

# 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est \$0.05 to \$1.85, establishing a well above consensus 02 est of \$2.25 and a price target of \$68 to replace a very out of date \$110 target, representing an over 50% upside with what we view as limited risk.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

**David Fleischer, CFA**  
david.fleischer@gs.com  
New York: 1-212-902-6018

**David Maccarrone, CFA**  
david.maccarrone@gs.com  
New York: 1-212-902-0324

**Eric W. Mandelblatt**  
eric.mandelblatt@gs.com  
New York: 1-212-357-7547

**Goldman Sachs**  
**Global Equity Research**

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 co-managed 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.**

---

(C) 2001 Goldman, Sachs & Co. All rights reserved.

This report is not to be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. We are not soliciting any action based upon this material. This material is for the general information of clients of Goldman Sachs. It does not take into account the particular investment objectives, financial situation or needs of individual clients. Before acting on any advice or recommendation in this material, a client should consider whether it is suitable for their particular circumstances and, if necessary, seek professional advice. Certain transactions, including those involving futures, options, and high yield securities, give rise to substantial risk and are not suitable for all investors. The material is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon as such. Opinions expressed are our current opinions as of the date appearing on this material only. While we endeavor to update on a reasonable basis the information discussed in this material, there may be regulatory, compliance, or other reasons that prevent us from doing so. We and our affiliates, officers, directors, and employees, including persons involved in the preparation or issuance of this material may, from time to time, have long or short positions in, and buy or sell, the securities, or derivatives (including options) thereof, of companies mentioned herein. No part of this material may be (i) copied, photocopied or duplicated in any form by any means or (ii) redistributed without Goldman, Sachs & Co.'s prior written consent.

This material has been issued by Goldman, Sachs & Co. and/or one of its affiliates and has been approved by Goldman Sachs International, which is regulated by The Securities and Futures Authority, in connection with its distribution in the United Kingdom and by Goldman Sachs Canada in connection with its distribution in Canada. This material is distributed in Hong Kong by Goldman Sachs (Asia) L.L.C., in Korea by Goldman Sachs (Asia) L.L.C., Seoul Branch, in Japan by Goldman Sachs (Japan) Ltd., in Australia by Goldman Sachs Australia Pty Limited (ACN 092 589 770), and in Singapore through Goldman Sachs (Singapore) Pte. This material is not for distribution in the United Kingdom to private customers, as that term is defined under the rules of The Securities and Futures Authority; and any investments, including any convertible bonds or derivatives, mentioned in this material will not be made available by us to any such private customer. Goldman Sachs International and its non-U.S. affiliates may, to the extent permitted under applicable law, have acted upon or used this research, to the extent it relates to non-U.S. issuers, prior to or immediately following its publication. Foreign-currency-denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of, or income derived from, the investment. In addition, investors in securities such as ADRs, the values of which are influenced by foreign currencies, effectively assume currency risk.

**Further information on any of the securities mentioned in this material may be obtained upon request, and for this purpose persons in Italy should contact Goldman Sachs S.I.M. S.p.A. in Milan, or at its London branch office at 133 Fleet Street, persons in Hong Kong should contact Goldman Sachs (Asia) L.L.C. at 2 Queen's Road Central, and persons in Australia should contact Goldman Sachs Australia Pty Limited.** Unless governing law permits otherwise, you must contact a Goldman Sachs entity in your home jurisdiction if you want to use our services in effecting a transaction in the securities mentioned in this material.