Goldman Sachs

Enron Corp. (ENE)
A LOT Better Than it Feels; Prospects Never Better: Raising Estimates; Reit. RL

Analyst Comment

6:30 AM - June 27, 2001

Recommended List

Large-Cap Growth

Price: US$44.19

S&P 500: 1217

United States

We strongly reiterate our Buy rating on ENE following a visit with mgmt, are raising our 01 est $0.05 to $1.85, establishing a well above consensus 02 est of $2.25 and a price target of $68 to replace a very out of date $110 target, representing an over 50% upside with what we view as limited risk. Our confidence in the direction of ENE's strategy and our conviction in the continuing strong execution of its business plan continue to be extremely high. We view the extreme y-t-d share price weakness as an unusual and major opportunity for investors to purchase this best-in-class company with a sustainable 25% growth rate at an under 20 p/e of forward eps.

Stock data	
52-week range	$90.00-44.05
Yield	1.1%

Price performance	1M	3M	12M
Absolute	-17%	-28%	-37%
Rel to S&P 500	-12%	-34%	-20%

Capitalization	
Market cap	$33.0bn
Latest net debt/(cash)	-
Free float	-
Shares outstanding	746mn

Forecasts/valuation	2001E	2002E
EPS	$1.85	$2.25
P/E	23.9	19.6
Next quarter EPS	0.43	-

We are hosting a conference call at 11am (EST) Wednesday to discuss our views on ENE shares with clients. The dial in # is 800-203-4101. A replay of this call is available at 800-615-3210; passcode: 5338365.

Full details

No Fundamental Deterioration´ On the Contrary, Prospects (Except for Telecom) Have Never Been Better Enron shares have fallen 47% in 2001 as investors have cast doubt about both the company's strategy and management's execution of its wide ranging and ambitious business plans. We have no such doubt. Following a day long series of one-on-one meetings with virtually all of top management, we are only more confident that both the company's wholesale and retail businesses are extremely well positioned to generate substantial growth that well exceeds expectations, supporting our high-on-the-street 25% long-term eps growth expectation. We also believe that value exists in the company's telecommunications businesses and that, at a minimum, current operating losses will be sharply reduced over the coming year. We believe that the current share price discounts none of this potential and paradoxically is actually penalized for not meeting earlier expectations.

Wholesale is Much More than a Great Trading Operation; This is about Services, Structured Products and Risk Management We continue to be extremely impressed with Enron's flagship wholesale marketing operation, which accounts for 77% of earnings and where earnings growth has averaged 41% over the past five years. Growth prospects continue to be excellent in both energy products, which account for over 90% of segment results, and where we believe the potential exists for earnings to triple over the coming six

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Important disclosures appear at the end of this note.

to eight years, and a variety of non energy products where Enron is effectively transferring its logistics, trading, risk management and structuring capabilities. The business opportunity in such major commodities and products as paper and pulp, metals and weather derivatives is substantial, although difficult to quantify. We absolutely believe that Enron's very broad capabilities are transferable to a wide variety of products and commodities and also see it as critical to emphasize that the company's wholesale operation is much more than the trading business many view it as being; rather it is a very sophisticated marketing operation with very broad and deep value-added capabilities in contract structuring and risk management and a track record of consistent and strong earnings growth in both up and down markets. We view this business as more of a services business than a trading operation.

Winning a Game No One Else is Playing-Enron Energy Services Enron Energy Services (EES) has long been far overshadowed by the extremely profitable wholesale operation. However, all this is about to change as this business charges ahead into substantial profitability and soon becomes a major driver of growth at Enron. Enron has built totally unique capabilities in retail (the business serves light industrial and commercial customers, not residential customers) and yet this business has fallen from the radar screen of many because of the long start-up period and lack of profitability until quite recently. As a result of: (1)$16 billion of contracts signed in 2000 (and nearly twice this amount expected in 2001), (2)strong and rapidly rising earnings expected by us, and soon to be expected by others as visibility to this future is radically increased, and (3)a DCF valuation of $15 per share becoming evident, EES is likely to soon become a very important earnings and value driver at Enron. We forecast $250 million of EBIT in 2001 (7% of ENE's earnings) and a 50% long-term growth rate. The market opportunity for this segment is huge (hundreds of billions of dollars) and market acceptance of Enron high. No other company is able to deliver the suite of products and services (flexibility of energy and delivery options, risk management tools and management of assets) that Enron is positioned to provide. EES has finally reached the 'take off' point where Enron is very likely to benefit significantly in the near-term from the major people and capital investments made. Existing contracts virtually assure this upside and value creation even as investors appear to be almost unaware of this rapidly emerging business.

Valuation: Trading at a Much Lower Multiple than Other High Growth Companies Despite Our Confidence in Long-Term Earnings Growth Enron is currently trading at 19.6 times our $2.25 per share estimate of 2002 earnings. The universe of over $20 billion market capitalization companies in the S & P 500 with greater than 20% forecast long-term growth trades at an average 1.4 times P/E to growth ratio. In this list of 25 companies, very few trade at less than one times growth rate. We are establishing a price target of $68 per share, representing a 55% appreciation, based on a 1.2 times P/E to growth ratio. Our 25% long term earnings growth rate is without question significantly higher than the 16% (First Call) and 17% (Baseline) growth estimates and it is this difference in growth rate expectation that represents the opportunity in the shares as our (as we believe) expectations become more generally embraced by investors.

Telecom and Other Parts of This Story Enron management told an extraordinary story in January 2000 about prospects for its bandwidth intermediation and content businesses. The demonstration of its (then and still) Modulus technology as part of its more capable broadband network and management's confidence in building very major businesses drove ENE shares sharply higher. Neither of these two businesses has yet come close to meeting the very high expectations encouraged by management. And unfortunately, management never publicly altered its very bullish expectations. As a result, investors have incorrectly generalized these obvious shortfalls in telecom to other areas such as wholesale and retail that continue to perform strongly. Not only are these conclusions totally off base, but telecommunications continues to have reasonable prospects, even if significantly diminished and delayed.
However, there is no value or even negative value in Enron shares currently for its telecom operation.

Other issues have also plagued Enron in recent periods and we will briefly address the several major issues and our analysis:
**California-Enron owns no major assets in the State, but has been a major marketer of energy and energy products in California. Without question, Enron has made strong returns in the state. We believe Enron has heavily reserved against revenues and see very limited risk.
**Dabhol India-Enron has a major investment ($850 million) in a power project in India and the Indian government has effectively repudiated the contract. We believe that Enron has exceptional

protections in its contract and that Enron is unlikely to suffer any loss; in fact, we expect an outcome with Enron selling the project for a meaningful profit.

**Portland General-This asset has been identified for sale and a sale agreement fell through because of California related issues. We believe this lower returning asset will in time be sold and yet do not see it in the mean time as a negative to the company.

**Other major international assets-Enron has stated a commitment to selling a large (but not defined) group of international assets. The weak Euro (European companies are the most likely buyers of many of these assets) has delayed these sales of low returning assets. We continue to anticipate significant asset sales over the coming two years with cash proceeds that could exceed $4 billion; proceeds could be utilized to repurchase shares or pay down debt.

**Share sales by top management-Sales of shares have been part of long term sale programs and mostly related to expiring options (except for one major seller who is leaving the company). CEO Jeff Skilling indicates that he has terminated his share sale program given the price of ENE shares.

Goldman, Sachs & Co. or an affiliate has rendered significant corporate finance services to the following companies or one of its affiliates within the past 12 months: Enron Corp. An affiliate of Goldman, Sachs & Co. has acted as dealer in the commercial paper of the following companies and/or affiliates thereof within the past 12 months: Enron Corp. Goldman, Sachs & Co. or an affiliate has managed or comanaged a public offering of the following companies' securities in the past several years: Enron Corp. Goldman Sachs & Co. or an affiliate may deal as principal in any of the securities mentioned.