely to accelerate. We expect a sale of the Dabhol interest within 2002, as well as progress in selling other international assets. This is in line with a renewed focus on core merchant energy business which we see capable of outperforming guided eps estimates of \$2.10 by 30 cents in 2002. Continued volatility in gas and power in core markets plus continued success of retail energy business growth supports our earnings forecasts and Outperform rating.

Risks

With progress of both India and California issues at hand, risk of nonpayment or large writedowns appears to be mitigating. However, if Dabhol can not be sold soon, Enron is likely to be forced into a fire sale loss, or becomes involved in a long term argument with Indian power buyers. If progress in India or California reverses, the shares could go back to where they were before either issue appeared to be improving, about a 20% downside from current prices.

