BEAR STEARNS

Equity Research
Basic Industry

Enron Corp.
(ENE-79 3/4)

Distributed Energy Services

Rating: Attractive

52-Week Range
$91-$41

Earnings per Share
2000: $1.47
2001E: $1.75
2002E: $2.05

P/E
2001E: 45.6x
2002E: 38.9x

Dividend
$0.50

Yield
0.63%

Com. Shares (mil)
746.6

Equity Market Capitalization (mil)
$59,541

Book Value per Share
$13.60

Est. 5-Yr EPS Growth Rate
15%-30%

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An Energy *and* Communications Giant

- **INITIATION OF COVERAGE.** We initiated coverage of Enron Corp. on December 15, at the previous day's closing price of $76 1/2. Already an established leader in the natural gas industry, Enron is moving rapidly — through revolutionary communications systems and interfaces — to become the world's preeminent energy and commodities marketer, high-density Internet distributor, and distributed energy leader. We believe that Enron should be compared to leading global companies like GE, Citigroup, Nokia, Microsoft, and Intel, and that its valuation reflects this eminence.

- **SIZE AND FIRST-MOVER ADVANTAGE ARE KEY DRIVERS.** Above all, Enron is about harnessing the intellectual capital of its employees to aggressively pursue perceived market opportunities. While the company embraces risk and speed in this regard, it does so with a strong capital and intellectual base, and constantly evaluates its moves to avoid mistakes. This has enabled Enron to beat rivals to market and enjoy the strong margins afforded first-movers, as well as to de-emphasize less attractive markets and businesses.

- **UNLIMITED POTENTIAL IN BROADBAND SERVICES.** Enron is organized around four independent business units: Wholesale Energy, Retail Energy, Transportation and Distribution, and Broadband Services. We see the potential for Broadband Services as being virtually unlimited. We also believe that Enron's four operating segments comprise a company that could one day dominate all aspects of the energy and communications industries on a global scale.

- **$98 PRICE TARGET.** Our Attractive rating and 12-month price target reflect Enron's highly successful existing businesses, customer relationships and contractual agreements; its advanced online systems and business models; and its valuation relative to potential financial results (based on both a conservative DCF and comparables analysis).

ENRON CORP. (ENE-79 3/4)

BEAR STEARNS

Company Description:

Enron is a Houston-based energy and communications company principally engaged in the transportation of natural gas through a pipeline system to markets throughout the U.S.; the marketing of natural gas, electricity, metals, pulp, bandwidth, and hundreds of other commodities and related risk management and financial services worldwide; the development, construction, and operation of power plants, pipelines, and other energy related assets worldwide; and the development of an intelligent network platform that provides bandwidth management services and delivers high bandwidth and intensive data streams to customers worldwide.

Key Upcoming Events/Developments:

- **January 22, 2001.** Enron reported fourth-quarter 2000 EPS of $0.41 versus $0.31 a year earlier.
- **January 24-25, 2001.** The company will hold its annual analyst conference in Houston.

CAPITALIZATION (9/30/00)

	$ Mil.	%
Long-Term Debt	10,013.7	91.2
Minority Interest	514.7	4.7
Equity	447.5	4.1
TOTAL	10,975.9	100.0

KEY FINANCIAL RATIOS

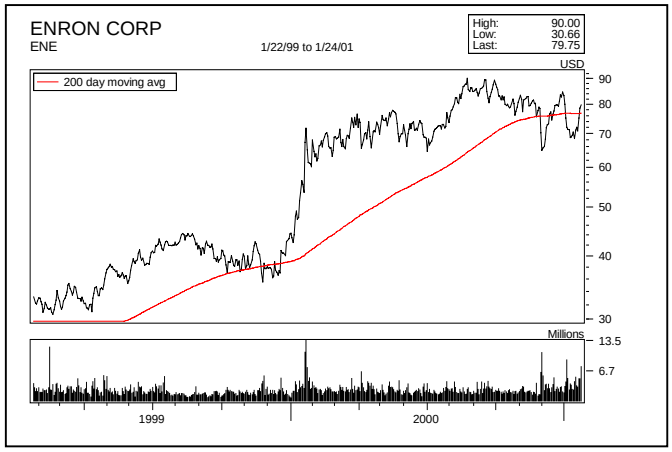
Debt/Equity	1.36%
ROE LTM	11.6%

VALUATION

	2000	2001E
Price/Earnings	54.3x	45.6x
Enterprise Value/IBITDA	26.5x	24.0x

BENCHMARKS

	2000	2001E
S&P 500	23.9x	22.4x
P/E Relative to Market	2.3x	2.0x



Source: FactSet Research Systems Inc.

QUARTERLY EARNINGS PER SHARE

	1999	2000	2001E
March	$0.34	$0.40	$0.46
June	0.27	0.34	0.41
September	0.27	0.34	0.41
December	0.31	0.41	0.47
YEAR	$1.19	$1.47	$1.75

FINANCIAL SUMMARY

($ in millions, except per share data)

Year-End	Revenue	Operating Income	Operating Margin	Pretax Income	Pretax Margin	Net Income	Diluted EPS	IBITDA
2002E	$126,027	$3,646	2.9%	$2,641	2.1%	$2,112	$2.05	$5,471
2001E	111,731	3,022	2.7	2,047	1.8	1,637	1.75	4,597
2000	100,789	2,746	2.7	1,677	1.7	1,266	1.47	3,631
1999	40,112	1,995	5.0	1,128	2.8	893	1.19	2,865
1998	31,260	1,582	5.1	878	2.8	703	1.01	2,409

All pricing is as of the market close on January 24, 2001, unless otherwise indicated.

An Energy and *Communications Giant*

We strongly believe that Enron can be characterized as being "at the forefront of the energy marketing and communications revolution" because it appears that the technologies and services that the company is using and developing will literally change the way people live and businesses operate throughout the world. While numerous competitors in the energy services industry are following Enron's lead by moving into the realm of energy marketing and communications services, we view Enron as the clear industry leader due to its sizeable base of existing energy assets, long-term penetration of high-growth markets, superior financing and optionality strategies, and, finally, its commitment to the exciting and immensely profitable world of bandwidth trading and utilization agreements.

Enron's track record of growing its top- and bottom-line figures over the past several years has been superb, and we see substantial opportunities for an extension of this remarkable pattern as the company continues to broaden its wholesale energy and trading business on a global basis, further harvests earnings from the scale infrastructure it has established in its energy services business model, and begins to capitalize on its leading position in the emerging bandwidth communications trading segment. We have established an Attractive rating and a 12-month price target of $98 for Enron shares to reflect the company's highly successful existing businesses, customer relationships, and contractual agreements; its advanced online systems and business models; and its valuation relative to potential financial results (based on both a conservative discounted cash flow [DCF] and comparables analysis).

The company, with more than $50 billion in energy and communications assets, produces and markets electricity, natural gas, broadband, and a myriad of other commodity-type products, including metals and paper pulp. Enron currently operates several hundred power and processing plants, trading exchanges, storage facilities, pipeline systems, and miscellaneous facilities in at least 55 countries worldwide. The company is organized around four major business groups: Wholesale Energy Operations and Services, Retail Energy Services, Broadband Services, and Transportation and Distribution Services. Already one of the nation's largest natural gas distributors — transporting more than 15% of U.S. natural gas — Enron is also the world's leader in wholesale and retail services, and is on the cusp of experiencing explosive growth in its Broadband Services business. All told, with consistent earnings and cash flow from the Transportation business, market dominance in the Wholesale and Retail sectors, and projected hyper-growth in its Broadband business, Enron's long-term vision is to possess unbeatable scale and scope in every business and region in which it operates.

REASONS TO INVEST

- **Financial Giant with a Penchant for Saving.** With more than $50 billion in assets, Enron has the financial ability to enter into new regions, industries, and projects far quicker than most of its competitors. This financial strength has proven critical in Enron's wholesale energy marketing and trading business, where a fundamentally strong, liquid balance sheet has become necessary to operate in today's volatile mark-to-market environment. In addition, we see

particular value in Enron's practiced philosophy of asset divestment in areas of underperformance or where a negative outlook is perceived. This enables the company to release capital for more profitable investment opportunities.

- **Online Marketing and Trading Platform.** The company's Internet-based commodity trading platform, EnronOnline, has revolutionized the manner in which commodities — including natural gas, electricity, natural gas liquids, weather derivatives, metals, and paper products — are traded between counterparties. This site, a second version of which was recently unveiled, has grown in slightly over a year to offer customers more than 1,400 products across a broad range of languages and currencies. Since its November 1999 inception, EnronOnline has completed more than 548,000 transactions with a gross transactional value exceeding $336 billion. Finally, Enron is actively pursuing the trading of numerous products that were previously considered uncommoditizable. With this business platform, the company is pursuing ways to make money that have never been tried before, and so far it has proven that they can work.

- **Wholesale Energy: Enron's Most Profitable and Dynamic Business.** Wholesale Energy has undergone explosive revenue and earnings growth during the past two-year period, with substantial gains coming in 2000 due to significantly increased prices and volatility in the gas and power markets. We believe that this business segment, benefiting from Enron's worldwide market penetration, its overarching EnronOnline trading system, and a coordinated push into new commodity markets (Enron Industrial Markets), should experience annual growth of approximately 20% for the next several years.

- **Bandwidth Technology and Applications — The Future of Enron?** By now, we have all heard of the benefits afforded Internet users through assorted bandwidth technology. Enron truly believes that this technology will fundamentally alter how business (and life in general) will be conducted in the future. Currently building out a worldwide bandwidth network, Enron is focused on having the ability not only to transmit high-content data but also to *trade bandwidth as a commodity between customers.* While unsupportable at this time, Enron sees a future (sooner rather than later) where earnings from bandwidth could surpass the *combined earnings* from the rest of the company.

- **Short-Term Pricing and Long-Term Demand Projections Favor Enron.** We consider Enron (and other wholesale energy companies) to be "long volatility." In essence, high prices and price volatility are Enron's friends due to the company's growing marketing, trading, and retail (energy management) operations. We expect this trend to continue throughout 2001, with prices decreasing from their current highs and high volatility continuing throughout the year. For the long term, we envision demand for natural gas increasing significantly faster than in the past, with domestic demand rising approximately 5-8 Tcf over the coming decade. Of course, given Enron's flexibility and the trading culture it has established, we would expect the company to go "short" volatility at some point, in advance, perhaps, of a dampening in the volatility of the gas and power markets.

INVESTMENT RISKS

- **Wholesale's Performance Overshadows Everything Else Enron Does.** With the Wholesale Energy segment consistently generating 85%-plus of the company's revenues and earnings — and a large portion being driven off of unpredictable commodity pricing volatility — we are concerned that building and maintaining a meaningful forecasting model will become virtually impossible. As with most wholesale energy companies, Enron provides analysts with little information beyond end-of-reporting-period bottom-line figures with regard to its respective marketing and trading operations. In the financial world, these types of inherently volatile and unpredictable earnings streams have historically garnered lower valuation multiples due to their lack of visibility and predictability.

- **Market Volatility: Important to Enron's Success, but Is It Sustainable?** Although it is hard to prove without internal financial information from Enron, we believe that the company has benefited tremendously from the increased price volatility seen in the gas and power markets over the past 12-18 months, particularly in North America. We may lack an historical basis for this claim, but we believe that we are at or close to a cyclical peak in price volatility, especially in the North American market. If so, given the lack of information concerning daily trading operations at Enron, there is the potential for *unquantifiable and unexpected* downturns in revenues and earnings (or at the very least a deceleration in the rate of growth in these two important financial metrics), or at least the potential for a slowdown in the rate of growth in this segment.

- **Economic Outlook.** Daily business news and economic events continue to point to a "harder landing" than was originally hoped for. While we like the short-term outlook for gas and power pricing and volatility, we are concerned that a major economic slowdown would dampen the positive effects of both, diminishing earnings throughout Enron's global presence. We will continue to monitor this situation, but it is obvious that the markets (and the Federal Reserve) have become increasingly worried about the economic backdrop. A dramatic slowdown in growth could not only slow Enron's overall expansion efforts, but also dampen volatility (through decreased demand) in key markets such as gas and power.

VALUATION

Despite a difficult year for the major market indices, the shares performed extremely well in 2000 (almost doubling) as the market embraced Enron's bold moves to exploit heretofore-unrecognized market opportunities. However, as with many market darlings, this has created tension for investors, who must weigh the company's obvious strengths and its favorable business outlook against the generous valuation levels that accompany such perceptions.

Although price-to-earnings is not our preferred valuation measure, the stock is trading at a P/E multiple of approximately 45x forward consensus estimates for 2001 (clearly it is not being ignored). Complicating the valuation task is the fact that Enron is aggressively pushing forward into new, potentially enormous markets that could take its already strong performance to even higher levels. These efforts, of course, come with risks that must be measured against the opportunities. *Because Enron most resembles a Wall Street firm in the energy business, one wonders whether an enterprise that is inherently a trading business should be valued at levels*

that are in fact multiples of what the best trading businesses command. To the extent that this type of valuation perception were to increase in the marketplace, risk in the shares could rise given their comparatively high valuation status.

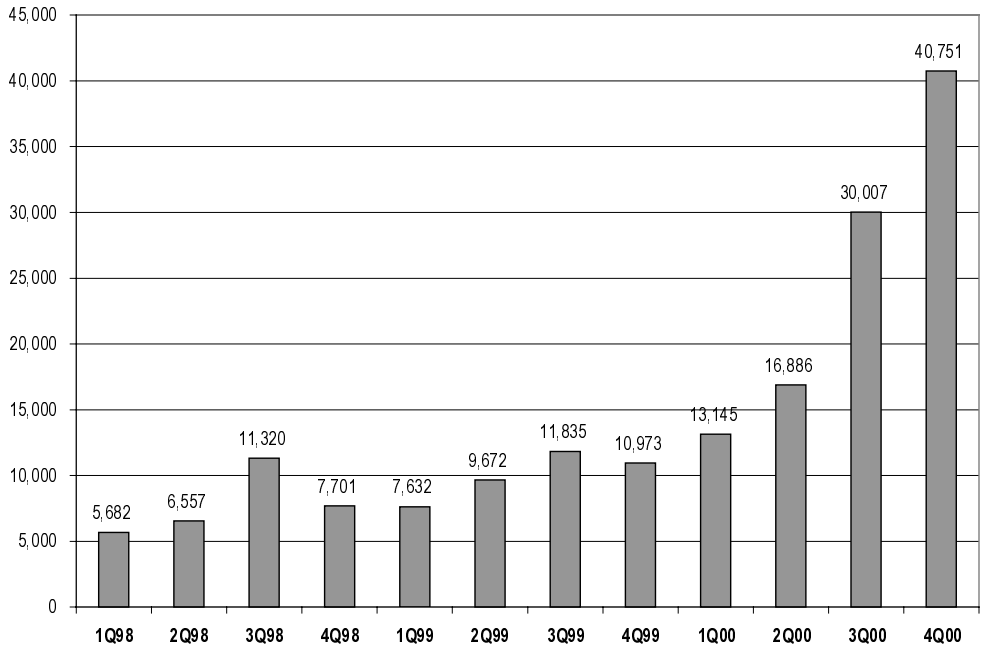
For our own purposes, and because the company is seeking significant growth in several nascent businesses that are currently under development (most specifically bandwidth intermediation and content delivery, but also the Enron Net Works business area developing within the Wholesale Energy segment), we are relying primarily on two methodologies, DCF and DCF-based terminal IBITDA multiple, to value Enron. Using projections through 2005, as well as a terminal/perpetual growth rate of 4.5% and a discount rate of close to 7% (based on our calculation of Enron's weighted average cost of capital or WACC), we arrive at a present value of around $89 per share. This discount rate figure was determined using both a tax-adjusted cost of equity and cost of debt calculation, drawing on an approximate corporate tax rate and a long-term risk free rate of 5.65% (30-year government bond rate quoted on January 24, 2001). Using a 12x terminal IBITDA multiple through our second valuation method, we arrive at a present value of approximately $108 per share. Splitting the difference between these valuation techniques, we arrive at our 12-month price objective for the shares of $98 as well as our Attractive rating.

This valuation is roughly $8 above our initiation of coverage 12-month target price of $90 per share. As the recent run-up in share price is most likely attributable to investor exuberance following the release of fourth-quarter earnings, we are sticking to our Attractive rating for shares of Enron. Again, while we view Enron as an excellent company with several quality businesses, we are mindful of the firm's high P/E multiple and we are not yet ready to incorporate the extremely generous valuation for Enron's broadband/communication business that other analysts (and Enron itself) have incorporated.

POSTING STUNNING RETURNS

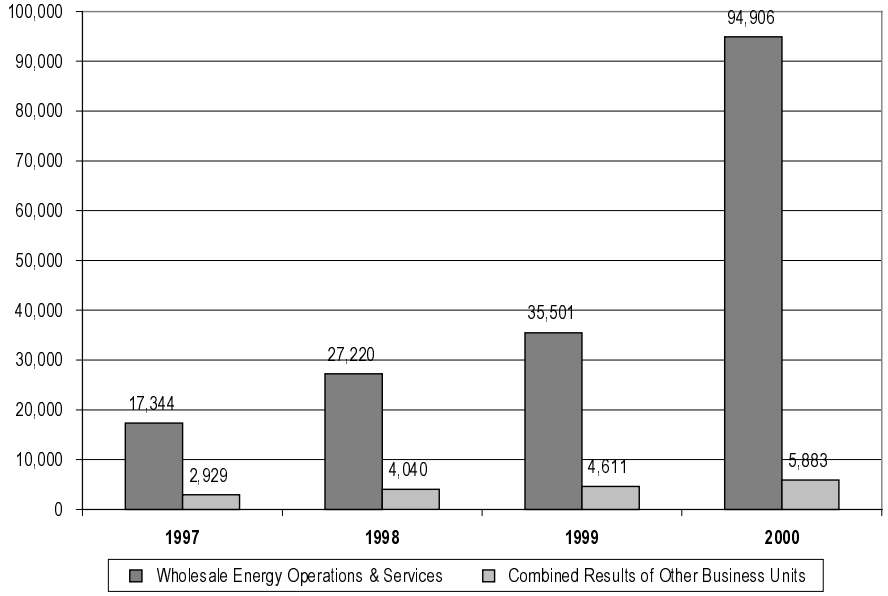
After several years of steady growth in revenues and earnings, the company has posted stunning returns for all business segments during the past four quarters, particularly in Wholesale and Retail Energy Services. Compared to 1999 results, Wholesale's full-year 2000 revenues and earnings have increased by 162% and 72%, respectively, while Retail's revenues and earnings have risen by 155% and more than 250% respectively. Enron's Wholesale Energy operations have grown at a rate of 35% (CAGR) over the past five years.

Exhibit 1. Enron's Impressive Revenue Growth — Quarterly Results, 1Q98–4Q00 ($ in millions)



Source: Enron Corp.

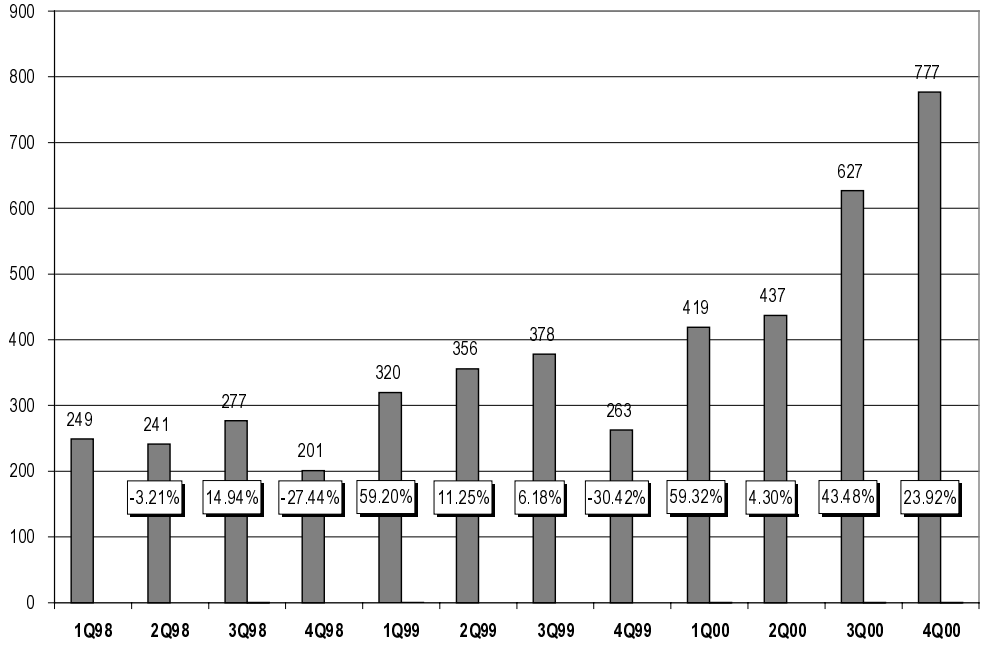
Exhibit 2. Enron Revenue: Wholesale Energy Propels the Ship ($ in millions)



Note: Other reporting business units include: Retail Energy, Broadband Services, Exploration & Production, and Corporate and Other.

Source: Enron Corp.

Exhibit 3. Wholesale Energy's Explosive Quarter-over-Quarter (Sequential) IBIT Growth, 1Q98–4Q00 ($ in millions)



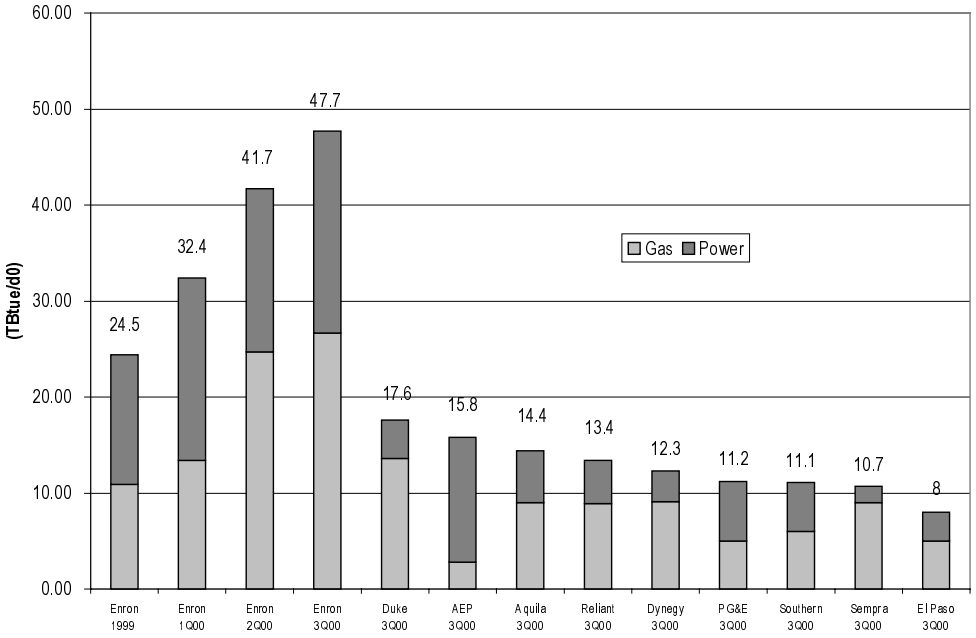
Source: Enron Corp.

While we don't see this type of heady growth rate continuing in the future for the North American segment of the company's Wholesale Energy and Trading operations, we do believe that the company has positioned itself well to take advantage of similar growth potential for this group in markets such as Europe and Asia over the next several years. In these markets, the liberalization of the gas and power markets is already under way, although clearly behind the U.S. market. These

opportunities, barring a major economic slowdown (which should be considered as potentially in the picture at this juncture) could enable this important business area within Enron to deliver 20%-25% annual growth over the long term.

Also in the energy arena, Enron's retail subsidiary Enron Energy Services (EES, also referred to as Retail Energy Services) is clearly the best-positioned company in this business to exploit the enormous $250-$300 billion retail (commercial and light industrial) market opportunity. The company has spent several years building out an unmatched infrastructure for this business and is now beginning to harvest substantial profits from it.

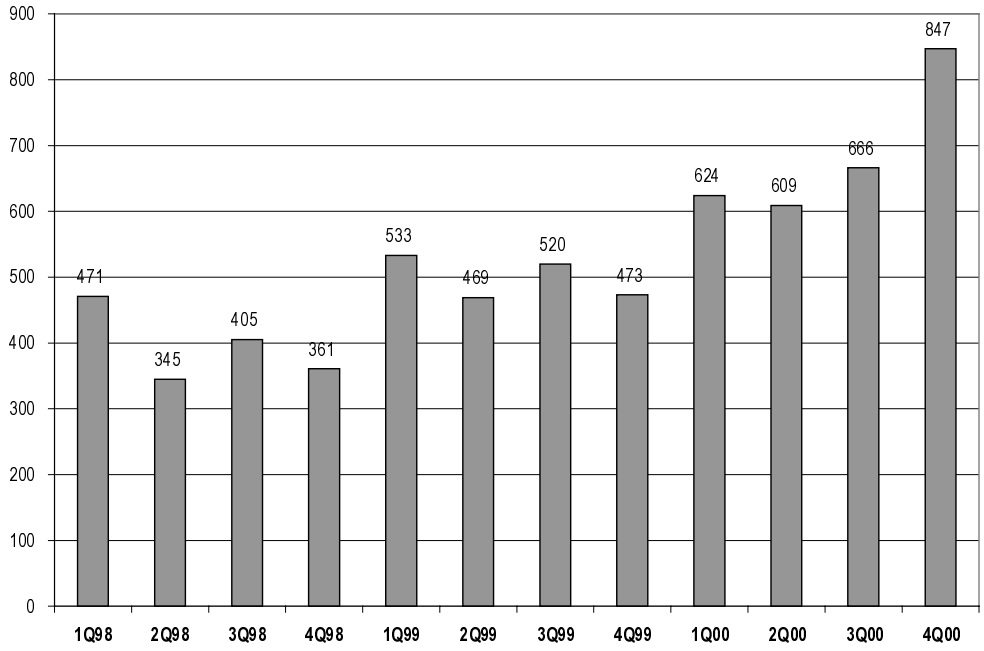
Exhibit 4. Enron's Dominant Market Position Versus the Competition (Delivered Gas and Power)



Source: Enron Corp.

In addition (and a glimpse of what we believe is still to come), Broadband Services has jumped out of the starting block by posting significant increases in revenue and gross transactional value. Shares of Enron have benefited significantly from these results, rising from a September 30, 1999 closing share price of $40.25 to a third-quarter 2000 closing price of $87.64 on September 29, 2000. This 100%-plus increase in market price corresponds exactly to the introduction of Enron's Wholesale Energy Services' online trading system, EnronOnline, and the initiation of operations within the Broadband Services business unit. It also enabled Enron's shares to dramatically outperform the market in 2000, a year that was difficult overall for the equity markets. For reasons that we will go into throughout this report, we expect these high-growth returns to continue for the foreseeable future and, in the case of Broadband Services, to increase exponentially once the company completes the infrastructure and service agreements for its worldwide Broadband system.

Exhibit 5. Enron's Year-over-Year IBIT Results: 2000 Was an Impressive Year ($ in millions)



Source: Enron Corp.

Enron Has Size, Scope, and Financial Health — and Increasing Asset Velocity

With more than $50 billion in assets, Enron clearly has the market capitalization and financial resources with which to undertake nearly any project in which it sees value. In addition, its investment grade credit rating provides the company with access to lenders for the long-term financing of projects and other investment decisions. We view this ability as critical in the ever-expanding wholesale energy marketing and trading business because a strong balance sheet has become a virtual necessity to absorb the mark-to-market swings across these markets as volatility continues to increase.

Furthermore, we expect the company, based upon a practiced philosophy of monetizing those business units and projects that are no longer deemed as commanding high rates of return, to continue to sell assets whose return-on-capital-employed potential — and actual historical results — are lower than what it perceives it can achieve in new market opportunities. Enron is making an important transition from being a capital-intensive company with only modest overall returns on capital employed to a less capital-intensive company that is increasingly utilizing its intellectual capital not only to grow its existing businesses but also to develop and push into new markets. This transformation, already well under way, is expected to boost (perhaps significantly) the company's total return on invested capital. Enron is currently seeking to monetize several billion dollars worth of assets over the next year, including sizable past investments in its international portfolio. While we applaud these steps, sales of certain assets could prove more difficult in the current global economic environment.

One external sign of this move by Enron's management is the asset disposal program that is already in progress. The company has an agreement to sell its Portland General Electric power generation business to Sierra Pacific Resources for $2.1 billion and the assumption of $1 billion in debt. Enron has also agreed to sell three peaking power plants in North America to Allegheny Energy, which could net the company about $1 billion in proceeds. It is also looking to sell a number of international power and gas assets from its portfolio. These assets could generate approximately $3 billion of proceeds for the company, but it is not at all clear whether or not an appropriate buyer for these assets, at the right price, can be found in the current economic environment. In particular, given the precarious status of portions of the fixed income market amid market retrenchment, as well as the possible unfolding of a more severe global economic slowdown, we are becoming less confident in the ability of Enron to find a buyer for these assets in the near term.

Taking these factors into account, we estimate that the debt load on Enron's balance sheet could be reduced (through the use of cash made from asset sales) by $3-$4 billion (taking it from over $10.5 billion to approximately $7.5 billion by the end of 2001). This could enable the company to become more aggressive in its pursuit of the many high-growth, high-margin opportunities it has pinpointed. Taken as a whole, Enron's past success and current business methods have created substantial reserves from which to finance its new business efforts.

In Worldwide Market Penetration, Enron Is Out in Front by a Mile

Enron has offices, exchanges, power plants, pipelines, storage facilities, liquefied natural gas (LNG) and natural gas (NG) facilities, and investment interests in more than 55 countries and territories worldwide. This global philosophy, besides allowing Enron to enter the developed markets of Western Europe and parts of Central and South America, has provided Enron with the opportunity to enter key developing nations, such as India and China, where energy and broadband demand will undoubtedly surge in the coming decades. While some of these forays in the past have not been without mistakes (with some investments ending up as clear failures, in our opinion), they do demonstrate the company's willingness to aggressively pursue perceived opportunities. Importantly, a ruthless self-evaluation process accompanies these moves, which leads to quicker changes or withdrawals from investments when expected opportunities fail to materialize.

With regard to Western Europe, Scandinavia, the United Kingdom, and portions of the former Eastern bloc, Enron's "first-mover" advantage cannot be stressed enough. Over the course of the past decade, Enron has developed and enhanced business relationships throughout the continent, to the point where the company is known and trusted by local regulators and customers, giving it a decisive advantage over U.S. competitors that are only now arriving.

A presence since 1989, Enron's European operation has grown to employ more than 1,750 people in 16 countries. Exhibit 6 details the degree of market penetration Enron has achieved in Europe relative to its closest competitors — sobering statistics for any energy company that wishes to enter into and capitalize upon the growing European market! In fact, whereas Enron has been in Europe for more than ten

years, some of its ambitious wholesale energy competitors in North America are just now beginning to establish trading desks in Europe.

Exhibit 6. Tangible Evidence of Enron's Superior International Presence

	Number of Employees	Number of Offices	Number of Countries	Total Megawatts	Miles of Pipeline	Time Spent in Region
Enron	1,750	25	16	7,000	0[1]	Since 1989[3]
Duke	NA	2	2	0	0	1999
El Paso	NA	NA	5	944	0	1997
Dynegy	65	5	7	1,200[2]	0	1994
Williams	0	NA	NA	NA	NA	NA

(1) Enron is presently developing/constructing several European pipeline projects.
(2) This 1,200-MW plant (located in Germany) is not yet in operation.
(3) Represents a company's earliest entry into the European market. Although not fully detailed here, Enron not only has an advantage in terms of employees and energy related assets, but it has also entered into all of its markets (i.e., multiple regions/nations) in Europe well ahead of its rivals. In fact, while some intend to challenge Enron as a marketer/trader of natural gas and power, we believe that none of these companies pose a near-term threat to Enron's European physical asset portfolio.

Source: Company documents.

Enron's first-mover advantage has indeed resulted in significant gains for the company throughout its European base of operations. Over the past three years, total gas and power volumes (BBtue/d) delivered to the U.K., Scandinavia, and Continental Europe have surged more than 272%, 302%, and 10,000%, respectively. Due to its ten-year working relationship with Enron, we view the U.K. as the cornerstone of a European energy market that is expected to rival that of the United States in the coming years. As will be shown later, over the past decade, the U.K. has emerged as the market leader in terms of energy assets and technological hardware. With numerous power plants and energy-related facilities (in particular the Teeside facility) forming the U.K.'s physical infrastructure base and trading platforms such as Enron Direct comprising the high-speed network, we see Enron having a powerful advantage over would-be competitors — which have none of these.

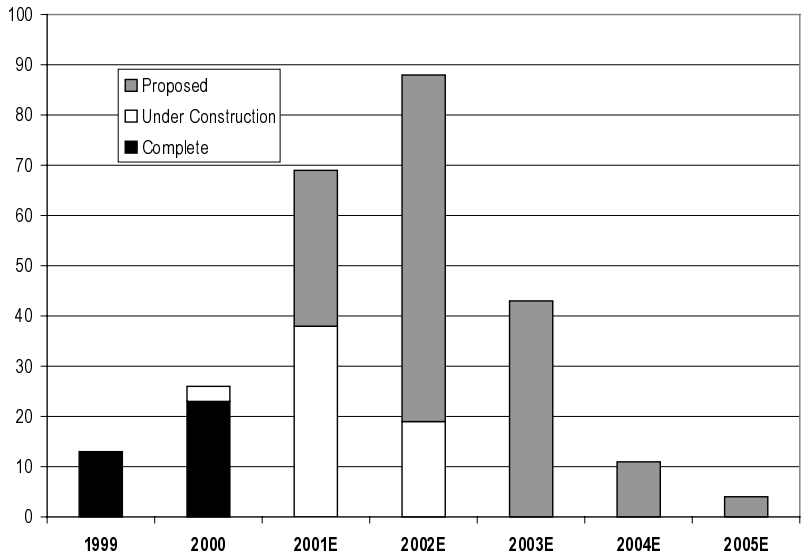
Expected Increase in Demand for Natural Gas Is Good News for Enron

By all accounts, the demand for natural gas in North America — currently 21.5 Tcf/year — is expected to increase significantly through 2010, with specific estimates ranging between 25 and 30 Tcf/year. This increase in gas consumption is fueled primarily by the anticipated increases in domestic gas-fired power generation. Natural gas currently accounts for approximately 16% of domestic power generation, a figure we expect to rise over the next decade given the flood of new industrial gas-turbine power plant projects that are currently under way.

Often thought of as the most conservative estimator of future power demand, the Energy Information Administration (EIA) recently announced its updated projections for power demand growth: It increased its average power demand growth rate through 2020 to 1.8% from a previous 1.3%. On a nearer-term outlook, Cambridge Energy Research Associates (CERA) estimates that approximately 240,000 megawatts (MW) of new capacity have been proposed for development over the next three to four years, although it clearly believes that this level of planned (or

proposed) capacity expansion is absurdly high. While we believe that only a fraction of this amount will actually be built, any amount of newly constructed capacity will have significant ramifications on the natural gas supply/demand markets, as more than 90% of all new capacity is expected to be powered by natural gas.

Exhibit 7. North American Power Generation Project Status



Source: Cambridge Energy Resource Associates.

According to data available from the EIA, more than 90% of all new power generation capacity will use gas as its primary energy source. While natural gas's ability to be the *sole* provider of the fuel for this power-generation projection is questionable, we do think it will deliver the vast majority of it. This supply/demand imbalance concept is covered in further detail in a later section, where we explain our short- and long-term forecasts for natural gas supply, demand, and price. In general, while we believe that much of the announced new capacity will not be constructed in the given three- to four-year timeframe, the amount that is likely to be built would in itself represent a major increase in domestic natural gas demand.

Enron's Technology Arsenal Is Formidable

Enron has the capability to successfully market virtually any traded commodity . . . on-line. The company's revolutionary Internet-based commodity trading platform, EnronOnline, represents the only global principal-based system that allows users to view real-time prices for numerous energy and related commodities while also affording them the opportunity to transact with others instantaneously. This commodity trading system now markets more than 1,400 products related to 35 different commodities in 13 currencies and 140 languages, including electricity, natural gas, natural gas liquids, weather derivatives, emission credits, metal, paper, pulp, and bandwidth. The system was launched in November 1999, and Enron has seen the number of transactions conducted per quarter via the system increase from approximately 5,000 in fourth-quarter 1999 to more than 150,000 during third-quarter 2000. Furthermore, in just over one year of full operations, EnronOnline has completed more than 548,000 transactions with a gross value exceeding $336 billion. Currently, 45% of all of Enron's transactions and 80% of its physical gas sales are

performed on-line. Daily volumes are now averaging $2.5 billion, and on one recent day, EnronOnline recorded $5 billion in sales.

Our view of this system as a viable, profit-generating business platform is heightened by the recent launch of EnronOnline 2.0, an enhanced version of the original Internet trading site. This new system offers customers new features and flexibility, including price-limit orders, customized quote screens, and non-business information such as news, weather, and sports. As few competitors have yet commenced operations on even an initial commodity trading system while Enron is already well into its second, we strongly believe that Enron possesses a strong competitive advantage in the commodity-trading marketplace. This edge is fully brought to light when we take into account the projected market for online trading. According to Forrester Research, online sales of natural gas will reach $166 billion by 2004 — representing approximately 25% of all natural gas sales. Similarly, Forrester projects that online sales of electricity will reach $101 billion by 2004, an 11% share of all electricity sales. The following exhibit displays Enron's clear edge in the gas and power marketing industry. Given this advantage and the projections for the industry as a whole, we believe that Enron is positioned for significant earnings growth in the years ahead.

Exhibit 8. The North American Gas and Power Market: Enron Blazes the Trail

Top 20 North American Gas Marketers (Bcf/d)			Top 20 North American Power Marketers (MWh)		
	3Q00	3Q99		3Q00	3Q99
Enron	**24.6**	**13.3**	**Enron**	**163.0**	**111.3**
Duke Energy Trading	12.0	10.4	Duke Energy Trading	90.0	34.1
Reliant Energy	10.5	8.3	American Electric Power	89.2	99.6
Aquila Energy	10.4	10.1	PG&E Power Trading	77.1	75.4
Coral Energy	10.3	9.7	Reliant Energy	68.4	43.4
Dynegy	9.8	8.5	Southern Energy Marketing	54.9	72.2
BP	8.3	5.2	Aquila Energy	46.6	78.1
Koch	8.0	5.5	Edison Mission M&T	45.5	NA
Sempra Energy	7.9	6.5	El Paso MerchantEnergy	40.9	21.0
Southern Energy	7.3	4.6	Dynegy	40.0	22.7
PG&E	6.1	8.2	Williams Energy Services	38.2	29.8
Engage Energy	5.7	5.3	Avista	36.2	61.4
TransCanada	5.5	6.9	Sempra Energy Trading	21.8	6.3
El Paso Energy	4.9	6.5	Peco Energy Power	18.4	19.2
TXU	4.1	2.8	Tractabel	15.1	22.5
American Electric Power	4.0	2.6	Koch	14.8	12.1
Texaco	3.8	3.3	Constellation Power Source	12.4	20.6
ExxonMobil	3.7	3.6	Entergy	11.9	50.5
Conoco	3.4	3.1	BP	8.3	0.0
Oneok	3.2	1.3	Coral Energy	6.4	6.4

Source: The Federal Energy Regulatory Commission, *Natural Gas Week*.

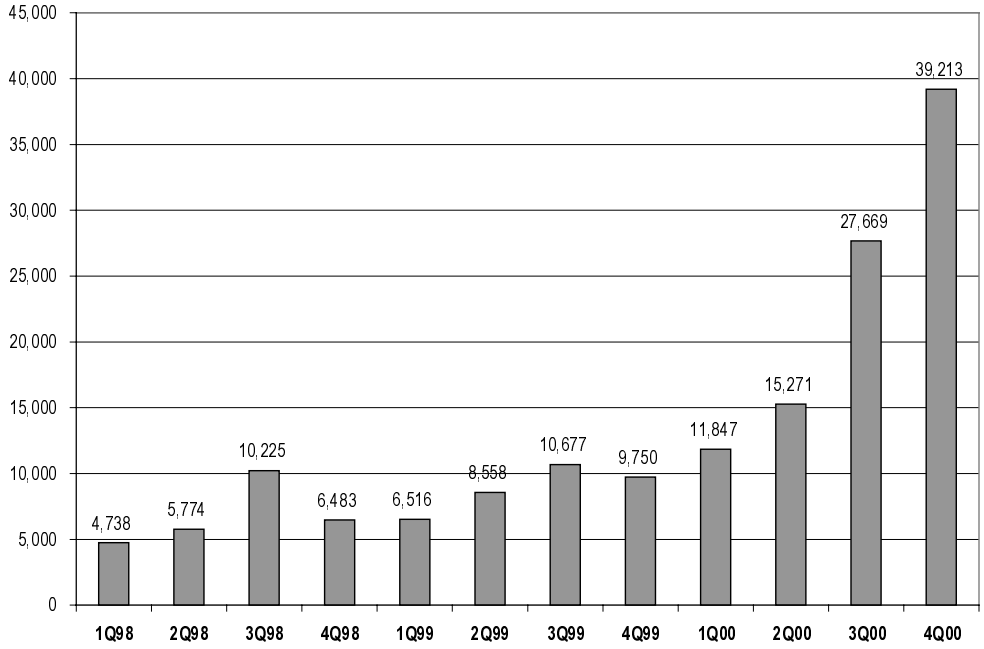
Wholesale Energy Is the Growth Monster Within Enron

Enron's Wholesale Energy business has grown at an enormous rate over the past several years, with revenue more than doubling in the past year alone to an astounding $94 billion-plus level. The IBIT (income before interest and taxes) performance of this business has also experienced record growth, reporting nearly $2.3 billion of IBIT in 2000 (close to a 72% increase over 1999 levels), or up nearly 246% versus the levels just three years ago. As can be inferred from these results,

this business unit has certainly benefited from the substantial increase in prices and volatility within the North American natural gas and power markets.

Enron, however, has also positioned itself to continue to grow this business in Western Europe and in Asia as these markets continue to deregulate. As a whole, Enron believes that it can continue to grow this business area in the 20%-plus area per annum as opportunities continue to unfold in North America, Western Europe, and Asia.

Exhibit 9. Wholesale Energy: The Revenues Just Keep Growing . . . ($ in millions)



Source: Enron Corp.

Enron Aims to Commoditize the "Uncommoditizable"

Enron Industrial Markets, also loosely referred to as Enron Net Works — located within the Wholesale Energy business segment — is focusing on many of the large-scale, basic industry companies from which Enron has determined that commoditization of products is possible. These industries include, but are not limited to, pulp and paper, metals (including steel), lumber, textile products, bulk chemicals, agricultural chemicals and products, building materials, various types of plastics, and data storage. Similar to its natural gas, power, and bandwidth trading businesses, Enron is looking to market and trade these industrial products to customers, gaining upside on the realized price "spread" found on each product.

Enron believes that it can take the lessons learned from its ongoing gas and power trading operations and successfully transfer them to products and industries that were once thought impossible to commoditize. We believe that the company can successfully transfer its trading skills to these new industries because of the many functions the business can handle, including credit and price-risk management, market-making abilities, logistics management *and* physical-delivery capability, a

highly sophisticated and established Internet portal (EnronOnline), and proven marketing and trading expertise.

Beyond these services, we are also encouraged by Enron's commitment to the development of uninterrupted product delivery through the acquisition of physical plants and assets. While Enron utilizes an "asset-light" philosophy for all of its operations, it understands the benefits gained with the purchase of *strategically well-timed purchases.* (As with all of Enron's holdings, once these strategically purchased assets have outlived their profitability, or once the company has built up marketing/trading capability based upon a liquid market, it will then look to sell these assets to free up capital for better investment opportunities.) Having control over a product's physical flow and deliverability is important for increasing liquidity into a marketplace, creating arbitrage opportunities, and ensuring the long-term success of the business through increased customer usage and reliance.

Given the market value/potential of the businesses sought by the company's Industrial Markets group, the inherently high — and most likely inefficient — cost structure found in these industries, and its proven track record in the marketing and trading business, we believe that Enron is uniquely positioned among its competitors to gain a foothold with these types of customers. As Enron is the first company to attempt this type of commoditization of basic goods, we see it gaining significant first-mover advantages with this endeavor.

Enron Has Made Huge Strides in Bandwidth Intermediation and Content Delivery

As most know, basic broadband technology is designed to radically improve the functionality and experience for Internet users by making high-bandwidth content delivery, such as video and intensive data transfer, more efficient, cost-effective, and convenient than is currently offered. Enron sees its business model, combining the power of the Enron Intelligent Network (EIN) and the Enron Broadband Operating System (BOS), as positioning the company to become the future nexus of worldwide bandwidth intermediation and broadband delivery services.

As will be discussed in detail later in this report, Enron has made great strides over the past year in constructing an overarching infrastructure, the Enron Intelligent Network (EIN), that will support Broadband Services, including fiber-optic cable, servers, and pooling points. This network is now substantially complete as Enron completed 25 pooling points (as compared to an initial year 2000 target of 13) in the U.S. and Europe. Once complete, this burgeoning global network will facilitate the business's two major goals: bandwidth intermediation and content delivery. For those not familiar with these services, bandwidth intermediation is the marketing, trading, and "delivery" of bandwidth capacity to customers. This delivery of bandwidth is, in simple terms, *the reservation of bandwidth time*. Content delivery services is focused on the creation of a system to allow for the online transmission of high-content data and video.

In its first full year of operations, Enron Broadband Services executed 320 transactions, with 236 transactions coming in the fourth quarter alone. Enron also made great strides in its bandwidth delivery business, exceeding its annual targets

with 5,209 DS-3 month-equivalents of capacity delivered (2,393 in fourth-quarter 2000). In addition, the business now offers customers 32 types of bandwidth products, all of which can be immediately quoted and traded via EnronOnline. Concurrently, Enron has completed revolutionary, and highly lucrative, content delivery agreements with companies such as i2 Technologies, Compaq, BellSouth, and, most notably, Blockbuster. These agreements, particularly the recent launch of "entertainment-on-demand" services among Blockbuster, Enron, and four pre-selected U.S. cities, offer Enron the opportunity to become the world's premier intermediary between customers and businesses working to distribute high-content video and data via the Internet. While Broadband Services has not yet turned a profit, nor do we expect it to until 2002, we believe that once the numerous capital-intensive infrastructure hurdles have been overcome, earnings from operations will quickly ramp up and possibly (according to Enron) surpass the combined earnings of the remainder of Enron Corporation. (Obviously, this type of statement demands an explanation, and we will detail the reasons behind and factors determining our earnings forecast later in this report.)

For the Short Term, We Expect Natural Gas Prices to Remain High

As we all know, 2000 was one of the most volatile years for oil and natural gas prices — with both fuels hitting all-time highs on several occasions. Bear Stearns expects gas prices to decrease over the next 12 months, with average prices dropping from the fourth quarter's record highs to approximately $4.50 by fourth-quarter 2001. Increased price volatility during this time period will afford the company numerous opportunities for increased earnings through its use of options instruments, price hedging, and experienced risk management techniques. At this time, due to typical petroleum products risk and unforeseen political risk, we are prepared to forecast natural gas and oil prices only through 2001. For the short term, we see continuing high prices occurring primarily because of a tight supply/demand market balance and record low gas storage levels. It is our belief, however, that if past oil cycles are considered a basis for future shifts in natural gas prices, an extended period of high prices (as we are now in) will eventually cause a decrease in demand and a consequent decline in prices.

Retail Energy Services Is Beginning to Enjoy Explosive Growth

Following several years of build-out and establishment of its business model, the Retail Energy Services business unit within Enron (outsourcing of energy management needs for commercial and small-scale industrial customers in the U.S.) is starting to pay off. While revenue is again enjoying explosive growth this year (it was up 155% over 1999), IBIT from this business is now consistently generating positive returns after crossing into the black during the fourth quarter of 1999. For 2000, Retail Energy exceeded our projection of $100 million in IBIT by recording a full-year figure of $103 million. While this pales in comparison to the Wholesale Energy business for Enron, this represents a swing of more than $170 million from the prior year. In addition, growth in IBIT for this business could be in the range of 50%-100% per year over the next several years as Enron continues to expand the customer base here and leverages the large base business that it has established. In addition, because of this business segment's inherently stable fixed-cost structure and

the exponential increase in customers that is projected, we see tremendous future value in this business model.

Enron's Philosophy: Asset Divestment in Favor of Higher Returns Elsewhere

Enron has consistently demonstrated a willingness to sell off assets with low rates of return to free up money for expansion and investment in projects that will yield higher returns. While the company is clearly guilty of some investment mistakes (the water company Azurix adventure and some international power portfolio assets, many of which are currently being looked to be sold, come most immediately to mind), Enron has shown a remarkable ability to recognize mistakes and to quickly engineer a solution whenever possible (most often through an exit strategy). In fact, next to Enron's (and its employees') ability to envision some new markets and opportunities opening up before others and to go after these opportunities aggressively, we regard its ability to recognize and remedy mistakes made as one of the company's strongest attributes. We believe this demonstrates a clear focus on shareholder value by Enron's leaders, who are unwilling to accept long-term losses in a project or business unit when the resulting money gained from a monetization of said assets will yield better returns for the company.

A recent example of what we are talking about concerns the possible sale of Enron's oil and gas production interests in India as part of a company-wide plan to free up money for the expansion of the highly profitable trading and market-making business model. In addition, while the adventure into the water business through Azurix can most properly be labeled a disaster, the company has taken steps to rectify this situation. Enron's initial move several years ago into California's retail electricity market was followed quickly by an abandonment of this effort as the company recognized that the market opportunity really wasn't there yet. While there was some embarrassment associated with this entrenchment, it appears that Enron's withdrawal from this business was absolutely the right decision.

The company will also soon be divesting its investment in Portland General, getting itself further out of the business of outright ownership of electrical generating assets. While the investment will have proved a wash for the company, nonetheless it will free up capital to be deployed more rewardingly in other areas with higher return potential. More importantly, though, it was from this acquisition and some of the people acquired through it that the original idea for Enron's pioneering move into bandwidth trading was derived.

SIX CAUSES FOR PAUSE

Competitors Could Make Technological Inroads

While we believe that Enron holds significant technological first-mover advantages over its competitors, it is possible that one or more rivals will gain critical insight from Enron's performance and move to establish itself in the commodities marketing and/or bandwidth service industries. This so called "second-mover" advantage is difficult to forecast, but we think there are numerous firms — most likely without the capital resources of Enron — that are studying Enron's performance in an effort to determine the best possible area of entry and, in effect, "leap over" the existing technology in order to get a foothold. As Enron is essentially attempting to provide

all things to all customers, it is possible that a smaller competitor will be able to establish itself as a significant rival in a particular market.

Will Earnings in Key Business Segments Become More Visible?

As the percentage of IBIT being generated for Enron by the Wholesale Energy business continues to mount, one of the drawbacks for analysts, investors, and other observers is that Enron's earnings potential becomes less visible and more difficult to predict. While we believe the potential for this business area continues to be large, especially as opportunities begin to open up in overseas markets where Enron has already positioned itself, nonetheless the ability to develop a somewhat predictable business model of this business for the future is mostly an exercise in futility. Much depends on Enron's ability to position itself profitably from a trading standpoint in these energy markets, as well as the underlying volatility present in these markets. While we believe the company has perhaps the best skills in these marketplaces, beyond that there is not a lot to go on. While it is true that the IBIT performance of the wholesale energy and trading businesses has tended to track delivered volumes (which have been on a strong upswing), the ability to project these figures, again, does not rise much above guesswork. In addition, we believe that volatility is inevitably cyclical, and thus when economic growth slows and supply begins to overtake demand in certain markets, volatility is likely to suffer a cyclical downturn.

Will the Bandwidth Trading Business Opportunity Come to Fruition?

As we have already discussed, Enron's pioneering move into bandwidth trading opens up tremendous potential growth opportunities for the company in the future. As others have followed Enron's footsteps in seeking to create their own bandwidth trading operations, the company's strategy here appears to be vindicated. However, the infrastructure for this business still needs to be built out (at significant cost) and we are still a number of years away from knowing whether or not this trading activity will fulfill all the projections that are being made for this market. To perhaps state the obvious, the failure of the bandwidth trading market to approach a significant market opportunity would represent a major setback for the company.

Is Volatility in the North American Gas and Power Markets at a Cyclical Peak?

Analyzing Enron's enormous wholesale energy trading operations is no easy task, let alone trying to project revenue and IBIT estimates for this business segment in the future. In general, as we have already discussed, the performance of this group has tended to track the number of transactions this business segment has undertaken, which, of course, has increased at an exponential rate over the past several years. Although difficult to prove, we believe that the performance of this business unit (and the growth of its contract volume) has been enhanced by the dramatic price volatility in the gas and power markets. Because we are in uncharted waters here with respect to the volatility in these segments, there is not much to go on in terms of historical patterns.

However, our sense is that we are at or close to a cyclical peak in volatility levels in a number of these markets, particularly in North America. While we do not necessarily

expect this volatility to go away or decrease significantly in the near to medium term, we do believe that this could make comparisons more difficult for this business segment. The offset could be the growth opportunities in Europe and Asia in the future, but the timing and volatility potential of these market opportunities is not completely clear at this time. Of course, further obscuring matters is the potential for a significant economic slowdown in the U.S. and on a global basis, which could further depress volatility in a number of these markets.

Bleak Economic Outlook

With each passing week the news on the economic front, both in the U.S. and overseas, appears to be getting worse, and the hoped-for "soft landing" could end up being harder than expected. While we continue to like the outlook for natural gas and electricity in general, and believe that volatility in these commodities will continue for the time being (volatility being good for Enron), if the economic clouds continue to darken, overall activity obviously could drop off. That, in our opinion, could begin not only to dampen overall U.S. and global demand in the gas and electric/power markets, but also quell the dramatic volatility experienced in these markets over the past two years. While not readily predictable as a manufacturing-based business model, we project that a drop-off in volatility would certainly slow down the growth potential in the company's Wholesale Energy and Trading operations. If a significant downturn were to occur, an absolute drop in earnings for this group could, of course, not be ruled out. The recent intra-meeting move by the U.S. Federal Reserve to cut interest rates by 50 basis points (it lowered the discount rate on January 4, 2001) could help mitigate the negative effects of the dramatic slowdown in business across the U.S. economy over the past two-three months. However, our sense at this point (for what it is worth) is that the Fed has its work cut out for itself in arresting the slowdown evident across many sectors of the U.S. economy.

Trouble in the Courtroom

A lawsuit — the second in the span of a week — was filed against Enron and numerous other wholesale energy companies (including Dynegy, Duke, Reliant Energy, and Southern) in California alleging that these firms overcharged California consumers more than $4 billion for electrical services. The complaints allege unfair trade practices and illegal trust activity, claiming that Enron and the other energy companies withheld power supply during the 2000 summer, creating shortages by selling power out of state, and used real-time data about power plant activity to drive up prices.

We see these lawsuits being brought forth more out of frustration with the current power situation in California than out of a true belief that Enron (and the other defendants) actually conspired to overcharge consumers. After analysis of California's energy situation, it is evident to us that the problems currently faced are caused more by inadequate power generation (primarily due to intense resistance mounted by radical environmental groups and a "not-in-my-backyard" mentality), low gas storage levels, unusually high winter demand following several years of warm weather, and an inherently untenable situation of spot purchasing and capped sale prices for the state's major utilities. In addition, the clearing mechanisms for

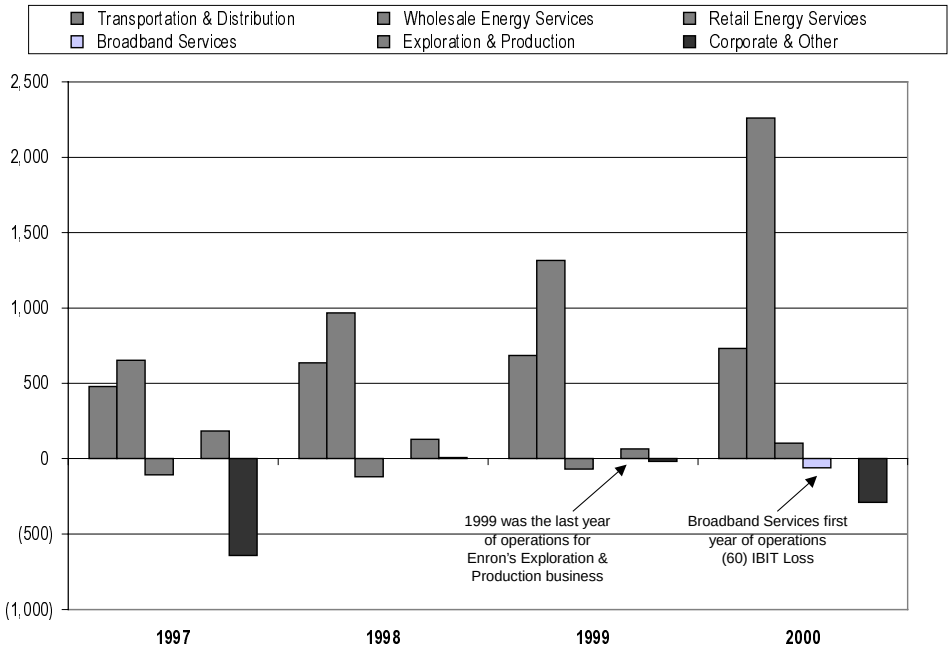
prices through the state's ISO (Independent System Operator) are obviously flawed. As the California power situation is an ongoing fiasco — with politicians, utilities, consumer groups, and the FERC taking up positions in and around any courtroom they can find — we can provide little guidance on when, if ever, this lawsuit will be brought to trial, much less what the outcome might be. However, when the heightened emotions are extracted from the situation, it's not clear to us that there is any factual basis for these claims.

PRODUCT OF TWO NATURAL GAS COMPANIES REINVENTS ENERGY SALES, MARKETING, COMMUNICATIONS

Enron was formed through the combination of two well-established natural gas companies, InterNorth and Houston Natural Gas (HNG). In 1985, InterNorth purchased HNG, creating the largest domestic natural gas pipeline system. Over the next few years, Enron slimmed down with the divestment of several debt-heavy businesses, expanded through the purchase of several international pipelines and utilities, and began establishing itself in the power marketing business. In the late 1990s, due primarily to the deregulating electric industry, the company began investing heavily in both domestic and international utilities, culminating in the purchase of its own electric utility, Portland General Electric. In the past three years, Enron has aggressively pursued and created opportunities in previously nonexistent industries, most notably the purchase and formation of Azurix, a global water business (a venture that largely failed for Enron and from which it is currently looking to extract itself), and the creation of Broadband Services. The company is also looking to translate the trading, market making, and risk management expertise it first developed in gas and then in the power markets to other markets beyond its nascent efforts in the communications market.

The company is organized around four independent business units: Wholesale Energy, Retail Energy, Broadband Services, and Transportation and Distribution. Exhibit 10 displays results for Enron and its four business segments over the past four calendar/fiscal years.

Exhibit 10. Per-Segment IBIT Breakdown, 1997-2000 ($ in millions)



Source: Enron Corp.

- The Wholesale Energy segment markets and delivers energy products on a worldwide scale via EnronOnline, its innovative real-time commodities trading system. Enron is the top wholesale power marketer in the U.S., trading more than 1,400 different products at the time of this report.

- The Retail Energy business is involved in the securing of energy and financial risk management outsourcing agreements to commercial and industrial customers. Retail Energy Services is currently experiencing rapid growth in revenues and earnings due to ten consecutive quarters of increased gross contractual value.

- Broadband Services is involved in the emerging bandwidth intermediation and content delivery services market.

- The Transportation and Distribution business is active in the transportation of natural gas products and the distribution of electric power. Combined, Enron is the nation's largest buyer and seller of natural gas, operating a 32,000-mile gas pipeline system that delivers more than 15% of all domestic gas across 21 states, Canada, and Mexico. To facilitate electricity distribution, Enron owns, operates, or has interests in worldwide power generation capacity of more than 14,350 MW.

Although it is difficult to predict the full potential of either Retail Energy and Broadband Services at this time, we believe the combination of these four operating segments of operations comprise a company that could one day dominate all aspects of the energy and communications industries on a global scale.

ENRON'S VISION AND STRATEGY FOR LONG-TERM GROWTH

At the core of Enron's vision is the burgeoning transformation of the company from a natural gas transportation and energy services company into a global distributed energy services juggernaut through the incorporation of advanced trading and communications networks. To achieve this vision, Enron must carefully alter its composition and structure — a task made more difficult because of the numerous business operations that comprise, and in many ways define, the company. From one viewpoint, Enron is a natural gas company (it is currently the largest buyer and seller of natural gas in the U.S.), operating more than 32,000 miles of gas transmission pipeline. From another angle, Enron, utilizing its innovative EnronOnline trading system, is a marketer and trader of natural gas, electric power, and a host of other commodities, acting much like a Wall Street trading house. From a third perspective, Enron and its innovative Enron Intelligence Network (EIN) form the nucleus of a communications company, one that is at the forefront of the emerging broadband trading and bandwidth management industry.

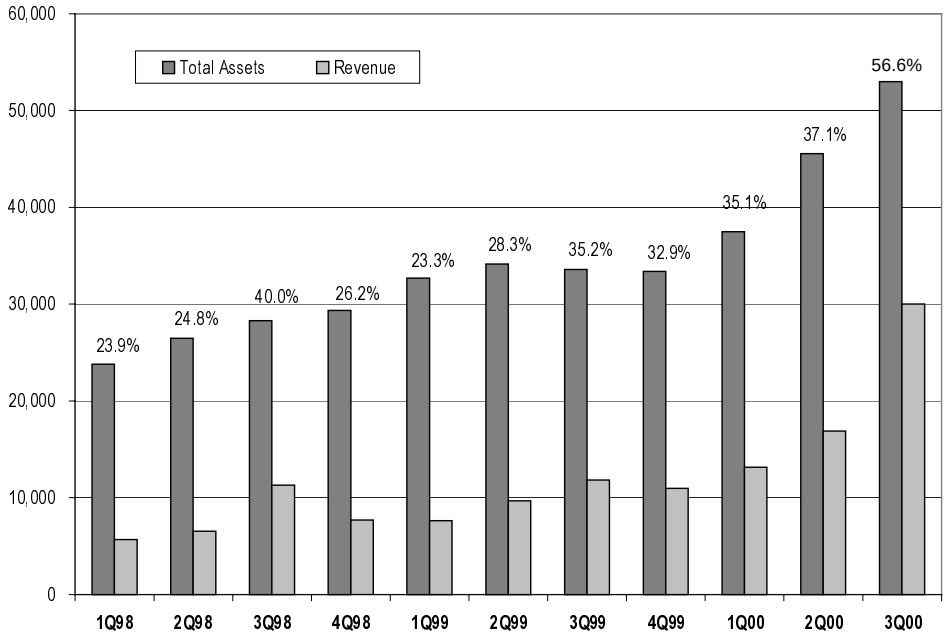
The challenge for Enron is to decide how to integrate these three seemingly different businesses into one company.

Enron's Asset Philosophy

To achieve this transformation, Enron is focusing on two key elements from its successful past. *First, the company continues to be an extremely efficient developer and holder of physical assets.* This asset strategy is based upon Enron entering into contractual relationships that gain access to, but not ownership of, the assets of others, and having the financial ability to create products and services that yield the most customer value. The essence of this strategy is simple: To Enron, physical assets have a strategic but not a central role in how the company makes money. With a decreased percentage of the company's returns tied to physical assets, Enron is free

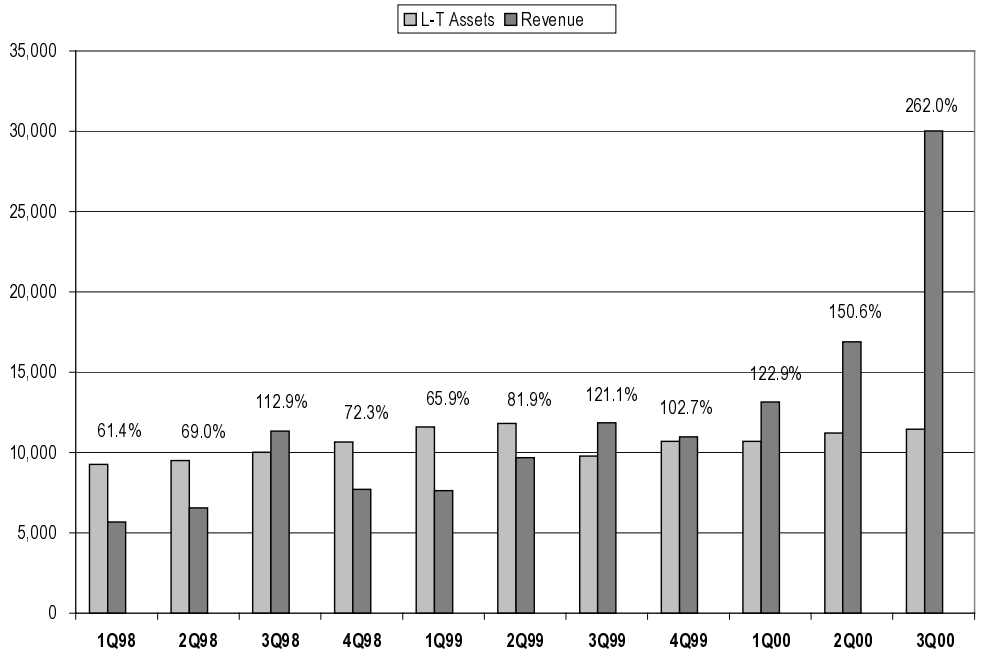
to divest non-essential assets and return the freed equity to other businesses with better profit potential. The following exhibits detail the percentage of Enron's assets and long-term assets to revenue over the past 11 quarters.

Exhibit 11. Sales to Assets, 1Q98–3Q00 ($ in millions)



Source: Enron Corp.

Exhibit 12. Sales to Long-Term Assets, 1Q98–3Q00 ($ in millions)



Source: Enron Corp.

As you know, the most publicized and significant asset divestment over the past few years is the impending sale of the Portland General Electric Company (PGE). This agreement — which is not expected to be completed until at least March 2001 —

includes the sale of PGE to Sierra Pacific Resources for $2.1 billion, comprised of $2.02 billion in cash and the assumption of Enron's approximately $80 million merger payment obligation. In addition, Sierra Pacific Resources will assume $1 billion in PGE debt and preferred stock. While this agreement has gained the majority of headlines, we see it as the culmination of a successful strategy that goes back for several years. The following are some additional examples of Enron's strategic selling and buying of properties:

- **August 16, 2000.** Enron announces the sale of its Wyoming-based gathering system to Northern Border Partners, L.P. for approximately $200 million. While this divestment removes these assets from its balance sheet, Enron continues to utilize these assets in the form of risk management and producer-outsourcing services.

- **May 22 and July 13, 2000.** The purchases of MG PLC and Garden State Paper are announced on these respective dates. We see both as examples of Enron's effective asset strategy. While these acquisitions are not tremendous in size ($446 million for MG and $72 million for Garden State), they are viewed as strategic purchases because they provide Enron with the physical assets it deems necessary to operate in the metals and pulp trading businesses. In short, these acquisitions provide Enron with a source for guaranteed physical deliverability, an important aspect in the marketing and trading business. These business/assets should enable Enron to more effectively establish its marketing position in these commodity markets.

- **November 14, 2000.** Enron announces an agreement to sell three natural gas-fired merchant generating (peaking) facilities in the Midwest to Allegheny Energy for approximately $1 billion. While no longer under Enron's control (or on its balance sheet), the company has realized a profit of approximately $250 million after repayment of debt associated with these plants — money now available for more profitable enterprises. As Enron is becoming more of a marketer and trader of electric power (and less of a generator), it is no longer "required" to control assets such as these as long as agreements are in place to allow the company *access* to the power generated from them.

- **Late-November 2000.** Following disappointing returns for nearly a year and a half, Enron announces its proposal to the board of directors of Azurix to provide funding to take the water company private at a buy-out price of $7.00 per share. In this proposal, Enron agrees to finance up to $275 million for the sole purpose of funding this buy-out. The proposed buy-out would allow shareholders of Azurix stock to receive a significant premium to the market price of the stock. This move is part of a multi-stage process through which Enron is effectively dealing with a failed investment. (On December 18, 2000, following several shareholder lawsuits claiming this proposal was inadequate, Enron announces that it has reached an agreement to buy out the public shareholders of Azurix for approximately $330 million. Enron expects this settlement to have a neutral impact on its own positive earnings and credit outlook. This divestiture follows the trend the company has pursued with regard to its asset portfolio.)

- **November 2000-January 2001.** There is much speculation about the possible sale of several of Enron's oil and gas assets in India. The company's Indian assets — consisting of the multi-faceted Dabhol Power Project and a stake in several oil and gas fields located in the western Bombay offshore basin — have recently become targets of possible divestment by Enron. While the Dabhol project has not been offered for sale yet, Enron has retained an investment bank to begin looking into selling its aforementioned oil and gas fields. As we will mention later, we see the possible sale of Enron's Indian assets as part of a general sell-off of noncritical assets over the next 12-15 months.

- **January 2001.** Enron announces that it has agreed to sell its Houston Pipe Line Co. (HPL) to AEP Energy Services for an undisclosed amount. This system, a 4,400-mile, intrastate (Texas) pipeline system with throughput capacity of 2.5 Bcf/d and storage capacity of nearly 120 Bcf, is one of two intrastate systems that Enron has to complement its four interstate pipeline companies. This deal is expected to close sometime in second-quarter 2001.

Throughout Enron's history, continuing up to today, the company has consistently pursued an "immediate sell-down strategy" with regard to its international investments. Often, the company avoids unilateral investment in international projects, instead relying on financial equity partners to share the costs and limit Enron's exposure if it decides to "cash-out" in favor of more profitable investments. Given the success of this overall asset strategy, we expect management to continue looking for ways to increase shareholder value through the sale of underperforming assets and reinvestment of capital into new business models and projects. Currently, Enron expects to monetize approximately $2-$4 billion of international assets over the next 12 months. While this range of asset sales/monetization has been put forth by Enron, we are cautious in our belief that this degree of divestment will actually occur during the next 12 months. Given the current slowing of global economic growth and the state of U.S. financial markets (particularly the debt and credit market), we believe that Enron's international asset sales will be toward (if not lower than) the lower end of its projected range of $2-$4 billion in sales.

Enron's Beachhead Tactic

We see the second element of Enron's long-term growth strategy as market penetration through an aggressive first-mover identification and implementation program. This first-mover strategy allows Enron to enter numerous markets virtually unopposed, build infrastructure, and develop business relationships — ultimately creating a formidable barrier to entry for any would-be competitor. The following is a chronology of several of the most prominent examples of Enron's first-mover advantage.

- **1989-94.** In response to the first signs of European energy deregulation, Enron establishes its European headquarters in London. Over the course of the next three to four years, Enron builds and commences operations of the Teeside power plant, the world's largest combined cycle gas-fired facility, and acquires its first power plant on the European continent (Germany). These actions pave the way for Enron to begin marketing natural gas to commercial and industrial customers through its trading system, Enron Direct.

- **1996-98.** Enron continues to forge its way into the European market, opening offices in Oslo, Norway (the world's most deregulated market) to provide risk management services and trading opportunities. Similarly, it beats the competition by opening up offices of various types in Germany, Russia, Poland, Finland, Spain, Belgium, and the Netherlands. The establishment of these offices and Enron's association with the construction of numerous power plants throughout the European continent allow the company to reap several first-mover advantages, including the award of numerous first-time gas and power marketing agreements (Enron was the first company to gain access to the gas and power marketing sector). In summary, Enron's ten-year relationship with the U.K. and Europe has helped secure its status as the most entrenched U.S. wholesale energy (and now communications) company in Europe.

- **November 1999.** The company creates the revolutionary e-commerce application, EnronOnline, the only global principal-based system that allows users to view real-time prices for numerous energy and related commodities while affording them the opportunity to transact with others instantaneously. Coming on the heels of this services' highly successful first year, Enron recently began using the second version of EnronOnline. Few of Enron's competitors have started trading operations with even a first-generation system.

- **Also in November 1999.** Enron establishes Enron Broadband Services. With the demand for broadband services expected to increase at least 150% over the next three years, Enron's early entry into this market is crucial. Subsequently, in May 2000, Enron introduces bandwidth products to the EnronOnline trading system. For the first time, buyers and sellers of bandwidth have the ability to make video and intensive data transfer delivery more efficiently and conveniently.

- **February 2000.** Enron launches Enroncredit.com, the first real-time credit department for business-to-business customers. This system provides live credit prices and enables business-to-business customers to instantly hedge credit exposures via the Internet.

- **June 2000.** In another demonstration of the true potential of the EnronOnline trading system, the company completes the first physical metals transaction.

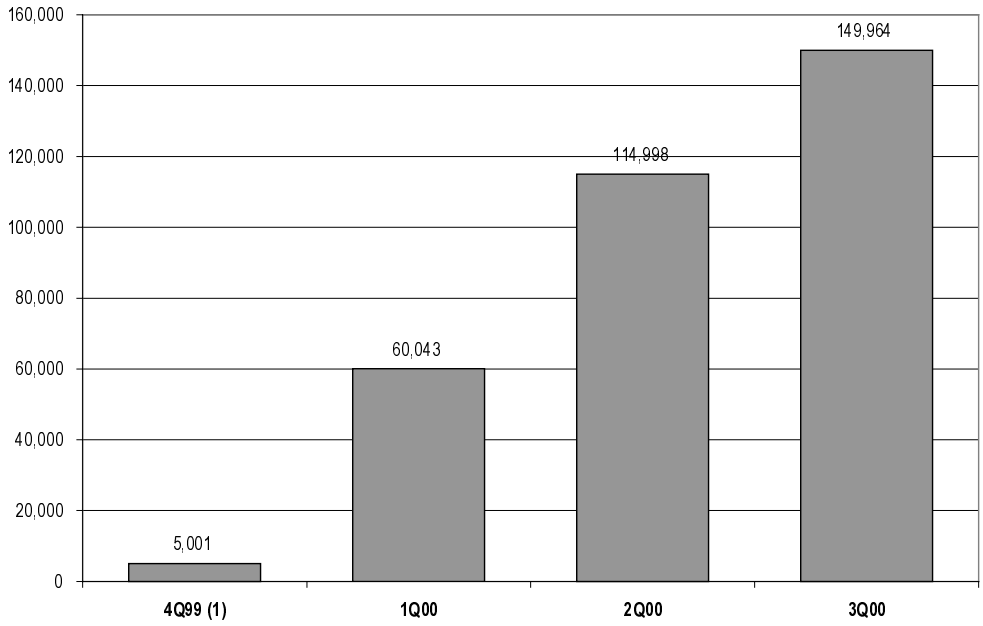
- **July 2000.** Enron Broadband introduces its broadband application services and wholesale bandwidth products to Europe. The introduction of this system complements the overall first-mover/market penetration advantage Enron already holds in Europe. After little more than a decade on the European continent, Enron has established itself as the largest merchant of natural gas in both the U.K. and the Nordic region.

- **Currently.** Similar expansions into heretofore-untapped markets are occurring in the following key regions: South America, the Asian Pacific and China region, the Caribbean, the Middle East, and, most notably, India. Through numerous projects and marketing agreements, Enron is poised to participate in every stage of the natural gas, electricity, and, eventually, communications market.

In many ways, Enron has already positioned itself to become exactly what it wants to be. As we know, the company is already a market leader in several of its core businesses, specifically the natural gas and wholesale power business. It has also repeatedly demonstrated the willingness and fiscal aptitude to excel within its self-created asset-efficiency program, and it has shown tremendous vision and market awareness during its many expansions and attempted market penetrations. Although not all of Enron's business gambits have worked out (Azurix being a prime example of one of its failures), the company has shown that it is not afraid to acknowledge a mistake and free itself of the poorly returning investment as soon as possible. Through the implementation of Enron's dual strategy, the company has made great strides in quickly planning, assembling, and improving upon its revolutionary Internet trading system, EnronOnline, and the Broadband Services business group.

Launched in late 1999, EnronOnline has already shown tremendous growth in the number of gross transactions and bottom-line earnings. During fourth-quarter 1999 and first-quarter 2000, EnronOnline completed nearly 70,000 transactions, gaining a 39% share of Enron's total wholesale transactions. By the close of the second quarter, EnronOnline had completed more than 200,000 transactions (a 65% increase over the first quarter), achieving nearly 60% of Enron's total wholesale transactions. Since inception, EnronOnline has completed more than 548,000 transactions with 3,000 customers, representing more than $336 billion in gross value. The next exhibit displays EnronOnline's results for the last four consecutive quarters.

Exhibit 13. EnronOnline — Number of Transactions per Quarter



(1) Operations did not commence until November 1999.

Source: Enron Corp.

Similarly, Enron Broadband Services has experienced outstanding growth during its first full year of operations. Revenue increased during second-quarter 2000 to $151 million, nearly a 140% increase from the first-quarter total of $59 million. While revenues for Broadband Services slipped to $135 million and $63 million in third- and fourth-quarter 2000, respectively, we are confident that this business unit is

poised for tremendous revenue and earnings growth over the long term. At first glance, this seems to be a tremendous decrease in revenues, but there is a reason for this drop that does nothing to darken our view of this business. In an effort to generate capital for future efforts, Broadband Services concentrated on fiber sales during first-half 2000 to generate cash flow. This has declined — in fact, there were no fiber sales during the fourth quarter as Enron Broadband Services is now concentrating fully on its core business of content services and bandwidth deliverability.

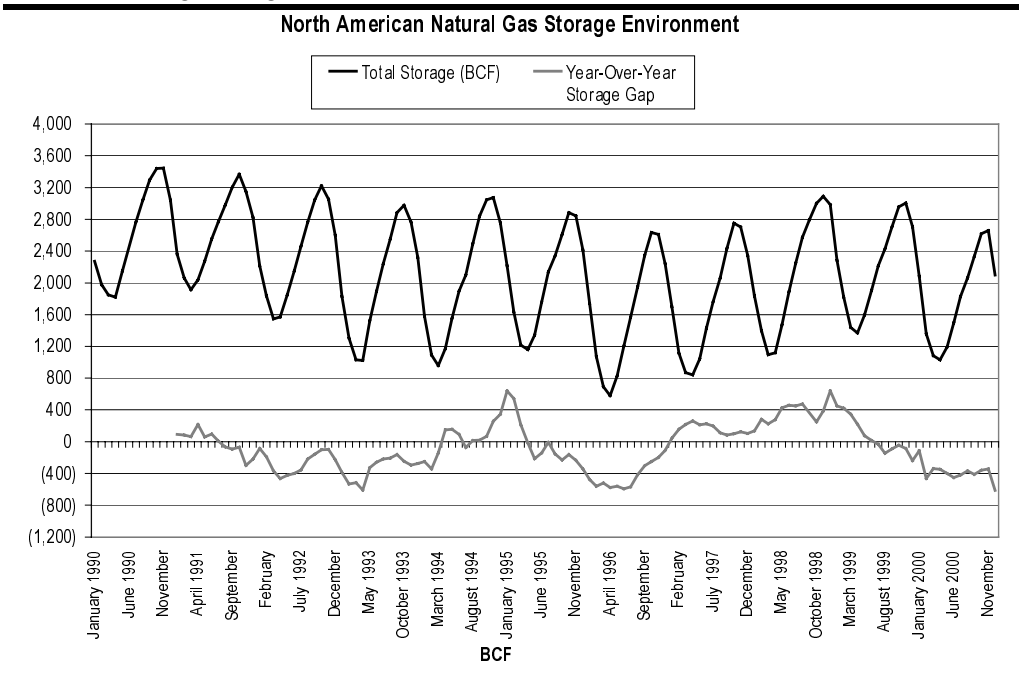
Although we will go into far greater detail later in this report, it is important to notice here that these two business segments, Broadband Services and Enron Online (Wholesale), are off to their great starts because of the two strategies we have outlined. Both businesses benefit greatly from the influx of capital gathered through asset sales in other parts of the company, and both also have made great efforts in securing first-mover advantages.

OUR SNAPSHOT FORECAST

Bear Stearns E&P analyst Ellen Hannan estimates that the price of natural gas will decrease over the next 12 months, with average prices dropping from fourth-quarter 2000's recent highs to approximately $4.50 by fourth-quarter 2001. For the short term (through the winter months), continuing high prices will occur primarily because of a tight supply/demand market balance and record-low gas storage levels. This increased demand has been especially spurred on over the past several months by the cold weather that has been experienced across the U.S. during the late fall and early winter. After three comparatively warm winters prior to this year, we have seen somewhat of a reversion to the mean (or, in some regions, beyond the mean) in terms of average temperatures experienced across the nation during the winter season.

This is obviously related to the absence of some of the seasonal effects of the Pacific Coast El Nino and La Nina weather systems. The following exhibit shows corresponding seasonal storage patterns for natural gas in the U.S. and how the current storage rate compares to levels seen over the past decade. As can be seen here, current storage levels are approaching historically unprecedented low levels.

Exhibit 14. Storage Changes over the Past Few Years

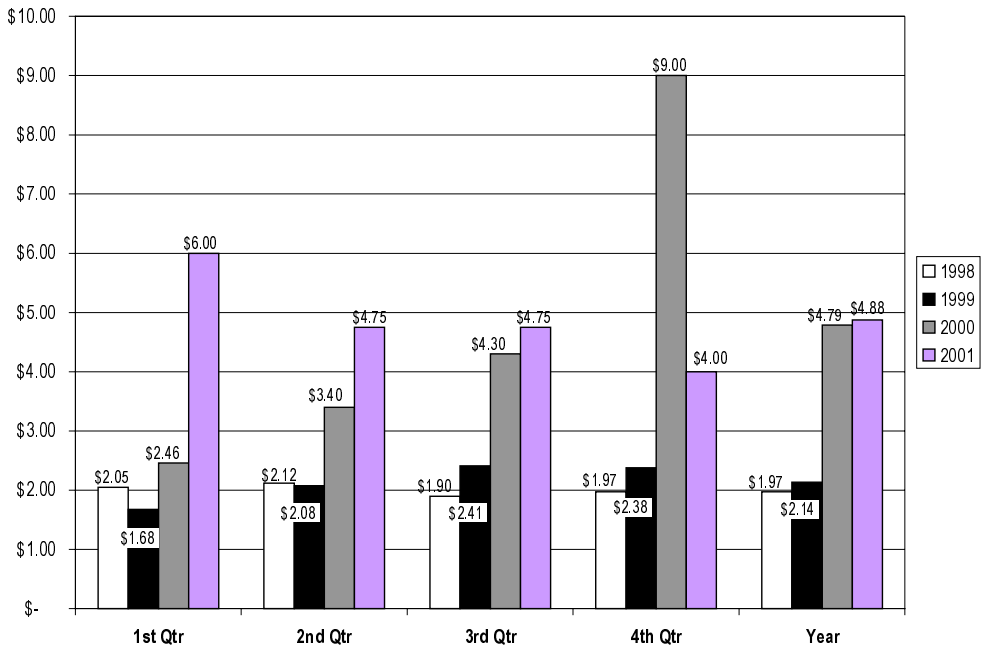


Source: Bear, Stearns & Co. Inc.

The upcoming summer season will also represent an important test for the natural gas and power industries in this country. According to detailed industry studies regarding gas-fired generation capacity being added over the next few years, more than 30,000 MW of new domestic capacity is expected to enter the market in 2001. Depending on the timing of the start-up of this capacity, this could greatly reduce the amount of gas put into storage during the spring, summer, and fall months. This, of course, could set us up for another winter season of high gas prices, depending on the severity of the weather. And, of course, these issues could (and need to be) tempered by the reduction in demand for gas from major industrial consumers of natural gas

(turned away by the high price), as well as potential increases in supply. The intersection of all these factors is likely to lead to continued high volatility levels for gas in 2001, although perhaps down from the extreme levels of the past two months. Overall, Bear Stearns is inclined — due to revised 1999 statistics concerning rig construction and natural gas production — to forecast a future environment of increasing demand and decreasing gas supply. The following exhibit details the historical and projected prices for natural gas.

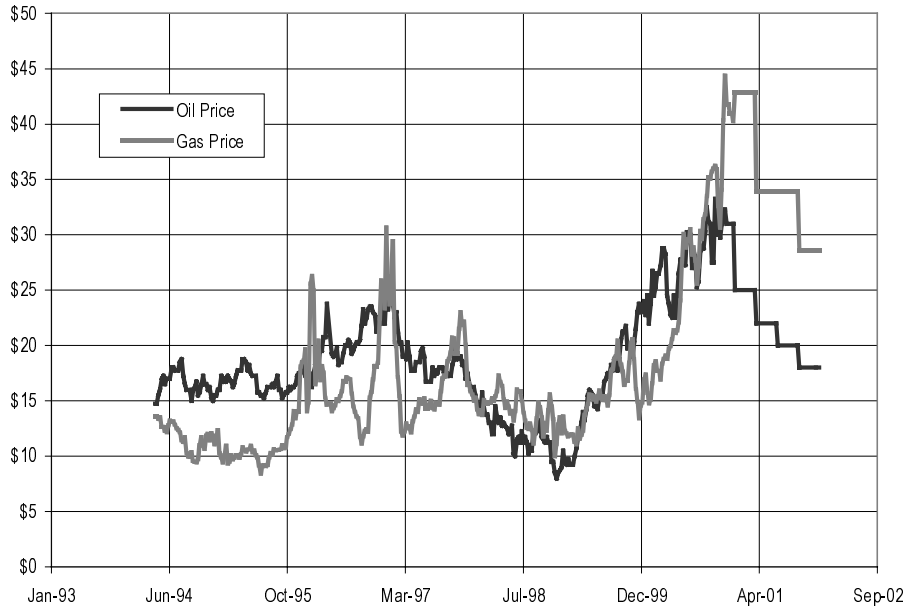
Exhibit 15. Natural Gas Price History and Forecast, 1998-2001E



Source: Bear, Stearns & Co. Inc.

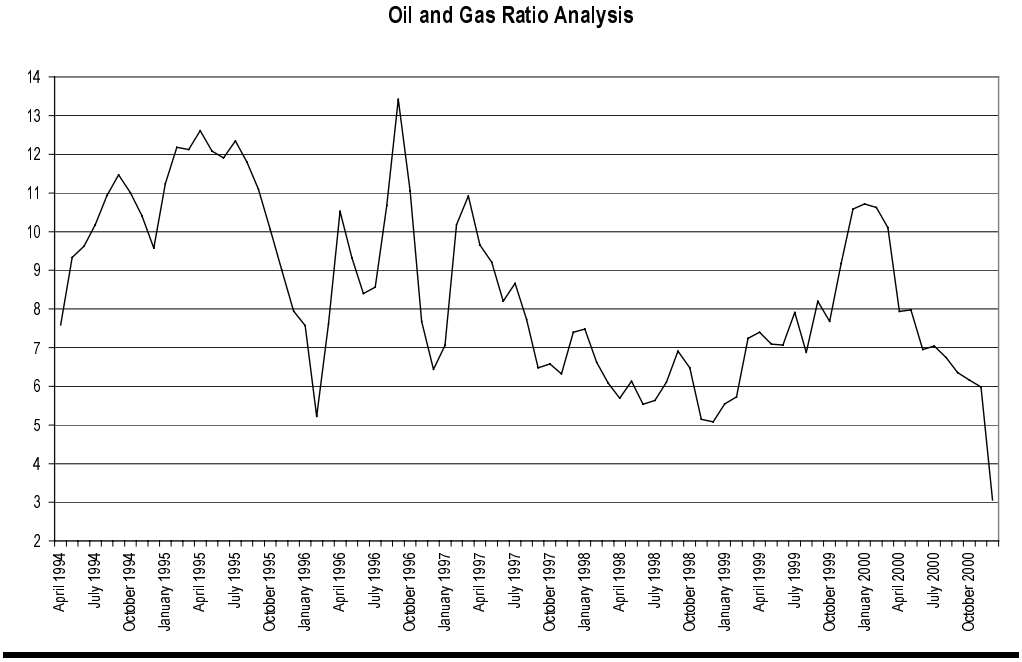
These price forecasts have been formulated based on an analysis comparing weekly WTI posted prices and weekly wellhead price, specifically focusing on how natural gas tends to follow the price of oil.

Exhibit 16. Historical and Projected Oil and Gas Prices



Source: Bear, Stearns & Co. Inc.; *Natural Gas Weekly*; WTI.

Exhibit 17. Historical and Projected Oil and Gas Trading Range



Source: Bear, Stearns & Co. Inc.; *Natural Gas Weekly*; WTI.

Based on this evidence, we can see that oil and gas has typically traded at an 8:1 ratio. Historically, this ratio has been below 8:1 during the peak winter and summer months. There is a conceptual, mathematical relationship between oil and gas prices, based on their respective heating equivalents, which should somewhat govern the price differential between the two commodities. As a rule of thumb, approximately 6 Mcf of gas equals the heating equivalent of one barrel of oil. Bear Stearns currently expects the gas to oil ratio to be particularly low in 2001 — approximately between 4:1 and 5:1. This ratio, and our projection for 2001 gas prices, stems primarily from

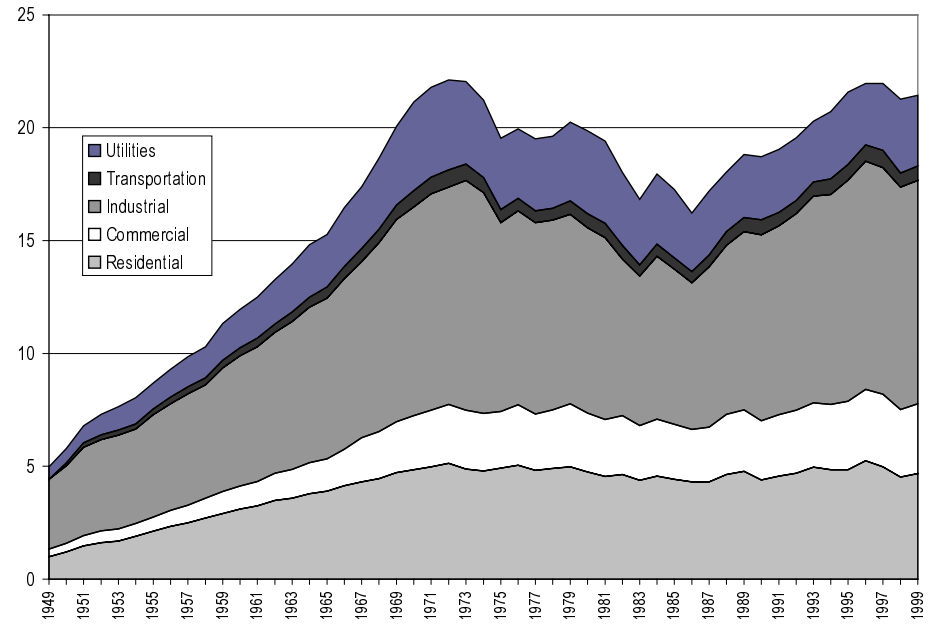
our price expectation for the oil and tight gas markets. Therefore, our expectation is that natural gas could/will inherently trade at a premium to the intrinsic value of its contained energy relative to oil prices measured by heating equivalents. This expectation is due to the aforementioned fundamental factors affecting the natural gas market, as well as the fact that switching between fuels by industrial users is not always an easy or quick process. Overall, our expectation is strengthened by a key indicator of future gas prices. Early bidding on New York Mercantile Exchange gas futures contracts for delivery during the upcoming year indicates that gas prices will probably drop to $5.50 by May but will remain above $5.00 through the end of 2001.

Can We Use History as a Guide?

Over the past year, industry professionals have been assailed with scores of optimistically skewed projections of domestic power generation demand and the natural gas needed to meet these demands. Population shifts, increased reliance on cleaner burning power plants, and the proliferation of the Internet have caused some analysts to estimate that construction of required power generation will climb as high 370,000 MW over the next decade — a whopping 37,000 MW per year of new capacity.

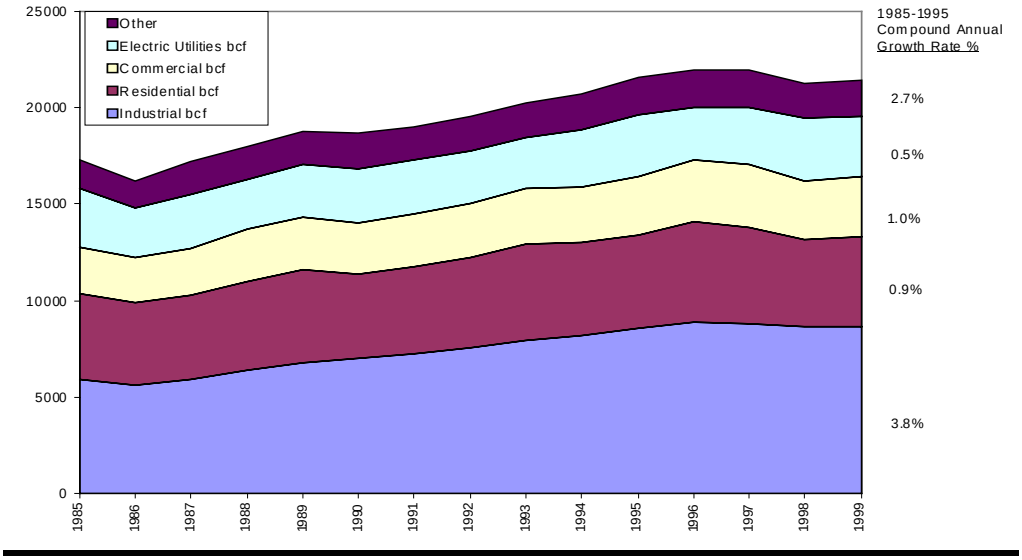
In addition, the oft-quoted figure of a 30 Tcf domestic market by 2010 is of particular concern to both the supply and demand sides of the natural gas market. Bear Stearns takes a more conservative approach to future gas demand. Similar to Research Data International's (RDI) analysis cited in the October 23 edition of *Natural Gas Week*, we see power generation demand increasing at a much more sedate rate of approximately 2.0%-2.5%. The following exhibits display both the 50- and 15-year demand curves for U.S. natural gas demand curve.

Exhibit 18. Natural Gas Consumption by Sector, 1949-99



Source: Bear, Stearns & Co. Inc.

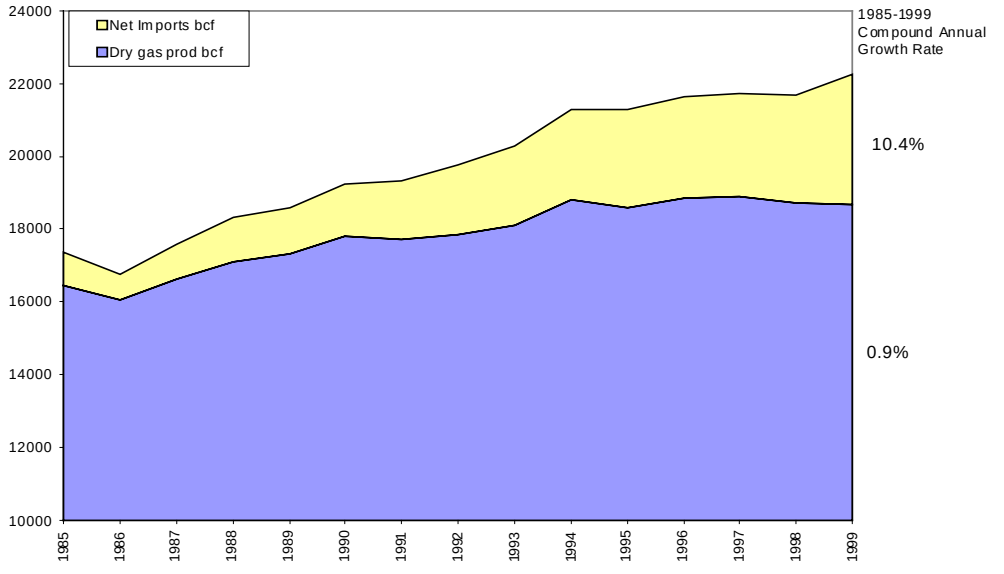
Exhibit 19. Natural Gas Consumption by Sector, 1985-99



Source: Bear, Stearns & Co. Inc.

As can be seen from the last exhibit, natural gas demand has increased at a combined annual growth rate of approximately 1.7% during the past 15 years, with industrial use accounting for nearly half of the increase. Similarly, the next exhibit displays the corresponding available natural gas supply since 1985.

Exhibit 20. Natural Gas Supply, 1985-99



Source: Bear, Stearns & Co. Inc.

Currently, approximately 16% of U.S. power generation is fueled by natural gas, with coal (54.7%), hydroelectric (7.3%), nuclear (19.7%), and other (2.9%) accounting for the remainder. EIA estimates suggest that planned capacity additions (which include power generation plants already approved at the state level) at U.S. electric utilities (net of planned plant retirements) are approximately 25,000 megawatts from 1999 through 2003. Of this total, more than 90% is expected to use natural gas as its primary energy source. This 25,000-MW figure is significantly below CERA's

(Cambridge Energy Research Associates) estimate of 240,000 MW of proposed power generation development in North America over the next four years. In addition, it should be noted that CERA and other industry analysts (including us) are very skeptical of the viability of all of the "announced" capacity additions.

It is difficult to determine how much gas this projected 25,000 MW will burn because of items such as plant design and efficiency rates. Bear Stearns, however, has attempted an estimate based on conservative assumptions and historical data. Using 25,000 MW of new capacity, and assuming an 80% net capability (rates run closer to 94%-96%, but we are being conservative) yields about 20,000 of incremental megawatts annually, or 20 gigawatts (GW) per year. Each GW would require 29 Bcf of gas heating equivalent, or about 580 Bcf of new gas demand per year. However, as plant efficiency rates vary (nothing burns 100%), we've used a 60% efficiency rate (which would be generous). That would require about 967 Bcf of gas annually to run the planned new capacity additions, or 2.6 Bcf/d. Even if these estimates are off by a factor of one, a substantial amount of new gas supply will be required. As our group is inclined to estimate a new power generation capacity figure closer to 200,000 MW, we view the daily throughput of required natural gas to be significantly higher than this 967 Bcf. The following exhibit displays a state-by-state estimate for new power capacity planned through 2005.

Exhibit 21. Proposed New Power Generation — Estimated New U.S. Turbine Power Projects: Combined Cycle and Combustion Turbine (3Q00)

	New Capacity, MW 1998 through 2000			Projected New Capacity, MW Year 2000			2000 through 2005		
Region or State	End of 2nd Qtr, 2000	End of 2nd Qtr, 2000	% Change	Prior Report	Current Report	% Change	Prior Report	Current Report	% Change
California	-	-	-	-	-	-	15,759	16,056	2%
Arizona	-	-	-	-	-	-	6,948	7,130	3%
New England	1,382	2,832	105%	4,430	2,420	-45%	13,122	13,943	6%
New York	77	77	-	-	-	-	11,522	11,522	-
Pennsylvania	324	305	-6%	-	268	-	14,512	17,203	19%
New Jersey	-	170	-	-	170	-	7,153	7,500	5%
Maryland	-	-	-	-	-	-	1,613	2,633	63%
Virginia	658	658	-	658	658	-	2,851	3,851	35%
South Carolina	-	-	-	-	-	-	1,850	1,850	-
North Carolina	1,622	1,672	3%	1,622	1,672	3%	3,932	3,982	1%
Georgia	-	-	-	697	697	-	5,281	5,441	3%
Alabama	523	1,063	103%	1,381	857	-38%	7,222	6,588	-9%
Florida	795	975	23%	325	505	55%	18,318	18,390	0%
Mississippi	800	837	5%	800	837	5%	6,168	6,205	1%
Louisiana	942	942	-	905	1,015	12%	4,831	6,657	38%
Texas	3,770	5,320	41%	4,767	4,917	3%	28,227	28,449	1%
Oklahoma	640	598	-7%	530	488	-8%	3,930	3,888	-1%
Ohio	1,090	1,220	12%	1,235	1,230	0%	7,441	9,441	27%
Illinois	1,683	3,399	102%	1,130	3,559	215%	7,293	19,816	172%
Indiana	1,050	1,260	20%	1,050	1,260	20%	4,550	5,108	12%
Michigan	1,175	625	-47%	550	-	-100%	4,260	6,100	43%
Wisconsin	563	563	-	383	383	-	3,138	3,138	-
Missouri	248	248	-	-	-	-	3,603	3,603	-
Other Regions	2,024	2,076	3%	1,392	1,444	4%	18,846	22,109	17%
Total	**19,366**	**24,840**	**28%**	**21,855**	**22,380**	**2%**	**202,370**	**230,602**	**14%**

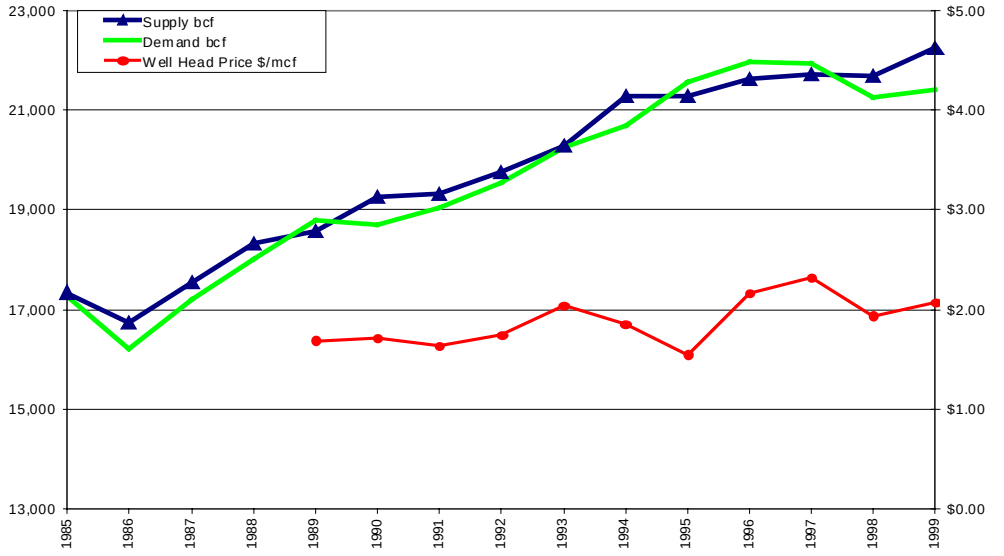
Source: Bear, Stearns & Co. Inc.

TWO IMPORTANT QUESTIONS

What Does the Future Supply/Demand Curve Look Like, and Can Natural Gas Alone Meet this Demand?

The next exhibit displays Bear Stearns' market projections for the next three years. From it, we can see that sometime in 2001, demand for natural gas should exceed available supply. What we consider to be the most important aspect of this projection is that it is based on the EIA's relatively low estimate of approximately 25,000 MW of new power generation capacity built through 2003. As we see power generation additions closer to the 200,000 MW range, this supply/demand disparity will become even more dramatic.

Exhibit 22. Supply/Demand Forecast Versus Wellhead Gas Price



Source: Bear, Stearns & Co. Inc.

Given the impending increases in gas-fired power demand (regardless of the degree of capacity requirements assumed) and the general decline in domestic gas production, it is obvious that natural gas production will need to be augmented by either new supply basins or alternative fuel sources. (In fact, due to the general decline in U.S. oil and gas exploration over the past three years, the U.S. already consumes more natural gas than it supplies, relying on Canada to make up most of the difference.) Liquefied natural gas (LNG) is an obvious source of additional fuel but for several reasons we do not see it becoming a major factor in bridging the gap between supply and demand. While the U.S. will soon have four fully operational marine terminals capable of receiving, storing, and regasifying LNG, it is unlikely to make a significant difference. Given the inherent difficulties and expenses involved in the ocean transport of LNG and a dearth of available boat capacity, we do not see LNG contributing more than about 1% of domestic daily demand until long-term contracts are signed. (To date, most LNG cargoes entering the U.S. have been spot deliveries, foreign cargoes that could not find a home port in their regional markets because of oversupply.)

The vast Canadian expanses of the Northwest Territories and the Western Canadian Supply Basin (WCSB) offer some possible help to the supply/demand imbalance. Currently, Canadian production accounts for approximately 16% of natural gas consumption in the United States. Estimates of gas reserves in sections of the Northwest Territories have been as high as 70 Tcf. While this is obviously a promising development, it will take significant amounts of additional exploration to verify these reserves and then approximately seven to eight years to develop the required field and transportation infrastructure. Any drilling in these potential supply areas will require major capital investments due to the greater distances to end-users and inherent difficulties operating in the harsh terrain and climate of the far North.

Further dampening the prospects of these areas are recent research announcements by Calgary's Canadian Energy Research Institute (CERI). CERI predicts that natural gas deliverability from Canada will rise roughly 1.8 Bcf/d between 2000 and 2002 —

just keeping pace with historical rates. This relative decrease in productivity, despite an approximate 30% increase in gas well completions since 1999, will certainly give pause to those who expect Canada to sufficiently supplement U.S. demand for natural gas. As natural gas wells are extremely efficient, they decline in productivity more quickly. This, in turn, means that producers must drill more and more wells just to keep up with their current level of deliverability.

The 30 Tcf Illusion?

As mentioned earlier, many analysts have forecast a 36% increase in the domestic natural gas market through 2010, rising from a current 22 Tcf/year projection to approximately 30 Tcf/year. For numerous reasons, on both sides of the gas market, we believe this number is not only unrealistically high but also unattainable. With respect to the demand side of the natural gas equation, as mentioned earlier, we expect an increase of only about 2.0%-2.5% per year. At these rates, we can project a 2010 domestic gas market falling in the 26-27.5 Tcf/year range.

While the capacity requirements of natural gas end-users are one thing, they are virtually irrelevant if the supply of gas is not there, or is unreachable due to political and/or environmental factors. Taking the 30 Tcf/year figure to be correct, many industry executives do not believe the required 8 Tcf increase is possible because of capital investments and, more importantly, reserve capacity. Linda Cook, chief executive of global gas and power for Royal Dutch/Shell Group, was recently quoted as saying that more than $500 billion in cumulative capital investments would be needed to bring on the needed 8 Tcf (to meet forecasted demand of 2010) — primarily in the form of transportation expansion between the U.S. and Canada and LNG receiving terminals. In addition, industry executives also note that there is more than just the point of adding 8 Tcf to existing output — natural declines in known natural gas fields take about 6 Bcf/d of supply out of the equation, or about 2.5 Tcf annually. Therefore, the required 8 Tcf is in excess of the volumes needed just to offset the declines.

Conclusion

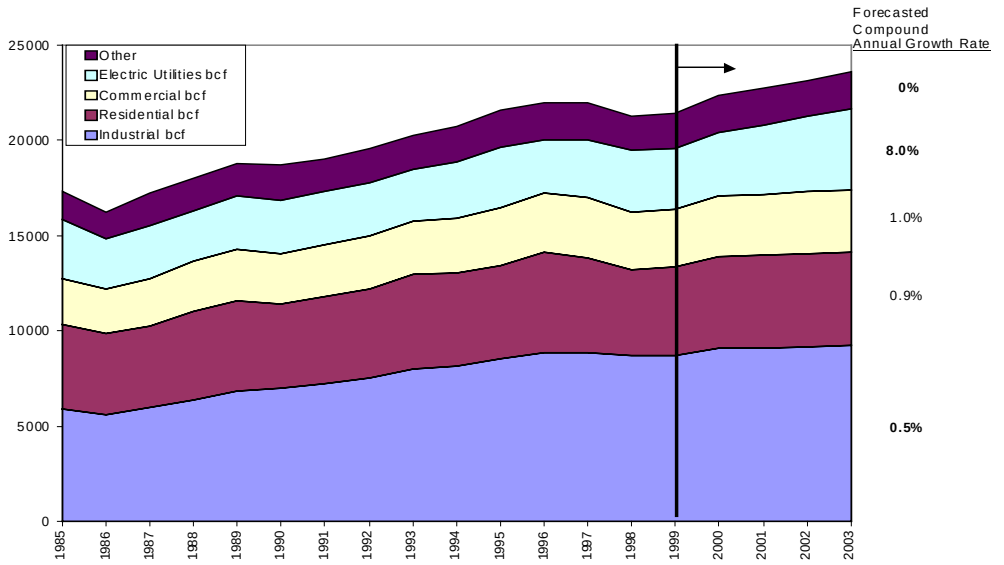
As mentioned earlier, for the short term, we (along with at least one futures market index) expect the price of natural gas to decrease substantially throughout the course of 2001, settling in a range between $4.40 and $5.50 at year-end. While still significantly higher than the $2-$3 range that natural gas has existed in since 1985, it will be a welcome relief to power suppliers and consumers, especially those in California. While natural gas pricing is surely important, we are more concerned with the present state and long-term outlook for domestic natural gas exploration and production.

Overall, we are concerned that during the coming years, the U.S. could face a continuous supply shortfall of natural gas because of pricing/rate policies, shortsighted storage arrangements, and environmental restrictions. In addition, during the course of the past few years, there has been both a natural decrease in U.S. gas reserves and a move by major producers away from the exploration and production business. Of all these factors, we see the federal government's restrictions on land development as the primary cause for concern. Not even

including the much-talked-about Alaskan reserves, the National Petroleum Council estimates that current drilling restrictions in the lower 48 states alone have put an estimated 213 Tcf of gas off limits to production — enough to meet the nation's natural gas needs for approximately nine years at current consumption levels. All told, there is the potential for a severe energy crunch in the coming decade if power generation requirements increase at or above forecasted levels and new areas of gas production are not brought into the fold.

Concerning our 12-month outlook, we see the energy situation continuing to benefit Enron, although likely not to the degree seen in 2000. Primarily, we expect continued (though decreasing) high prices and high volatility to continue to produce large profits in the company's marketing and trading business.

Exhibit 23. Natural Demand Forecast (Bcf)



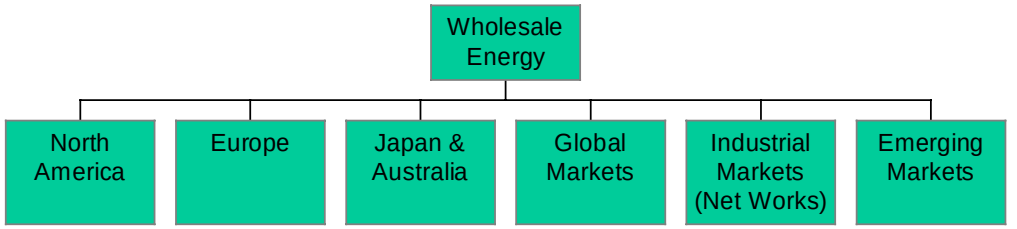
Source: Bear, Stearns & Co. Inc.

Enron's Wholesale Energy Business

FASTEST-GROWING PART OF THE COMPANY

Enron's Wholesale Energy segment is currently the fastest-growing business within the company. Wholesale's growth is best highlighted by the recent 162% jump in 2000 segment revenues and 72% increase in segment IBIT over the previous year. The following exhibit displays a simple breakdown of the "business groups" within this organization.

Exhibit 24. Breakdown of Enron Wholesale Energy Services



Source: Enron Corp.

Enron's Wholesale Developed Markets consists primarily of three geographic regions, North America, Europe, and the areas of Japan and Australia. All of these regions contain reliable infrastructure, a high degree of industrialization, and markets that are to some degree undergoing energy deregulation. An important aspect of these developed markets — not seen in most of the developing markets — is a high level of electrical and Internet penetration into the respective society, a vital component of Enron's emerging energy marketing and trading philosophy.

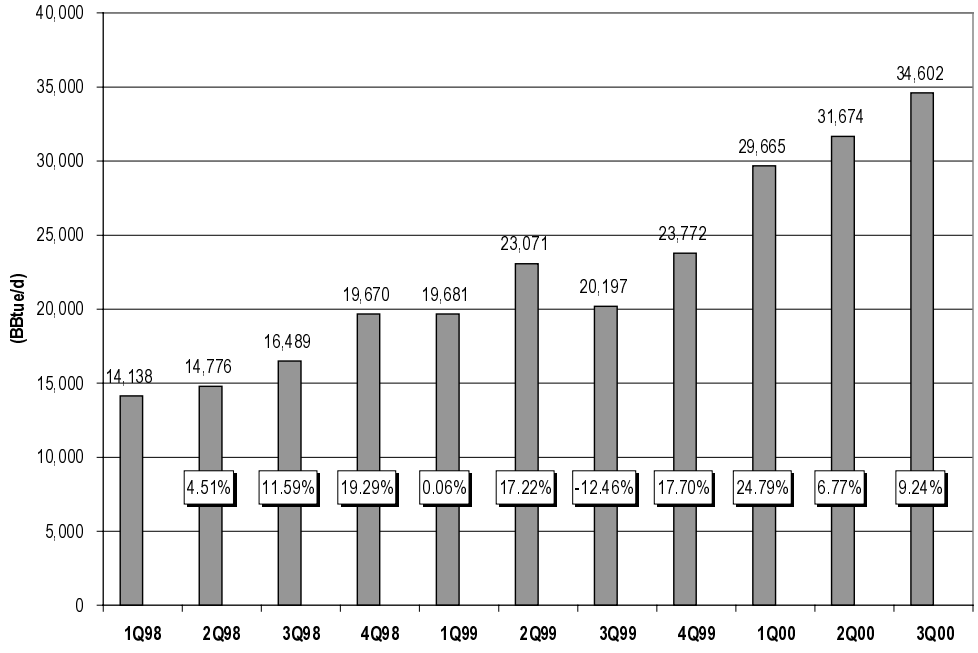
Enron is also developing wholesale energy networks throughout the world. The Wholesale Developing or Emerging Markets segment is currently focused on four regions: South America, Asia Pacific/Africa/China, the Caribbean and Middle East, and India. Enron's focus varies greatly from region to region, with most expansion and investment decisions being made on the basis of the local and national infrastructure, the growth phase and maturity of the economy, and a working knowledge of the regulations that bind local businesses.

As stated earlier, the Wholesale Energy Business is the most powerful earnings driver for Enron, at least for the time being. The group has experienced remarkable growth during the past two years, recording IBIT of $1.3 billion for 1999, or a 36% increase over the previous year. Similarly, the business has shown tremendous growth in 2000, recording IBITs of $419 million, $437 million, $627 million, and $777 million for the four quarters of 2000, respectively. All of these quarterly IBITs represent increases of at least 23% over results from the previous year. Overall, IBIT from the Wholesale Energy Business has represented approximately 67% of total firm IBIT for the past 11 quarters, but this percentage has quickly grown to approximately 90% over the past three quarters.

For the full year 2000, IBIT for Enron's Wholesale Energy business was nearly $2.3 billion, representing a dramatic 72% increase over 1999's record levels. The extremely strong 2000 performance for Enron's Wholesale Energy business has been driven by the company's strong position in the North American and global markets. However, the company and many of its peers have benefited extraordinarily this past

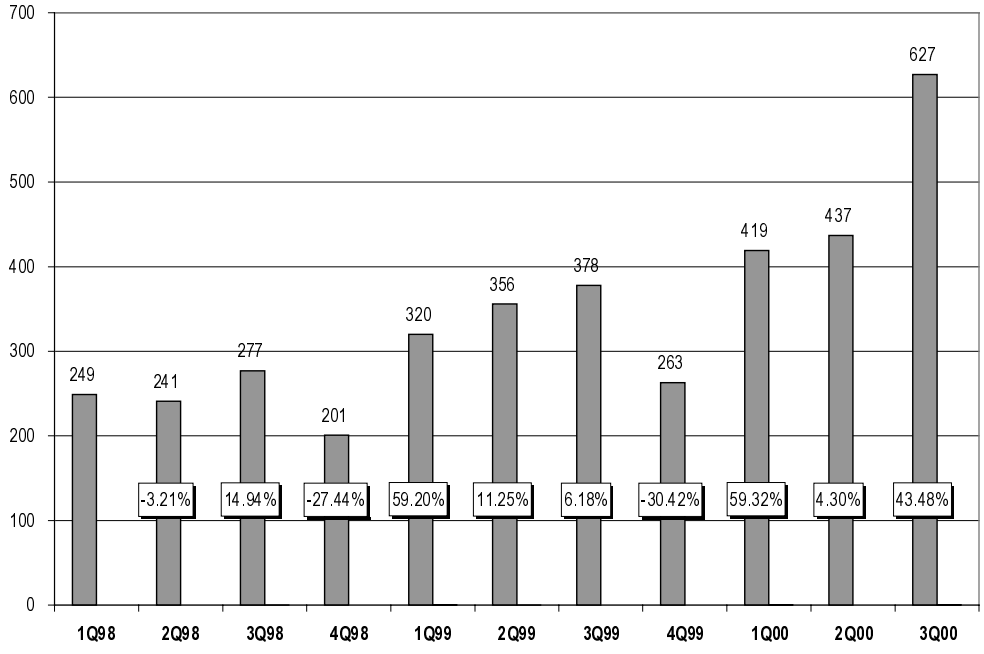
year from the remarkable increase in prices and volatility within the North American gas and power markets. Going forward, we are concerned that 2000's dramatic performance could create difficult earnings growth comparisons for Enron during the next 12 months, particularly given our concern about the general macroeconomic outlook.

Exhibit 25. Wholesale Energy — Physical Volumes and Percent Change, 1Q98–3Q00



Source: Enron Corp.

Exhibit 26. Wholesale Energy — A Record of Steadily Increasing Earnings, IBIT for 1Q98–3Q00
($ in millions)



Source: Enron Corp.

Before discussing the details of the developed and developing markets, we believe that EnronOnline, the company's revolutionary interactive trading system, must be fully described. In our view, the potential for continued increases in both sheer volume of transactional value and bottom-line earnings exists in the Wholesale Energy business because of EnronOnline.

ENRONONLINE

EnronOnline is a principal-based, electronic transaction platform that offers real-time pricing for commodities, including electricity, natural gas, coal, pulp and paper, emission (clean air) credits, weather and credit derivatives, petrochemicals and plastics, oil and refined products, metals, and, most recently, bandwidth. For purposes of classification, the Global Markets segment trades products such as LNG, crude products, coal, emission credits, and weather derivatives while the Industrial Markets segment trades products such as lumber, steel, pulp, paper, and metals. This interactive Internet site allows commodities consumers and producers from around the world to buy from or sell to Enron with the ease of a mouse click. The system's ease of use and subsequent acceptance by the commodities market is perhaps best exemplified by its performance since coming on-line.

- By March 31, 2000, Enron Online, which was introduced in late November 1999, had performed more than 70,000 transactions, representing $27 billion in gross transaction value. During this time frame, 39% of Enron's total wholesale transactions and 27% of volumes were performed through EnronOnline.

- By May 2, 2000, EnronOnline had completed more than 90,000 transactions with a gross transaction value exceeding $35 billion. This date also marked the introduction of bandwidth products to EnronOnline. As we will see in later sections, this was a watershed event for EnronOnline, Enron, and the entire commodities marketing industry.

- On June 1, 2000, Enron announced that the transactional value on EnronOnline had passed the $50 billion milestone for calendar year 2000. It had now conducted more than 130,000 transactions.

- By July 6, 2000, EnronOnline had expanded to include more than 850 products, completing more than 180,000 transactions for a gross transaction value exceeding $84 billion. This date also marked completion of the first metals transaction.

- Second-quarter 2000 results revealed that almost 60% of Enron's wholesale transactions were now completed through EnronOnline. More than 850 products were now being offered on-line, and since the Web site's inception in late 1999, more than 200,000 transactions, representing more than $100 billion in gross transactional value, had been executed.

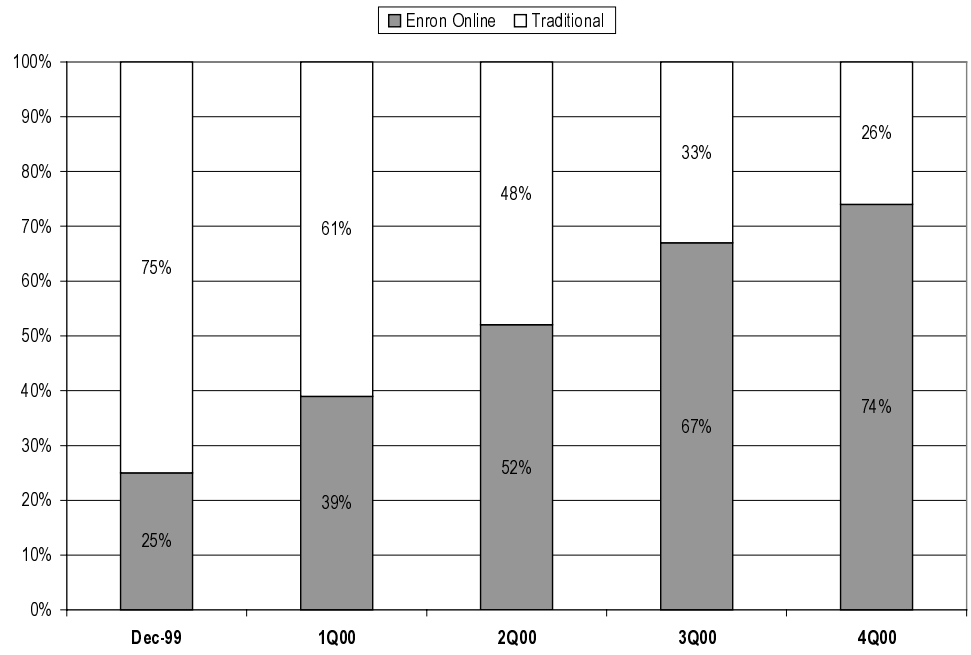
- Results for third-quarter 2000 confirmed that commodity traders are continuing to accept EnronOnline as a medium of exchange. More than 350,000 transactions have occurred with a total value of more than $183 billion. In addition, the site now offers more than 1,250 different commodity products.

- In early October 2000, Enron began use of the upgraded, second version of EnronOnline, Version 2.0, providing customers with a more flexible and interactive system. This system now offers customers the ability to place different types of market orders (limit, stop, etc.), customize their quote screens, and gain access to a multitude of Internet-related news and links.

- Finally, at the time of this report, EnronOnline was offering more than 1,400 products related to 35 different commodities, in 13 currencies and 140 languages. In just over one full year of operations, EnronOnline has completed more than 548,000 transactions with 3,000 at a gross transactional value exceeding $336 billion. Currently, 45% of all of Enron's transactions and 80% of physical gas sales are performed on-line. Daily volumes now average $2.5 billion, with a recent day recording more than $5 billion in transactional volume.

This $336 billion in total transactional value far exceeds the $40 billion that Enron had originally predicted for 2000. In addition, this amount essentially dwarfs the total value sold on-line by successful e-commerce merchants such as Dell, Cisco, and Intel. As the sheer number of products offered increases and more commodity consumers become aware of and comfortable with the online system, we expect a steady increase in the utilization of EnronOnline in the completion of commodity transactions. The next exhibit displays the system's quarter-by-quarter growth rate — for Wholesale Energy transactions only — since the inception of EnronOnline.

Exhibit 27. EnronOnline: A Quarter-by-Quarter Trend of Transactional Utilization



Source: Enron Corp.

We expect this utilization rate to continue increasing throughout 2001, an estimate that is founded on our belief that this online system will gain greater acceptance in the marketplace as a result of Enron's recent track record of strategic partnerships, acquisitions, and introductions of new online businesses.

EnronOnline's Growth Strategy: Partnerships, New Systems, and Products

Since the opening of EnronOnline in late 1999, there have been numerous product offerings and agreements that lead us to believe that this system is only in the early phases of its earnings and growth potential. In February 2000, Enron launched Enroncredit.com, the first real-time credit department for business-to-business customers. With all transactions conducted via the EnronOnline system, businesses now have the ability not only to evaluate the credit quality of their customers in real-time, but also transact bankruptcy swaps between them. With the geometrically increasing number of transactions being conducted between more and more customers, financially prudent companies are forced to use every asset available in order to reduce costs and effectively manage credit risks in real-time. At this time, we have little information on this business's earnings, customer lists, volumes, or transactional values. In our opinion, given that Enron is the first company to offer this service (again, first-mover advantage) and the market for this type service is growing, we see nothing but positives resulting from the introduction of this service.

We believe that the introduction of new products to the online system is a key driver of earnings growth since, in many ways, transacting over the Internet is simply taking the place of transacting through some other medium. (In other words, without the introduction of new products and/or services, Enron would simply end up receiving the same amount of revenues only through a different exchange medium, albeit at a lower overall operating cost to itself.) This being so, we see broadband and associated bandwidth products as the arena with the largest potential for increased earnings. To capitalize on this, Enron introduced the trading of bandwidth products to EnronOnline in early May 2000. Just like the traditional products listed on commodity markets (natural gas, power, emissions, etc.), this product introduction would offer customers a free, Internet-based system allowing them to buy bandwidth capacity from Enron or to sell it to the company.

While broadband (and the Enron Broadband Services sector) will be covered in detail later, it is important to touch upon the general factors and projections that give rise to our positive expectations. Enron estimates that the demand for premium broadband delivery services — consisting of high-content and rich media transmissions — will increase by more than 150% annually from now until 2004. If these projections hold true, this market could easily surpass the combined markets for natural gas and electricity. Overall, the market for bandwidth is expected to grow from $30 billion in 2000 to approximately $95 billion in 2004, or more than 200%. Given Enron's initial entry and subsequent market dominance in both the online marketing and bandwidth trading industry, we fully expect it to capture and hold a significant portion of the total bandwidth market.

Other notable additions to the EnronOnline system are the introduction of physical metal trading and emission allowance auctions. As with other traded commodities, the buying and selling of these two types of products through EnronOnline provides improved pricing, price risk management, and more flexible transactions for both buyers and sellers. What is important to realize is that the introduction of these two products to the system display Enron's desire to expand its range of products and to include products that are on the cutting edge of business. While this is particularly

true for bandwidth, the introduction of emission credits as a tradable commodity indicates that Enron understands the market and is ready to provide the services necessary to operate within it.

EnronOnline Should Radically Change the Commodity Products Trading Business

We envision the EnronOnline system radically changing the commodity products trading business. Product trading is fraught with pricing inefficiencies and complex sales mechanisms, and we believe that the Internet provides the most cost and time efficient way to conduct such trading in the future — and the dramatic increases in transaction volumes and values appear to spell this out. Enron has taken this new trading model one step further, however, with the recent acquisitions of MG PLC, a leading merchant of base metals, and Garden State Paper, a U.S.-based newsprint manufacturer. These acquisitions — and remember that Enron believes in an asset-light portfolio — are designed to establish a physical product flow for two products that are now trading through the EnronOnline trading system. Therefore, these strategic acquisitions will give Enron access to a heretofore-unknown market, allowing the company to become knowledgeable in and ultimately control the flow of these two products. These two acquisitions underpin a major portion of our next topic: Enron's Industrial Markets segment.

INDUSTRIAL MARKETS GROUP

Enron Looks to Use the Best of Its Gas and Power Trading Platform to Overhaul the Old and Inefficient

The industries targeted by this segment (also referred to as Enron NetWorks) — metals, steel and aluminum, pulp and paper, chemical, and lumber — have never been considered pioneers of efficiency in American business, but as fuel price volatility increases and cost structure becomes more important in today's increasingly competitive environment, what is needed is someone to come along who is able not only to manage the price and credit risk associated with these businesses but also the deliverability and logistics of their respective products. Given Enron's success in the oil and gas trading business, we believe the company is well-suited and prepared to turn into commodities many products and industries that have heretofore operated inefficiently and without regard to risk.

How Can Industrial Markets Help Customers?

Given the slow growth and entrenched business practices found at many of these industrial stalwarts, we assume that most do not welcome the commoditization of their business. For several financial reasons, however, we see their resistance as futile. As the majority of these businesses serve specific niche markets, it is unlikely that any will break out of their cyclical pattern of low earnings growth. With already razor-thin margins increasingly susceptible to power prices volatility *and* increasingly dependent on cost structure efficiency, we believe that utilization of the services offered through Enron is vital to their continued profitability.

As we have described in our discussion of EnronOnline, the Internet has offered a perfect medium for the instantaneous trading of commodity products. Sensing the potential market for industrial products, Enron expects to have a similar trading

portal operational sometime in 2001 — focusing exclusively on metals, paper, pulp, chemicals, plastics, data storage, and other products that the company places in this "category." We see this trading platform, in conjunction with other services provided by Enron, significantly increasing the stability and earnings of customers. Customers will have the ability to lock in a forward price for power, reducing the inherent risks associated with price volatility and market cyclicality. (Forward pricing for power is particularly important for several of these industries as it is by far their largest single expense — approximately 30%-35% for aluminum and 25% for paper/pulp.) Through financial management services (e.g., off balance sheet financing, asset divestment, etc.) provided by Enron, customers can improve the quality of their balance sheets. Finally, with Enron's strategically formed asset portfolio, many of these customers can often be assured of logistical details and product delivery. Enron's recent purchase of assets in the paper and metals industry is a good indication of this "ensured-deliverability" strategy and offers a glimpse into the types of assets the company may acquire in the future.

How Do These Services Help Specific Industries?

The first three industries that Enron expects to "cover" in this new group are metals (including steel and aluminum), pulp and paper, and lumber. These businesses have long exhibited many of the same operating traits: huge power costs, cyclicality, thin margins, and inefficient cost structures.

- **Metals.** This industry, and in particular aluminum, has long been burdened with tremendous power costs. While always inefficient, recent high prices and volatility in electricity prices have caused reverberations throughout the industry, causing more than a few companies to idle plants rather than incur power costs. This, combined with the inherent cyclicality of the metals industry, makes it a perfect candidate for Enron's price-risk/energy asset management services.

  We do not see Enron making a play into ownership of a steel plant for several reasons. As most know, steel is an industry beset by razor-thin margins, susceptibility to increases of imports (steel dumping), and poor pricing methods (because of oversupply, customers essentially dictate the price they are going to pay for steel). Besides these obvious reasons, there are a number of hidden costs involved in the ownership of a steel plant. Realities such as pension and union costs and long-term environmental liabilities certainly reduce the attractiveness of this industry for Enron as well as the overall horrible industry structure/fragmentation that still exists in this country. Perhaps the most important reason for Enron to stay out of this business is the questionable ability to sell this asset at some point down the road. This lack of a definitive "exit strategy" is a virtual red flag to Enron.

  While it is extremely unlikely that Enron will purchase a steel/aluminum plant to increase deliverability, we again see the company's purchase of MG PLC as a key development in its pursuit of becoming a player in the metals market. As Enron has little or no experience in this industry, this acquisition provides it with a base of knowledge and a source of continuous supply. After enough time has passed to transfer industry knowledge and liquidity to Enron, we are confident

that the company will divest these assets as they will no longer be necessary to operate the business.

- **Paper and Pulp.** Similar to the high capital (power) costs of the metals industry, paper and pulp companies are also beset with forward capacity problems, market cyclicality, and intense competition from rivals. This combination causes companies in an already low-margin environment to continuously fret over operating costs, often to the detriment of future performance. A particular problem in the paper and pulp industry is the inefficient marrying of supply and demand needs. For several reasons — for example, volatility in the U.S. market and price undercutting between competitors — it is particularly difficult to project future demand, causing frequent plant idling and all-out production spurts: a classic boom-bust cycle. Currently, U.S. plants are operating at an average of 90% capacity, far below the 100%-plus exhibited during the first half of 2000. We see, as do paper companies, the obvious advantages afforded by Enron's services: power pricing management and the ability to better manage future capacity through forward contracts, related financial instruments, and product deliverability.

  In addition, Enron's proprietary Internet trading system and a not-yet-developed Industrial Markets online portal offer pulp and paper companies the opportunity to streamline their sales process through the reduction of long positions and undue exposure to price volatility.

  Enhanced product deliverability will be afforded these paper and pulp companies through Enron's recent purchase of Garden State Paper. Similar to the company's acquisition of MG PLC, the purchase of this paper asset gives Enron a continuous supply of paper, a critical element if the company is to become a major player in the trading of paper and pulp products. This long position will again give Enron a chance to become familiar with the industry, establish credibility as a deliverer of goods, and gain liquidity in the marketplace. Given the market for paper and pulp products, we would not be surprised if Enron again acquired an industry asset (paper/pulp manufacturing plant) to speed up its entry into the business.

- **Lumber.** The lumber/timber industry is another business that is fraught with inefficiency. Intense cyclicality, stemming from housing starts (which are in turn directly correlated with the economy) and weather are two leading causes of inefficiency. Currently, the industry is faced with massive "market downtime," meaning that numerous plants are completely shut down due to an enormous inventory oversupply and poor pricing conditions. As with metals and paper, we believe the lumber industry is a prime candidate for the services provided by Industrial Markets. As with the aforementioned two industries, lumber can greatly benefit from price-risk and energy asset management, transparent trading platforms, and sources of deliverability. As with paper, we would not be surprised if Enron were to strategically purchase a lumber/timber plant in an effort to speed its entry and acceptance into the industry.

The Financing of Industrial Markets

Enron's Industrial Markets will be formed through the pooling of approximately $2 billion in equity from both Enron and private investors. In addition to its equity contribution, Enron will provide the majority of assets to be utilized by the newly formed group. Through this arrangement, Enron would retain 100% operational control over the business while not having it reflected on its balance sheet. During its initial stages of non-consolidated operation, earnings from Industrial Markets will essentially flow through to equity income. Enron believes that this arrangement may change over time, depending on the success of the business. At the time of this report, Enron was confident that the financing for the Industrial Markets group would be completed sometime in early 2001.

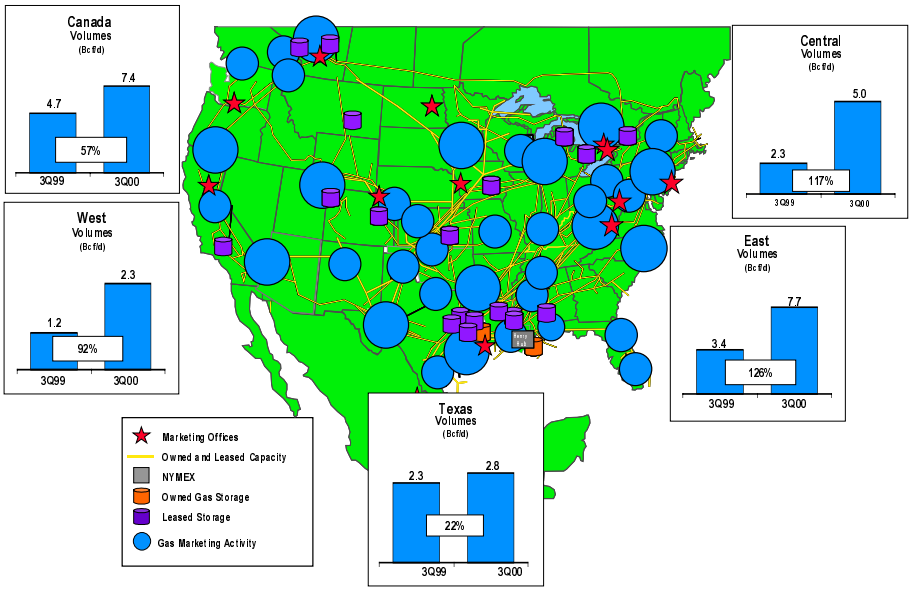
This type of financing arrangement is not new to Enron, as it bears a resemblance to the company's dealings with CalPERS (California Public Employees Retirement System). In 1993, Enron and CalPERS created JEDI (Joint Energy Development Investments, L.P.) with the purpose of pursuing investments in natural gas-related businesses and properties in North America. This $500 million fund ($250 million invested by both CalPERS and Enron) served as an off-balance sheet vehicle, providing both participants with equity income throughout the duration of the fund. Enron and CalPERS formed a second investment fund, Enron II, in early 1998, with each partner contributing half of the fund's $1 billion total value.

ENRON WHOLESALE DEVELOPED MARKETS

Wholesale North America

As stated earlier, the Developed Markets segment consists of North America, Europe, Japan, and Australia. These markets conduct transactions in natural gas, power, and other and produce or somehow contain the more than 1,400 products traded on EnronOnline. As discussed in the previous section, Enron's interest is not limited to only the pure marketing of these commodities; rather, the company has demonstrated that — in certain cases where it is economically advantageous — it will also become asset holders of businesses within certain industries. The natural gas business is Enron North America's most mature and stable business. The next exhibit details the geographic reach (and selected regional volumes) of Enron's U.S. National Gas Network.

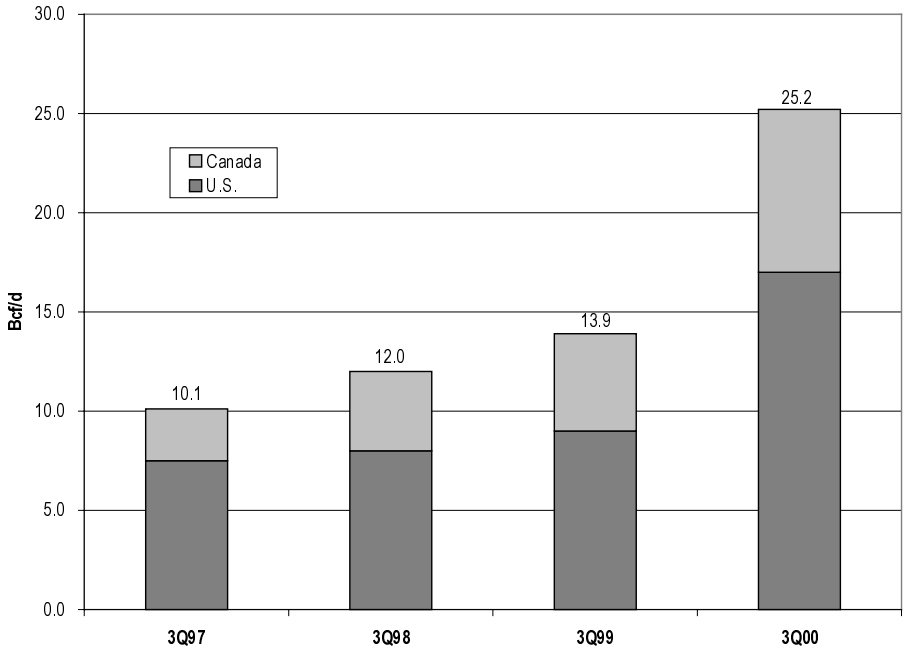
Exhibit 28. Enron's U.S. Gas Network



Source: Enron Corp.

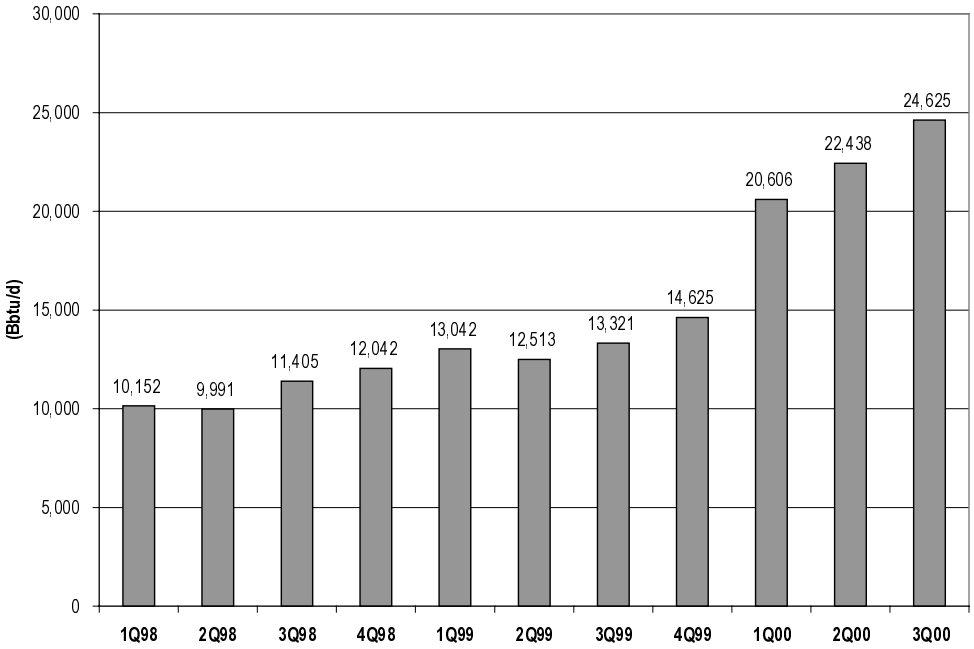
Based on our price forecasts for 2001 and our expectations of increased gas-fired electric generation (see Exhibits 7 and 15), we expect revenues and volume throughput to increase steadily over the next three to four years. This upward trend in gas volumes is clearly displayed in a quarter-by-quarter analysis shown in the next exhibit. All told, we currently expect gas consumption by electric generators to increase more than 60%, from 5 Tcf today to at least 8.8 Tcf by 2010.

Exhibit 29. Approximate U.S. and Canadian Natural Gas Volumes



Source: Enron Corp.

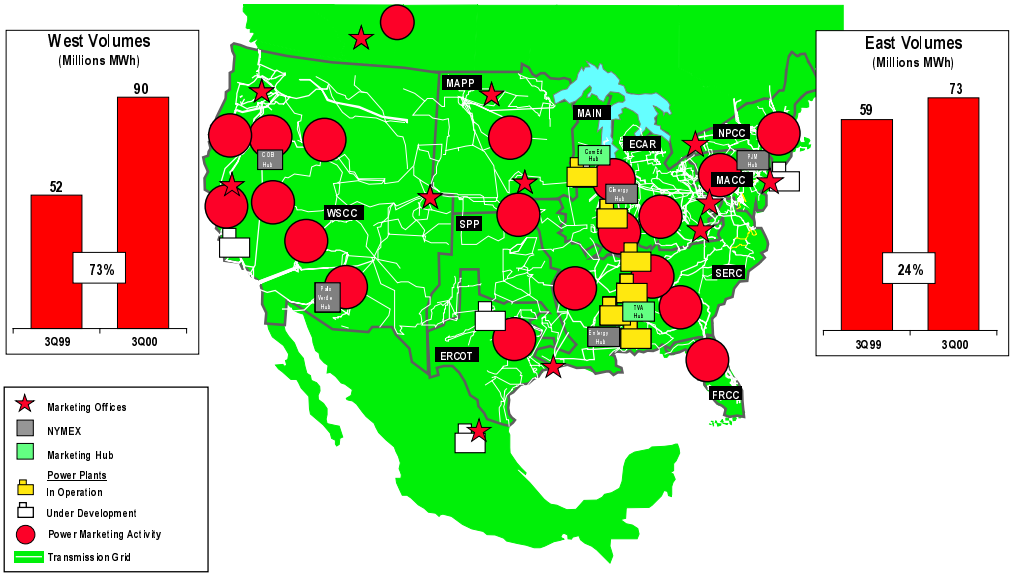
Exhibit 30. Wholesale Energy: North America Gas Volumes



Source: Enron Corp.

Similar to natural gas, we see both the electricity and other markets businesses providing significant earnings in the near future. Enron is currently the largest electricity marketer in the U.S., providing approximately 18% of the 25% of total capacity the nation has under merchant power accounts. Enron expects that within four years, it will provide approximately 50% of total U.S. capacity. The next exhibit provides a look at Enron's U.S. Wholesale Power Network, detailing regional power volumes and areas of power generation.

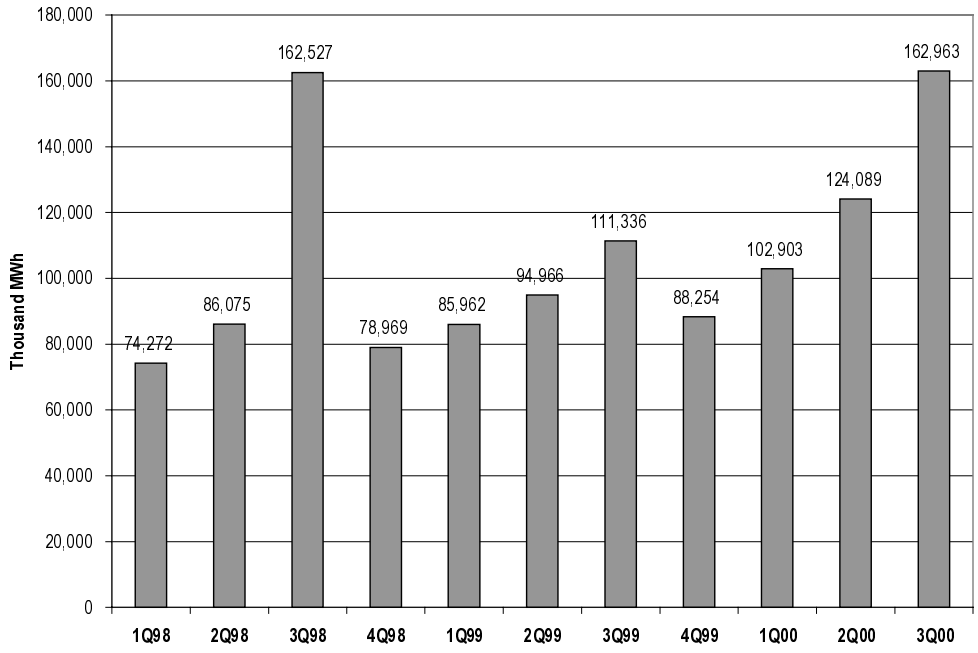
Exhibit 31. Enron's Wholesale Power Network



Source: Enron Corp.

Given Enron's present market dominance and rapidly growing EnronOnline capacity, we expect the company to take a significant portion of this emerging capacity. Enron North America's other markets consist of coal, pulp and paper, emission credits, crude oil petroleum products, weather derivatives, and the already-discussed bandwidth capacity.

Exhibit 32. Wholesale Energy: Electricity Volumes

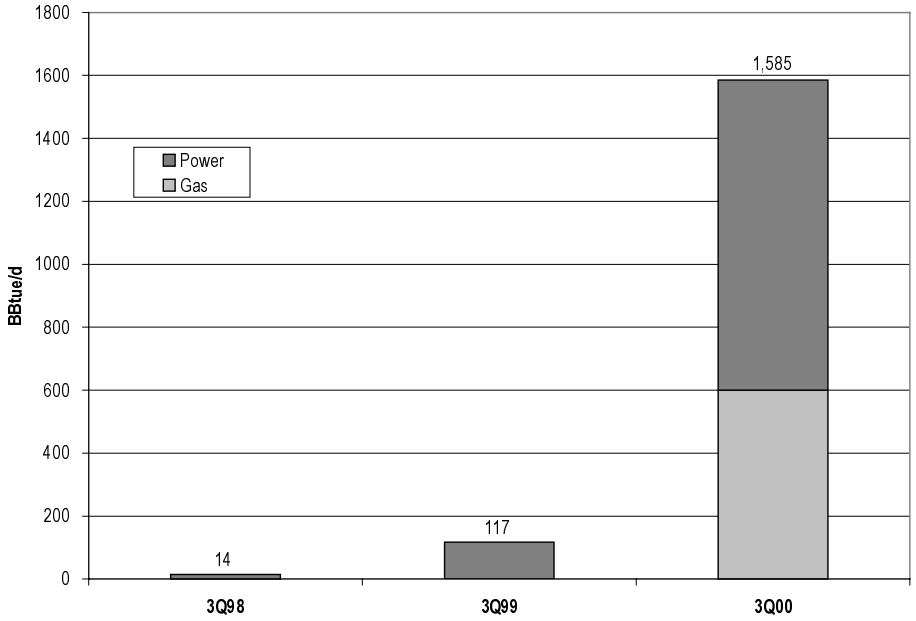


Source: Enron Corp.

Wholesale Europe

Over the past decade, Enron has rapidly entered into and become a force in the European gas and power markets. For classification purposes, Enron Europe is divided among the United Kingdom (U.K.), the Nordic region, and Continental Europe. Overall, Europe is a prime example of how Enron's first-mover strategy has allowed the company to enter numerous new markets and, with the help of technology and creativity, come to profit within them. The following exhibits detail the geographic breakdown of Enron's European operations and the year-over-year growth in the company's three distinct European markets.

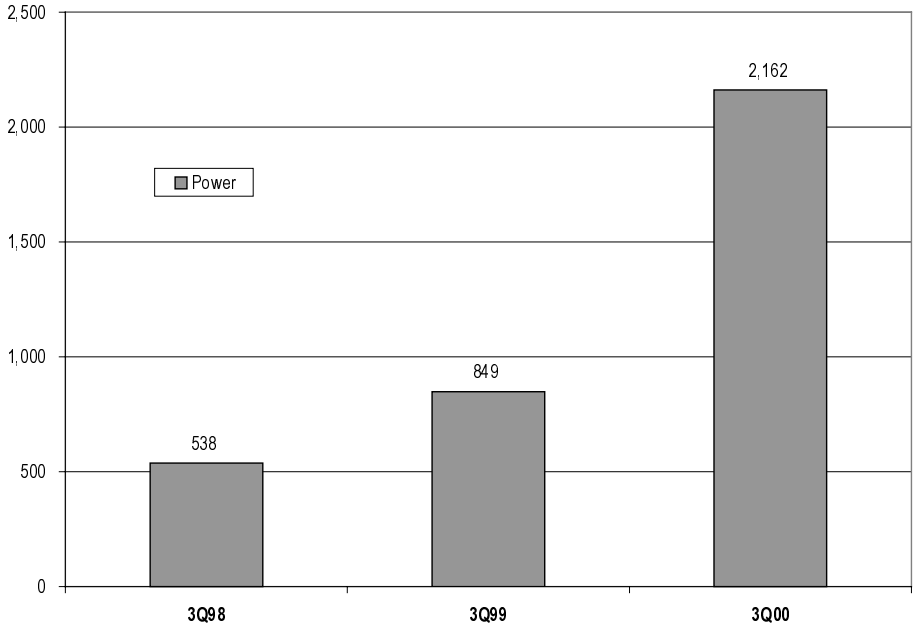
Exhibit 33. Continental Volumes: Year over Year



Note: Volumes include total physical and financial volumes.

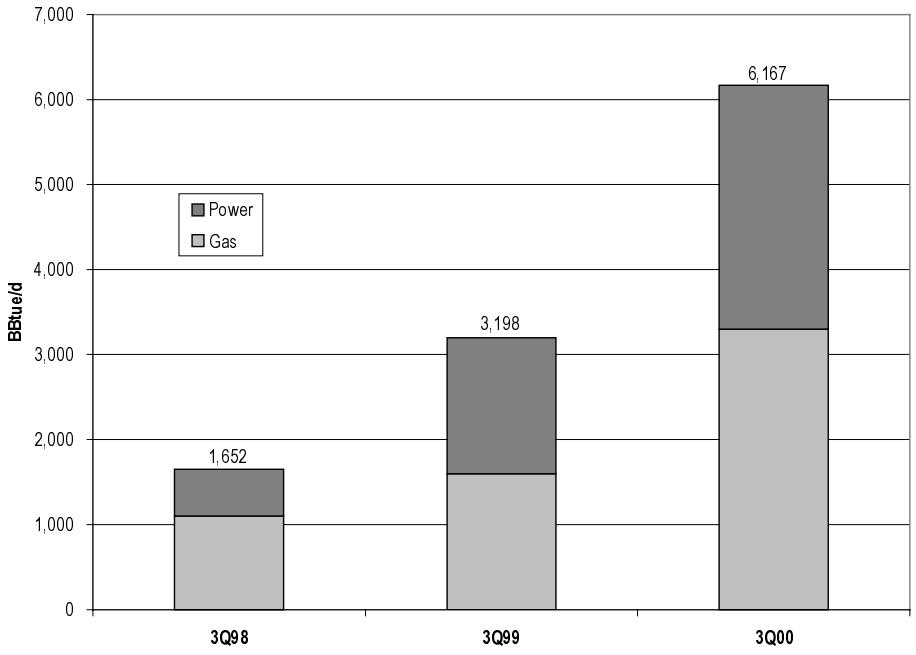
Source: Enron Corp.

Exhibit 34. Nordic Volumes: Year over Year



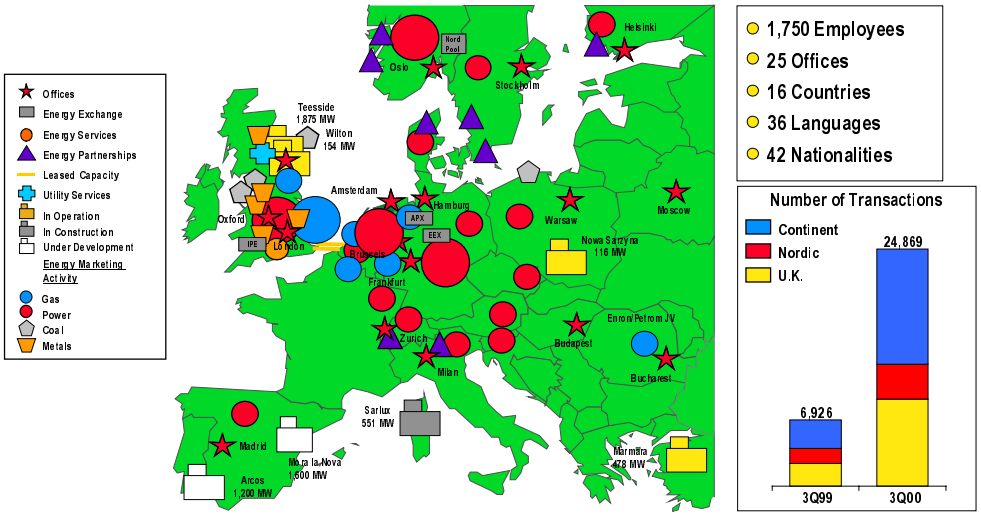
Source: Enron Corp.

Exhibit 35. U.K. Volumes: Year over Year



Source: Enron Corp.

Exhibit 36. Enron's European Operations

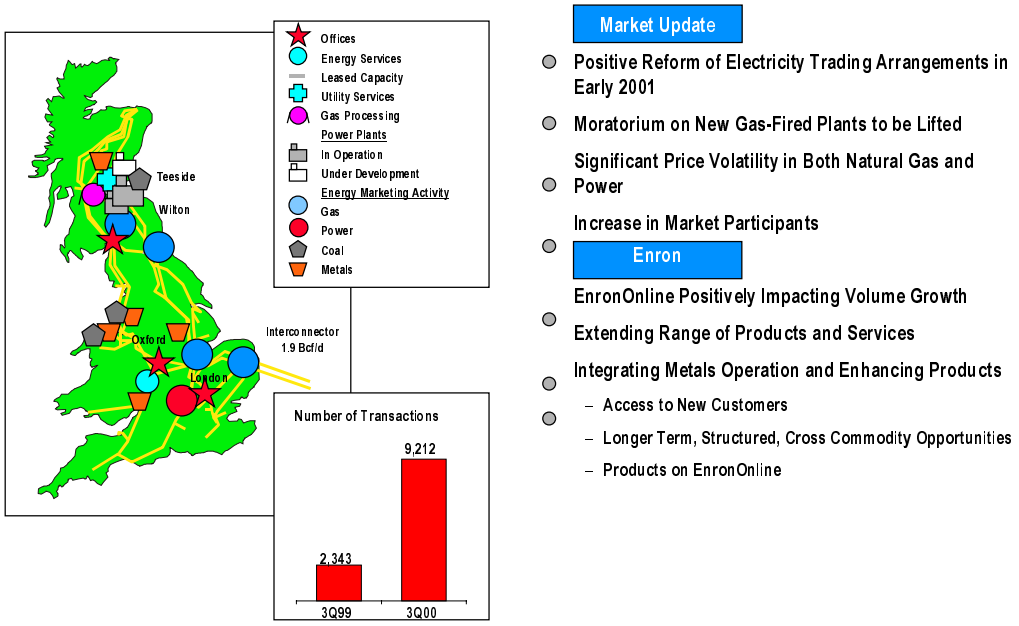


Source: Enron Corp.

In our opinion, Enron Europe is an organization that joins the best qualities of European assets and regional knowledge with Enron's inherent technological superiority and financial services flexibility. We see particular value in Enron's ability to meld gas and power transactions across 16 culturally, regulatorily, and geographically diverse nations into a semi-cohesive network of operations. Given the numerous language and ethnic barriers to entry, we trace Enron's success in Europe in large part to its first-mover strategy. With the European wholesale power market expected to nearly equal that of the U.S. within the next few years, we see Enron's ability to forge relationships as essential to continued growth in earnings and volumes.

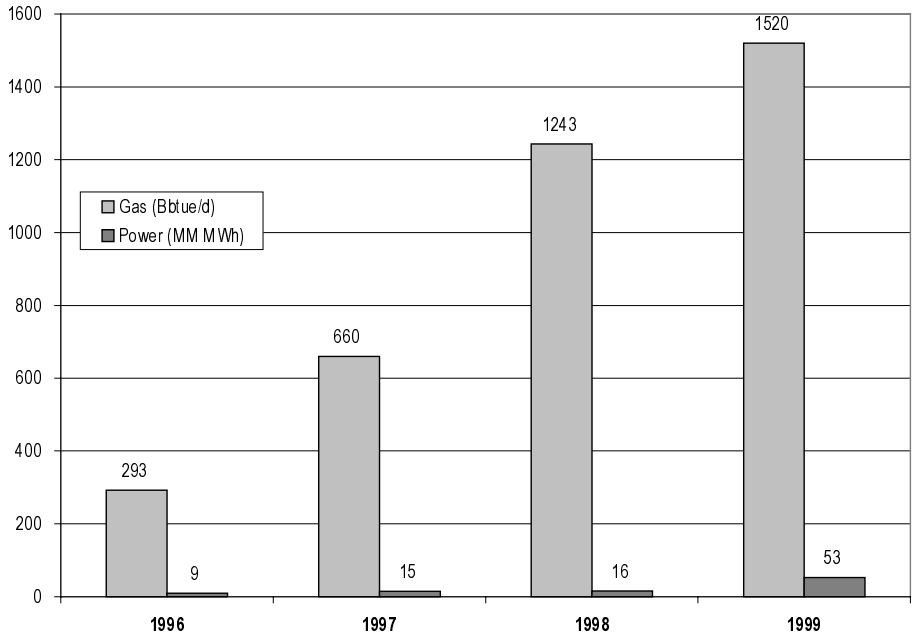
Enron's present market strength is best seen in the U.K. and Nordic regions (Norway, Sweden, Finland, and Denmark) of Europe. The company is currently the largest merchant of natural gas and power in the U.K., with gas volumes increasing by 21% in 1999 and power volumes tripling to 53 million megawatt-hours.

Exhibit 37. The United Kingdom: Enron's Base of Operations in Europe



Source: Enron Corp.

Exhibit 38. Enron U.K.: Enron's European Anchor



Note: Volumes represent total physical and financial volumes.

Source: Enron Corp.

Our bullish stance on Enron's operations in the U.K. has several underpinnings:

- Favorable reforms are expected to be placed on electricity trading arrangements in first-quarter 2001.

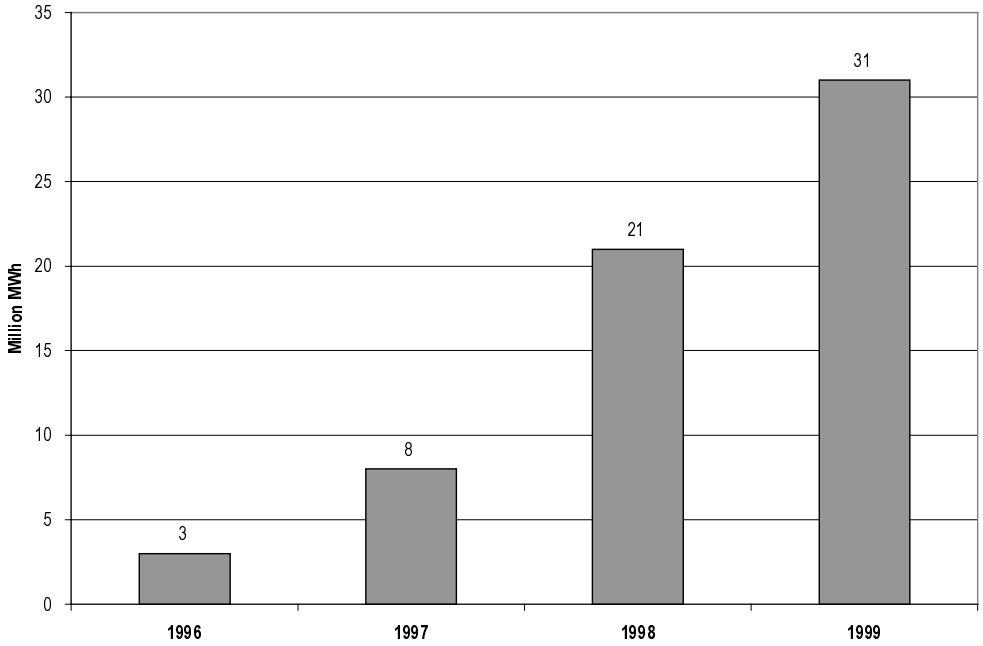
- The moratorium on construction of new, gas-fired generation plants will soon be lifted. Obviously, this will open up new avenues of business for Enron with regard to transportation and trading.

- Finally, much like the volatile market in the U.S., the increased price volatility of both natural gas and power opens the door for Enron to capitalize on risk management services and energy outsourcing agreements.

Overall, with the success of EnronOnline — a nearly 300% increase in the number of transactions from third-quarter 1999 to third-quarter 2000 — and the introduction of new products and services available for customer trading, we believe the U.K. will continue to form the core of Enron's European operations for some years to come.

Similarly, Enron is the largest power merchant in the Nordic region, with power volumes increasing nearly 48% in 1999. (At the present time, Enron has no gas business in the Nordic region.) This impressive growth trend has continued through 2000, with dramatic year-over-year volumetric growth. As the Nordic region is the world's most deregulated power market, Enron is actively trying to become a long-term participant in the power industry throughout this region. We believe the strongest driver of these volumetric increases is the technological additions Enron has made to the region's energy-marketing infrastructure. This technology includes online pricing systems such as PriceDesk and Strommarkt, for the Nordic and German markets, respectively. With the introduction of EnronOnline, these integrated systems are allowing the nations of Europe the opportunity to buy and sell commodities on a real-time basis.

Exhibit 39. Enron Europe: Power Volumes in the Nordic Region

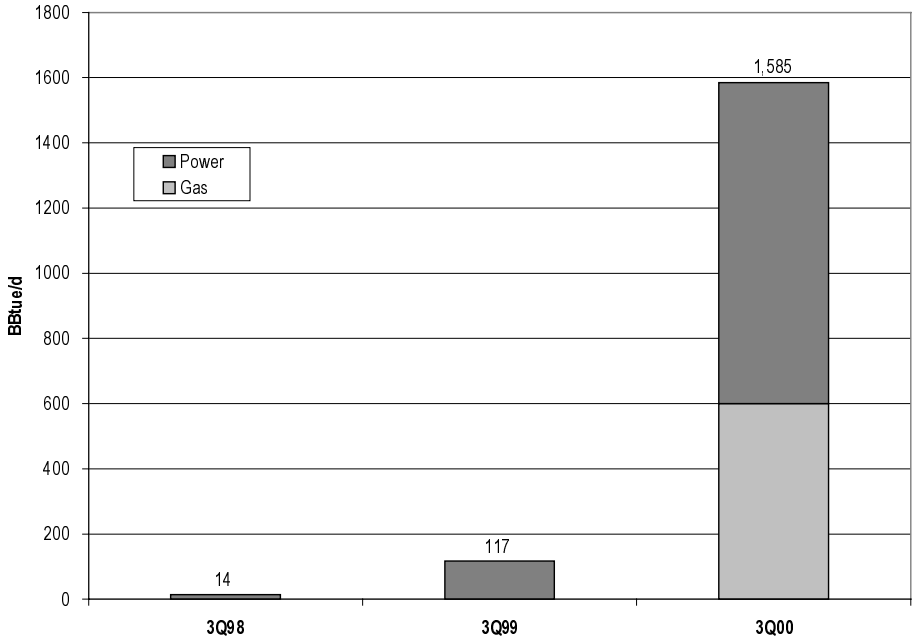


Note: Volumes include both physical and financial volumes.

Source: Enron Corp.

We are also encouraged by the ongoing successful performance of Enron's operations in Continental Europe. There has been a tremendous increase in both the number of transactions conducted and power volumes delivered during the past three years — a trend we expect to continue in the future given the significant gas and power infrastructures and supply basins found throughout Continental Europe. This market has annual gas and power demands of approximately 29.6 Tcf and 3,157 TWh, respectively. All told, the Continental wholesale market generates approximately $156 billion in annual revenues.

Exhibit 40. Enron Europe: The Continental Market — An Opportunity in the Making



Note: Volumes include total physical and financial volumes.

Source: Enron Corp.

Besides the obvious advantages already stated with the introduction of EnronOnline, there are numerous reasons why Continental Europe should rapidly form the backbone of a huge European market. As in the U.K. and the Nordic region, Enron is actively partnering with local/regional municipalities to gain access to physical supply networks. The securing of physical supplies will provide Enron with the opportunity to *control* some of the product flows that it markets and trades. In addition, the establishment of local partnerships will build Enron's regional brand equity, opening the door for the Retail Energy Services segment to engage in the outsourcing of risk management and structured product services. Enron's strategy of partnering has already led to agreements in Spain, Italy, and Turkey for power plant development and construction. Overall, we are encouraged by Enron's Continental power strategy.

As can be seen in the previous exhibit, only recently has Continental Europe become involved with the transportation of natural gas, and again we believe that Enron's willingness to go first will make the difference. Enron's first-mover strategy has allowed it to become the first U.S. gas company to gain access to Germany's natural gas transportation network. Besides having the largest economy in Europe, Germany is also centrally/strategically located between Eastern Europe, Italy, the Iberian Peninsula, and the Scandinavian countries.

The European Union February 2000 mandate requiring the liberalization (deregulation) of all member states has caused dramatic reductions in wholesale prices and therefore has opened up numerous opportunities for Enron to use its inherent power-management expertise in this now competition-riddled market. Enron has demonstrated great ability to tailor numerous types of product transactions among different European nations. Given the various language, cultural, and

infrastructure differences found across the nations of Europe, it is imperative that Enron have the ability to offer any energy service to any market.

Australia and Japan

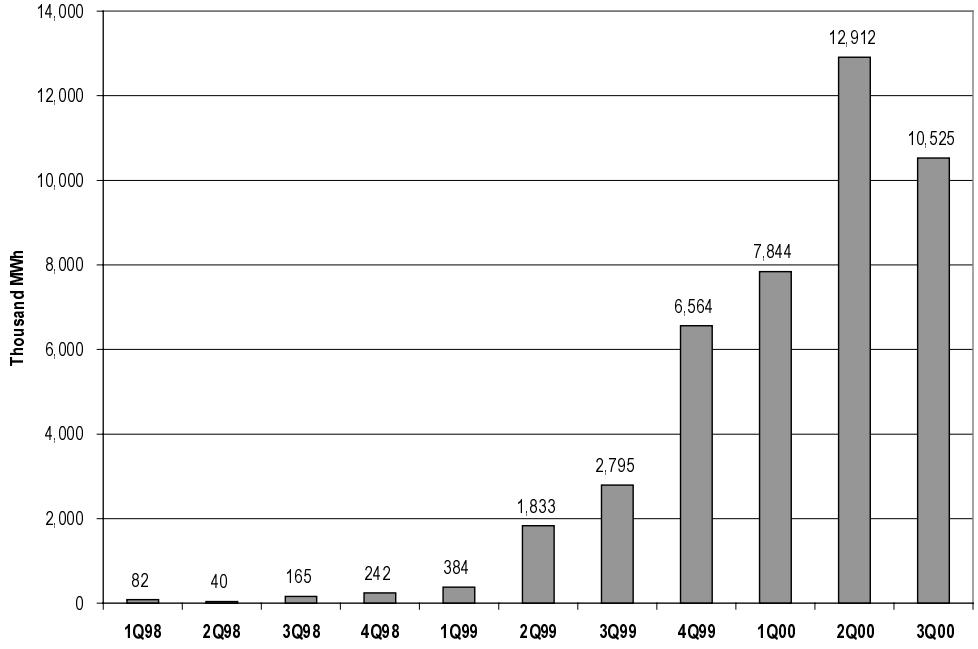
Aside from Europe, Enron has made inroads into the established markets of Australia and Japan. Enron Australia has been in operation for nearly two years and offers customers a suite of risk management and financial and trading solutions for a variety of commodities, including electricity, weather, coal, and crude oil. Enron Japan recently began operations in Japan, offering customers a similar suite of commodity trading solutions and risk management services. Enron sees particular value in the Japanese electricity market as the country enters the second phase of the deregulation of its power markets. Enron does not own or operate any power generation plants and/or pipeline assets in either of these countries.

Global Outlook

As seen in the map of Enron's worldwide operations, the company is taking an active role in many third world/developing markets, including South America, Africa, China, the Caribbean, the Middle East, and India. Specifically, Enron has taken a leading role in establishing operations in South America and India. In addition to numerous power plants, trading offices, and gas distribution centers, Enron owns and/or operates numerous pipeline assets throughout South America. Enron's Indian operations have grown considerably over the past few years with the company owning and/or operating several power plants, pipelines, and LNG facilities. There has been considerable conjecture in recent months that Enron will divest several Indian assets, but to date no deal has been completed.

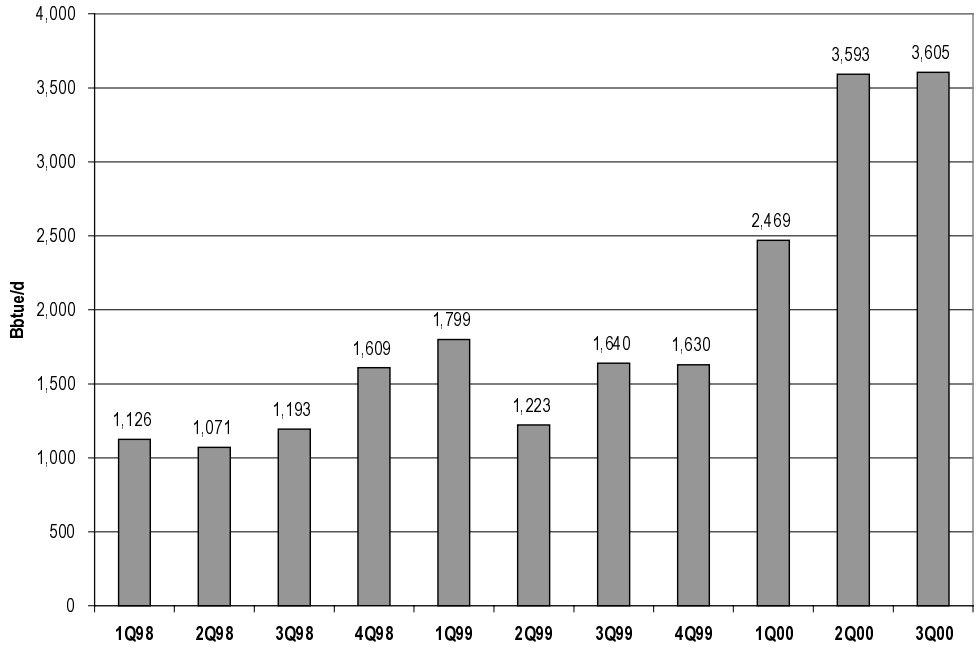
Overall, we expect Enron to make significant divestments in its international asset portfolio, with total asset sales projected to be $2-$4 billion over the next 12 months. In summary, we believe Enron has been extremely aggressive in its international strategy, building market knowledge and ultimately market control through a successful first-mover strategy. While these relationships often take several years (and often must overcome formidable regional/cultural/business obstacles) to build, as evidenced by the company's success in the U.K., we believe Enron is on the correct path in its pursuit of international markets.

Exhibit 41. Enron's Delivered Power Volume Growth — Europe and Other
(excluding U.S. and Canada)



Source: Enron Corp.

Exhibit 42. Enron's Delivered Gas Volume Growth — Europe and Other
(excluding U.S. and Canada)



Source: Enron Corp.

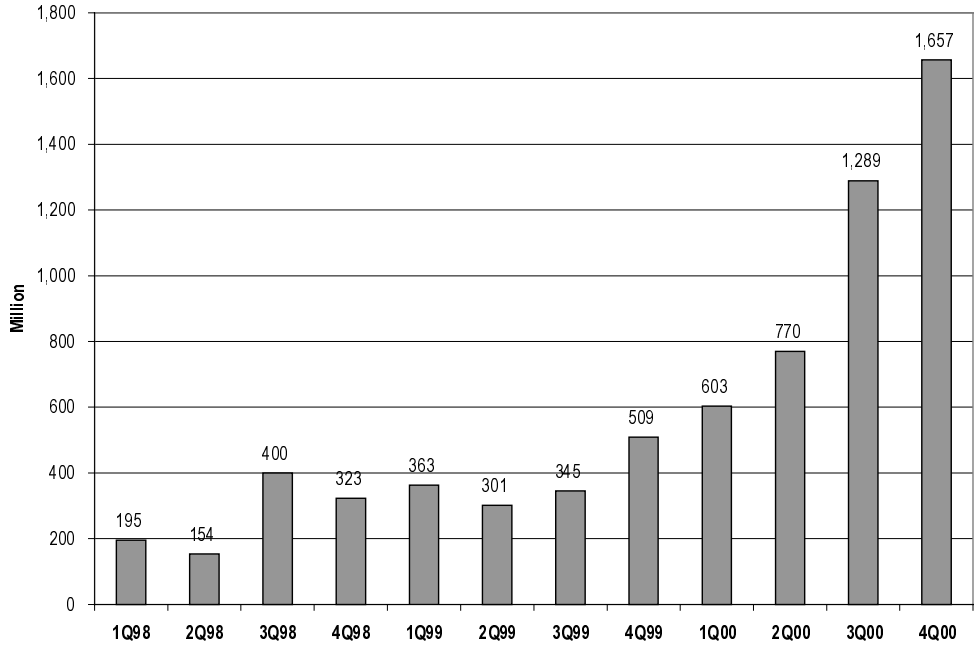
ENRON'S SOLUTION TO OTHER PEOPLE'S ENERGY PROBLEMS

Enron's Retail Energy Services (also referred to as Enron Energy Services) segment offers a variety of energy outsourcing products to commercial and light industrial customers throughout the world. Simply put, the core strategy of Enron Energy Services is to provide energy management services to companies that cannot or do not have the expertise to do it for themselves. Few companies have the knowledge and expertise to effectively manage their energy requirements and related financials. In addition, most do not possess the energy infrastructure and related equipment to manage energy strategically even if they do have the technical acumen required. Enron Energy Services offers solutions to these companies — helping them realize substantial savings and increases in efficiency through the optimization of electricity and natural gas purchases

We see Enron's competitive advantage as the manner in which it analyzes a firm and decides how to restructure its energy assets and infrastructure. Retail Energy Services actively manages the outsourcing company's commodity supply and corresponding commodity price risk. It also provides labor outsourcing for energy and facilitates management. Finally, Enron can provide its own capital and financing capabilities to structure and syndicate financial transactions. By thoroughly analyzing all aspects of a firm's energy value chain, Enron can accurately identify and alter inefficient segments. Overall, companies can use Energy Services to reduce energy expenditures and gain competitive advantages in the marketplace.

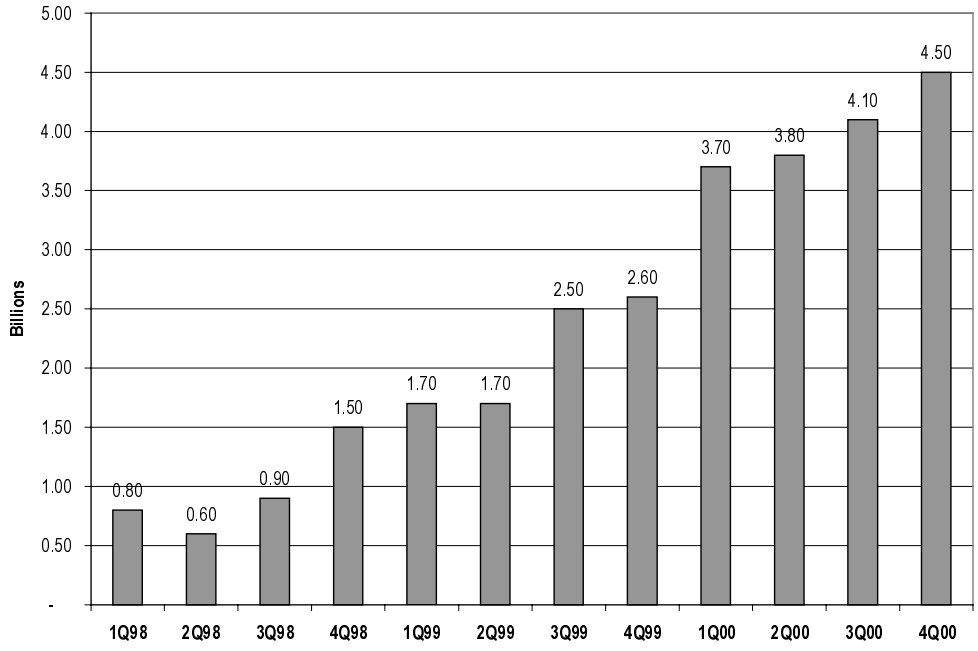
Enron's thorough analysis and financial restructuring techniques have allowed it to become the leader in the energy outsourcing market. Enron's Retail Energy Services segment has experienced record revenue growth for the past six quarters and positive earnings for the past five successive quarters. In addition, Retail Energy Services has experienced record quarterly contractual value for ten quarters and has exceeded its 2000 estimate of $16 billion in new contracts by posting $16.1 billion. Signing a record $4.5 billion worth of new contracts in fourth-quarter 2000, Retail Energy nearly doubled its full-year 1999 results of $8.5 billion.

Exhibit 43. Retail Energy: Surging Revenues Offer a Glimpse of the Future ($ in millions)



Source: Enron Corp.

Exhibit 44. Retail Energy: Total Contractual Value Since 1998 ($ in billions)

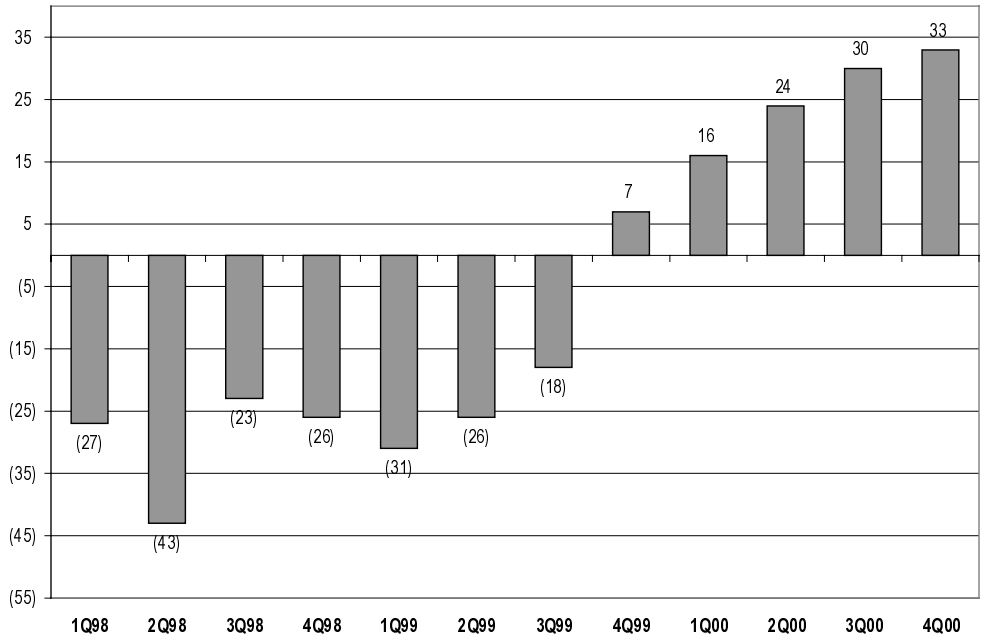


Source: Enron Corp.

As can be seen from the preceding exhibits, during 1999 Enron Energy Services entered into management contracts representing $8.5 billion of customers' future expenditures for natural gas, power, and energy services, more than double the $3.8 billion contracted in 1998. More significantly for this time period was that the 1999 IBIT loss of $68 million represents a tremendous improvement over the $119 million IBIT loss for 1998. This trend is continuing, with the segment recording positive IBIT for the past five quarters. What is most encouraging and vital for readers to

understand is that we view this success as only the beginning of sustained earnings for an indefinite period of time to come. Why? Because of Retail's inherently profitable business model. As an outsourcer or energy consultant to other businesses, Enron performs energy management through financial instruments and energy/facilities management. While this process may take some time and money (which Enron will earn back), depreciable assets are extremely low and the costs of operation are essentially fixed, regardless of the number of transactions. Therefore, as revenues increase and costs are kept nearly constant, Enron's income margin is free to grow at a tremendous rate.

Exhibit 45. Retail Energy: They Said It Would Start Making Money, and Now It Does (IBIT)
($ in millions)



Source: Enron Corp.

Significant Retail Energy Contracting Agreements

As can be expected, the revenue driver for Enron's Retail Energy Services segment is the growth rate of outsourcing contracts. Fourth-quarter 2000 was the tenth consecutive quarter of record new contracting activity. Contracting for the four quarters of 2000 ($3.7 billion, $3.8 billion, $4.1 billion, and $4.5 billion, respectively) represents increases of nearly 100% over same-period 1999 results. Following are details of some of the significant energy management contracts signed for in 2000:

- **February 2000.** Enron Energy Services agrees to a ten-year, $750 million energy management agreement with Chase Manhattan. As per the agreement, Enron will provide commodity management of approximately 30,000 annual utility invoices as well as overall project management for energy infrastructure upgrades.

- **March 2000.** An excellent example of Energy Services' ability to not only manage commodity supply but also *supply it itself* is the agreement with Ispat

Energy Ltd., where Enron will supply natural gas to Ispat's captive power plant currently under development in Maharashtra.

- **April 2000.** Enron Energy Services completes a ten-year, $610 million agreement with IBM. This agreement requires Enron to supply or procure electricity for numerous IBM facilities across the U.S., as well as to conduct price-risk management and produce a consolidated monthly invoice.

- **Also in April 2000.** Similar to the IBM deal, Enron completes a six-year, $210 million energy management agreement with Sonoco. This agreement requires Enron to provide or manage the electricity supply to Sonoco's facilities, as well as provide related energy management services, including consolidation of energy expenditures and assumption of energy price risk.

- **May 2000.** A ten-year energy management agreement is signed between Enron and Prudential that will require Enron to deliver and manage the supply of electricity and natural gas.

- **May 2000.** A ten-year, $1 billion agreement is struck between Enron Energy Services and Quebecor World, the world's largest commercial printer. Under this agreement, Enron will supply and/or manage electricity and natural gas at more than 60 Quebecor World facilities in the U.S. and identify, analyze, design, and implement energy infrastructure improvements.

- **September 2000.** Retail Energy signs a ten-year outsourcing agreement with Starwood Hotels, owner or operator of more than 400 properties within the U.S., for more than $1 billion. Through this agreement, Enron will provide energy price stability at Starwood's hotels by supplying and/or procuring electricity and natural gas; and managing the overall energy infrastructure through the implementation of various energy-related projects. As an example of why these services are sought after by business, Starwood expects this agreement to reduce its energy costs by approximately $200 million over the life of the contract.

- **October 2000.** Retail Energy announces a five-year energy-management agreement with Compaq Computer Corporation. This agreement requires Enron to supply natural gas and electricity while providing complete energy management services to numerous Compaq facilities throughout the country.

- **November 2000.** Retail Energy announces a ten-year energy management agreement with The Macerich Company (a self-administered real estate investment trust). Through this agreement, Enron will manage the supply of electricity and natural gas while providing related management services, including energy infrastructure upgrades for more than 40 wholly owned and joint venture properties.

In our opinion, the benefits companies can reap from an arrangement with Enron's Retail Energy segment are two-fold. These agreements free them from energy-related matters, allowing them to focus on their core competency. In addition, by contracting Enron, these companies can expect to enjoy significant cost decreases due to a more efficient energy process and infrastructure. As can be seen, the sheer

amount of these energy management contracts has increased dramatically over the past nine quarters — but how? While the steep rise in contracting is due in large part to the obvious advantages afforded by Retail Energy's services, we believe there is another reason for the continued success of Enron Energy Services, and Enron as a whole, as we explain below.

Teamwork and Innovation Make the Difference

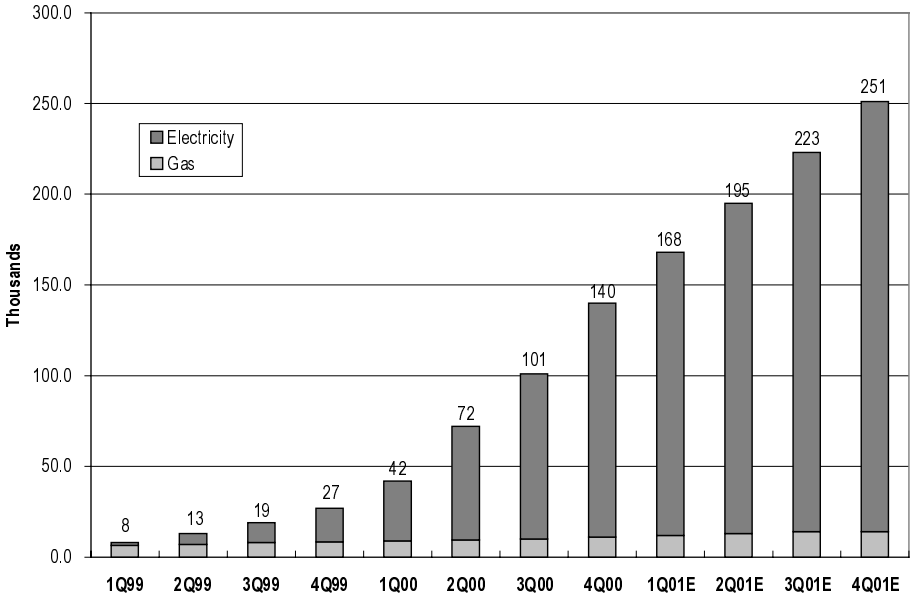
We believe that Enron's superior sales force is a key competitive advantage to the company. Ranked the No. 1 sales team in *Sales and Marketing Magazine* for 1999, Enron's group has demonstrated an ability to actively bring in customers from all types of businesses and deliver to them value-creating energy management contracts and services. In addition to these types of services and personal interactions, Enron is continually offering the retail market new products and services. These include the creation and compilation of retail electricity indexes and an interactive Web-based customer satisfaction and comment system. This online customer satisfaction system helps Enron determine how and where its operations can be improved and/or eliminated.

Recently, in an effort to bring its employees more into the online/broadband fold (not to mention to achieve some great PR), Enron announced that all of its employees will soon be issued a high-speed Dell computer with a broadband-capable Internet connection. While we realize that Enron undoubtedly has ulterior motives for this action (employees will now be able to work from home), this does appear to demonstrate a commitment by the company to stay one step ahead of its competitors while creating a flexible work environment. Enron has now been named by *Fortune Magazine* as one of "America's Most Innovative Companies" for five consecutive years, the No. 1 company for "quality of management," and the No. 2 company for "employee talent."

THE FUTURE OF ENRON RETAIL ENERGY SERVICES

As mentioned earlier, Enron Retail Energy Services surpassed its 2000 contracting goal of $16 billion. In addition, Retail Energy Services has been expanded into Europe, with future expansions set for the mature markets of Japan and South Korea. Concerning Europe, we are highly encouraged by the results of Enron Direct (U.K.), the online retail marketing division of Enron's European operations. Similar to Enron's domestic Retail Energy Services business model, Enron Direct is designed to provide cost savings to small- and mid-size industrial and commercial gas customers throughout the United Kingdom. We believe that this business model may soon be brought to the U.S., although at the moment there is no type of timeline for this to occur. Until then, we are confident that Enron Direct will continue its rapid rate of customer utilization throughout the United Kingdom.

Exhibit 46. Enron Direct (U.K.) — A High-Growth Business That May Soon Come to the U.S. (Customers)



Source: Enron Corp.

What is the potential market for the services that Retail Energy Services provides? In our opinion, it is virtually unlimited. All businesses are concerned with costs, particularly those that incur a disproportionate amount stemming from fuel, electricity, and overall energy prices, such as aluminum smelters, hotels and casinos, steel mills, and paper/pulp manufacturers. Given the aforementioned realization of fixed costs — and therefore increasing gross income — and the fact that the demand for this service is seemingly endless, we expect large, rapid increases in earnings (IBIT) over the next two to three years.

We are specifically looking for Retail Energy Services to have a breakout year in 2001. With the size of both the U.S. and European energy services market forecasted to be near $300 billion each, Enron expects executed contracts in 2000 to at least double the $16.1 billion posted in 2001 to approximately $32 billion. Following this 100% increase in revenues, Enron expects 2001 IBIT to also double to approximately $225 million. While this forecasted 100% increase of both revenue and IBIT is good news, we do not believe Retail Energy's IBIT should necessarily be directly correlated to revenues because of this business's inherently profitable business model. As an outsourcer or energy consultant to other businesses, Enron performs energy management through financial instruments and energy/facilities management. While this process may take time and money (which Enron will make back anyway), depreciable assets are extremely low and the costs of operation are essentially fixed, regardless of the number of transactions. Therefore, as revenues increase and costs are kept at a nearly constant level, Enron's income margin is free to grow at a faster rate. Overall, given the forecast for new energy contracts, we view a 2001 IBIT of $225 million for Retail Energy as a considerably conservative estimate.

THE FUTURE OF ENRON?

Of all of Enron's many core operations and business interests, Broadband Services is surely the most exciting and forward-looking. Enron Broadband Services is a leading provider of high-quality, high-bandwidth delivery and application services. The company's business model combines the power of the Enron Intelligent Network (EIN), Enron's Broadband Operating System (BOS), bandwidth trading and intermediation services, and high-bandwidth content applications to radically improve the functionality and experience of the Internet. This fiber-optic system is designed to make high-bandwidth content delivery — such as video and intensive data transfer — more efficient, cost effective, and convenient than before.

In our view, there are four elements to the Broadband Services segment that have been and will be the major determinants of Enron's continued success in this emerging industry:

- the complex fiber-optic network and embedded software intelligence systems,
- strategic partnerships and acquisitions of leading hardware producers and Internet service specialists,
- network system expansions, and
- first-mover competitive advantage.

Enron Broadband Services has two components, Bandwidth Intermediation and Content Delivery Services. These two businesses are dependent on and conducted over the Enron Intelligent Network, which uses the BOS as its primary software system.

- **Bandwidth Intermediation.** Bandwidth intermediation is simply the marketing and trading of bandwidth products to customers. Regardless of the type of bandwidth product (32 types are currently available), the marketing and trading of bandwidth will be accomplished on the same EnronOnline network that conducts trades in everything from natural gas to metals and paper. Once the trade component of a transaction is completed (again, this is completed over EnronOnline), it is Enron's responsibility to ensure prompt "delivery" of the purchased bandwidth product. This "delivery," or reservation of bandwidth time, is then conducted over the Enron Intelligent Network with the help of the hundreds of servers and pooling points that connect the planned 14,500 miles of fiber. During 2000, Enron completed 320 bandwidth transactions, with 236 transactions coming in the fourth quarter alone. Currently, there are only seven "city pairs" along which these transactions can be conducted, but this number is expected to increase in the near future.

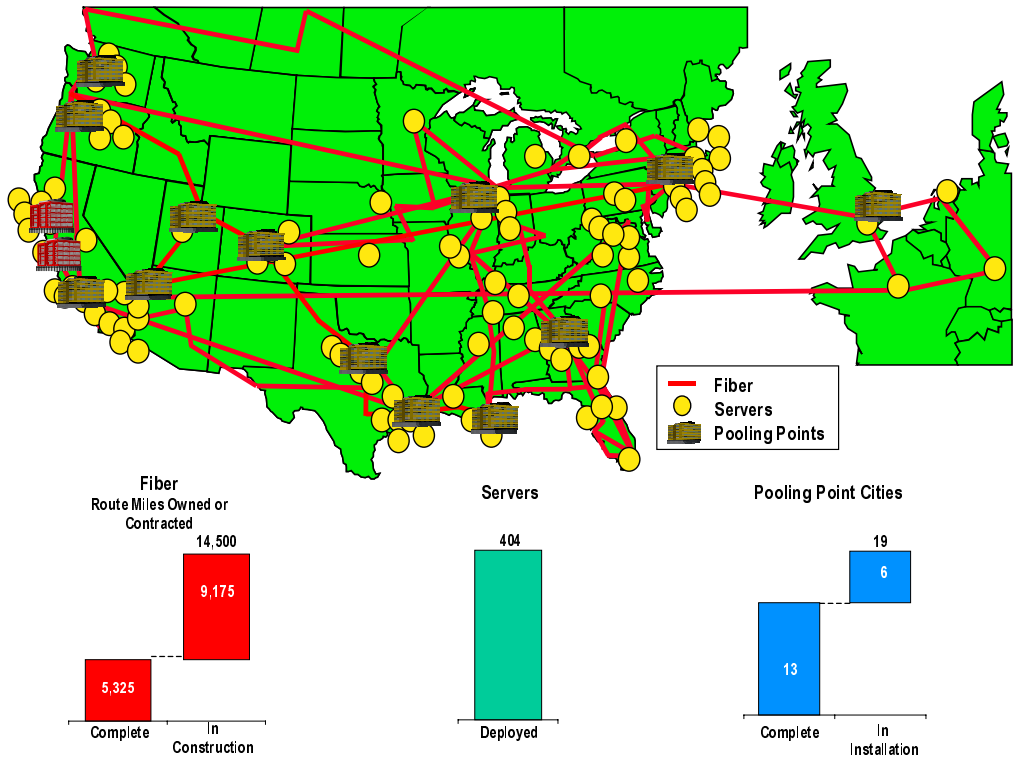
- **Content Delivery Services.** This is the second component of Broadband Services' business model. As stated earlier, this business is designed to allow for the delivery of intensive data and video to broadband customers via nationwide distribution partners (Verizon, Qwest, Covad, etc.). This type of content could

range from large volumes of written text to video games to full-length movies and video.

Powerful Systems and Networks Form the Base of Enron's Broadband Service

The Enron Intelligence Network (EIN) is based on a distributed server architecture, Enron's global fiber and satellite distribution, and the embedded software intelligence, called the Enron Broadband Operating System (BOS). The physical system that will facilitate this network is undergoing rapid expansion to keep up with customer demands, particularly in regard to transmission fiber, servers, and functional pooling cities. While more than 5,000 miles of transmission fiber have been laid to date, an additional 9,000-plus miles are contracted and under construction at this time. This network is substantially complete, as Enron completed 25 pooling points (exceeding the 2000 goal of 13) in the U.S. and Europe. Similarly, the number of sites serving as pooling cities will increase from a present total of four to 19 by 2001. This entire system is designed to bypass traditionally fragmented public Internet routes and deliver to customers faster, higher-quality data and video.

Exhibit 47. Enron Intelligent Network



Source: Enron Corp.

The Enron BOS allows real-time provisioning of bandwidth across numerous networks. This system includes intelligent technologies that provide a number of features including forward reservation and intermediation of bandwidth, real-time provisioning, dynamic content management, and data security. A particularly powerful component of the system is that it makes the Internet programmable — because of the built-in interfaces between the BOS and all the major physical elements of the network, such as routers and servers, and software elements such as

caching and reservation software. As the entire premise of the Enron system (EnronOnline) is to facilitate energy and commodities marketing and trade in real-time, the ability of the system to accomplish two-way data transfer and programmability is essential.

In addition, Enron's unique ability to conduct bandwidth intermediation — buying and selling this product on an *as-needed basis* — offers customers the opportunity to dramatically reduce costs through an increase in utilization efficiency and current price matching. As described earlier, Enron is in the early stages of building an all-encompassing merchant trading operation. With more than 1,400 products already offered on-line and triple-digit annual market growth expected over the next three to four years, we expect that Enron's competitive advantage in technological service will serve as the key to increased earnings and market share.

Strategic Partners and Acquisitions Increase the System's Capabilities

Since the inception of Enron Broadband Services, the business has continually sought out partners in the technology industry in an effort to improve the online experience for its customers and to protect and increase the future viability of the business model. These strategic partnerships and alliances have not only increased the technological prowess of Broadband Services but also given credibility and respect to a heretofore-untested industry model. During the first three months of operation, November 1999 to January 2000, Enron Broadband Services entered into strategic alliances with industry giants Lucent Technologies, Cisco Systems, Inktomi, and Sun Microsystems in an effort to form a solid base for future operations.

Early Agreements . . .

The Inktomi agreement, finalized in early November 1999, provided the means for the Inktomi Traffic Server cache platform to be integrated into the Enron Intelligent Network. This caching software increases Enron Broadband Services' ability to seamlessly and selectively push content to the desktop while handling massive volumes of high-bit-rate network traffic in a scalable manner. This combined system would assist in providing the "bread-and-butter" of the Enron Intelligent Network: high bandwidth content, including video and intensive data transfer.

In late January 2000, Enron Broadband Services entered into an agreement with Sun Microsystems intended to accelerate adoption of broadband Internet services. While the Inktomi agreement sought to increase the capabilities of the Enron Intelligent Network, the agreement with Sun seeks to both expand the physical size of the broadband infrastructure and to jointly market Enron Intelligent Network services to enterprises, software developers, and service providers.

The build-out of Enron's existing broadband footprint — specifically the EIN, which is based on fiber, servers, pooling points, and Enron's BOS — involves the purchasing of 18,000 carrier-grade servers and associated storage (pooling points) and services from Sun. These purchases will be used to expand Enron's presence to more than 2,000 points worldwide. The carrier-grade servers in question are specifically designed for easy deployment in network environments that require

continuous application availability, assisting in achieving Enron's goal of meeting broadband applications at guaranteed service levels.

These four early strategic partnerships are clear examples of Enron's intent to strengthen and broaden the system that it sees as the greatest source of potential growth: the online workplace. Given the significant first-mover advantage that Enron already has in the merchant energy and broadband segments, we believe that that these technological agreements and enhancements will continue to keep the company ahead of the competition for the next few years.

. . . Agreements in 2000 and Beyond

The numerous strategic partnership agreements made by Enron Broadband Services in 2000 all share the theme of network-system enhancement for the purpose of increasing and enriching consumers' online experience. Before we go into specific deals and the benefits stemming from each, we think it is important to explain why we feel Enron Broadband Services is uniquely positioned to be the leader in all of the services it currently provides. Although we have only scratched the surface with regard to the numerous products and services provided by Enron, we believe the company is strategically positioned to handle the impending convergence of past-generation television broadcasting technology with the next-generation technology of the Internet. The following agreements and strategic alliances, forged in 2000, represent the first steps into this new media arena, and while this new "industry" holds numerous potential risks, we see it as an endeavor that holds boundless potential.

- **March 2000.** Enron Broadband Services enters into an agreement with i2 Technologies designed to improve the efficiency of business-to-business (B2B) e-commerce network communications. Specifically, i2 will offer its TradeMatrix™ Solutions system over Enron's bandwidth network, allowing customers to work more efficiently by bypassing the congestion of the traditional Internet. Overall, this system gives the customers of i2 the opportunity to use a high-bandwidth Internet system at a lower cost and with progressive pay-as-you-go service rates. With the inherent capabilities of the Broadband Operating System (real-time capacity increases and reserving times for bandwidth usage in anticipation of application needs), this agreement provides TradeMatrix™ users with a consistent level of service regardless of overall network traffic. What B2B customer wouldn't want this type of service?

- **April 2000.** Enron Broadband Services' landmark agreement with Compaq is the first real network-system improvement that would be detectable to the millions of American computer owners. This strategic alliance enables Microsoft Windows Media solutions over Enron's fiber-optic high-bandwidth network. With Enron's significant high-bandwidth delivery capabilities and Compaq's status as the largest supplier of personal and business computers in the world, this deal is designed to enhance the Internet experience for all users through enhanced quality of live streaming video and reliability of the network during high-volume periods. These video streaming and reliability broadband transmissions can be anything from movies and live television feeds, to distance learning, health care, and multimedia centers. In addition, Enron and Compaq plan to work together to

implement Microsoft Windows 2000 internally as well as in product development for future product iterations. These two organizations will collaborate on the development of strategy and best practices for large-scale, high-volume Windows Media applications and deployments for service providers and enterprise customers.

- **April 2000.** Similar to the Compaq alliance, Enron Broadband Services enters into an agreement with BellSouth to enable BellSouth Internet users to receive broadband content available on the Enron Intelligent Network. As with the Compaq deal, the agreement is designed to allow for two things: transmission of high-bit-rate transmissions, including live streaming video and audio to BellSouth customers, and premium speeds that avoid the overcrowded public Internet networks.

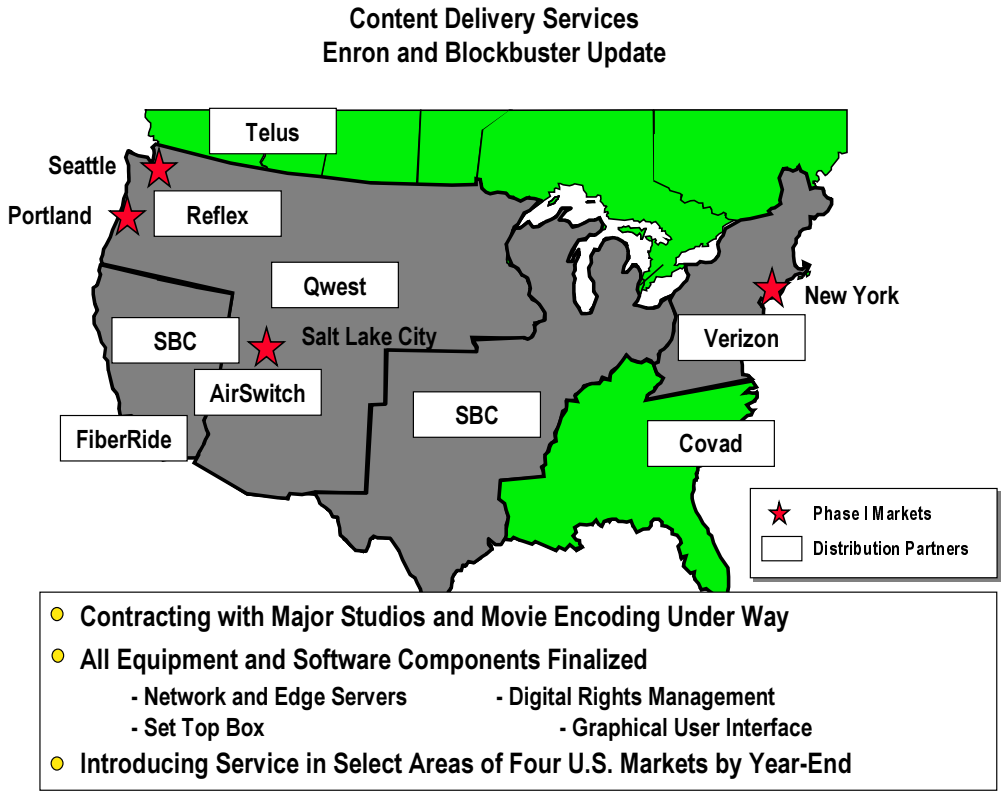
- **May 2000.** Enron Broadband Services' acquisition of WarpSpeed Communications in May 2000 further enhances the performance of the network system. The incorporation of WarpSpeed's MetaRouter™ software into the Broadband Operating System increases the speed and efficiency of switching between broadband networks and controlling the routing of data over networks. This capability allows for real-time bandwidth trading in scalable increments, and for dynamically adjusting the underlying bandwidth capacity to support broadband content delivery. The MetaRouter™ system sends signals throughout distributed networks to determine the optimal connectivity paths for any size bandwidth capacity from anywhere in the world. Capable of processing thousands of connections per second, MetaRouter™ significantly enhances Enron's ability to automate circuit provisioning. At full scale, this new application can manage up to 10,000 connection requests per minute. Perhaps the most significant element to the WarpSpeed technology is that it is fully scalable and can be applied to any type of hardware, which allows Enron Broadband Services to continuously adapt to new products in the market. This ability to match the current state of technical innovation should result in Enron staying ahead of industry competitors.

Finally, we come to the most recent and widely covered event of the past 12 months — the 20-year, exclusive agreement between Enron and Blockbuster to launch an entertainment-on-demand (most notably on-demand movies) service via the Enron Intelligent Network. Forged on December 18, 2000, this agreement — with a potential $1 billion contractual value — allows customers, basically anyone with a television, to order movies from Blockbuster's extensive movie library and watch the streamed movie at home while enjoying VCR-type control. This system is expected to be expanded to include games and associated Internet services, with both accessible through customers' televisions or personal computers. Due to many of the aforementioned strategic agreements and system enhancements, Enron's network system is already capable of allowing the scalability necessary to deliver secure, high-bandwidth content to millions of users simultaneously. Without these many improvements, this type of deal would have been all but impossible, especially given the video quality demands of paying customers. Enron and Blockbuster announced on December 18, 2000, that this revolutionary service had commenced operations, providing on-demand entertainment to pre-selected, broadband connected customers in Seattle, Portland, Salt Lake City, and New York City. Enron intends to use this

four-city service as a trial run of the eventual nationwide system, giving the company and its distribution partners time to work out kinks in the system.

In our view, this agreement represents a tremendous opportunity for two companies that are giants in their respective industries to create for themselves a major competitive advantage in an emerging industry that has few competitors at the present time. With Blockbuster's extensive customer base and content — 65 million households worldwide — and Enron's network delivery application and system capabilities of the distribution providers (SBC, Verizon, Qwest, Covad, Telus, and Reflex), this agreement brings together for the first time a global network system and an established bricks-and-mortar business that can effectively deliver quality, on-demand entertainment. With no other company in a position to match this capability, we believe that Enron is uniquely positioned to increase earnings and market share for a significant time period. The following exhibit displays the areas of the U.S. in which the aforementioned distribution partners provide services. Through this distribution network, Enron is positioned to have so-called "last-mile" broadband connectivity to more than 80% of the U.S. DSL market.

Exhibit 48. North American Broadband Distribution Partners



Source: Enron Corp.

System Expansions Increase Enron's Online Possibilities Across an Even Greater Scale

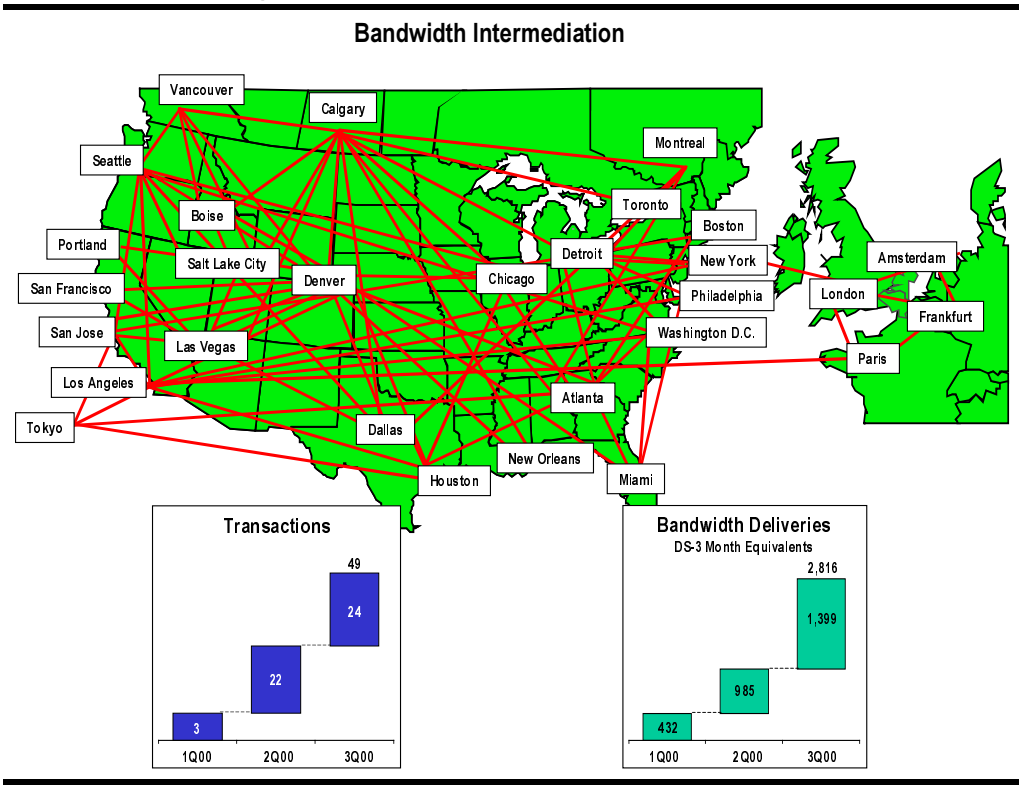
While the system enhancements and strategic agreements already mentioned improve the quality, speed, and reliability of Enron's online network, it takes physical expansion into new regions to attain the type of scale that Enron desires. Over the

past 12 months, there have been several significant system expansions (apart from expected domestic expansion) outside of the Continental United States.

- First was Enron's expansion into Canada through an agreement with BCE Nexxia, a subsidiary of Bell Canada. Under this agreement, Enron and BCE Nexxia will extend Enron's Intelligent Network across Canada, reaching the six largest population centers, which hold more than 70% of Canada's population. This expansion will provide all of the high-speed, high-bit content available on-line in the U.S. to the Canadian public.

- Enron's global reach was further increased following the mid-June 2000 announcement that Enron Broadband Services had expanded to Europe. Europeans will now be offered the same type of high-bandwidth content that U.S. customers have. Enron also now provides bandwidth products and services to wholesale and enterprise customers in the region. As part of the company's plan to create a bandwidth trading market in Europe (as in America), Enron has installed and is testing a pooling plant in London to facilitate bandwidth trading between the U.S. and Europe. These pooling points provide the interconnectivity between bandwidth trading principals. Future pooling points have already been designated for Amsterdam, Frankfurt, and Paris.

Exhibit 49. Enron's European and Domestic Broadband Presence



Source: Enron Corp.

As shown here, Enron intends to expand its established British and Western European broadband operations to points throughout the Iberian Peninsula and Scandinavia. As in the U.S., Enron has signed contracts with major European Broadband distribution partners such as cerbernet and Liberty Surf, allowing for expansion of its scope of operations.

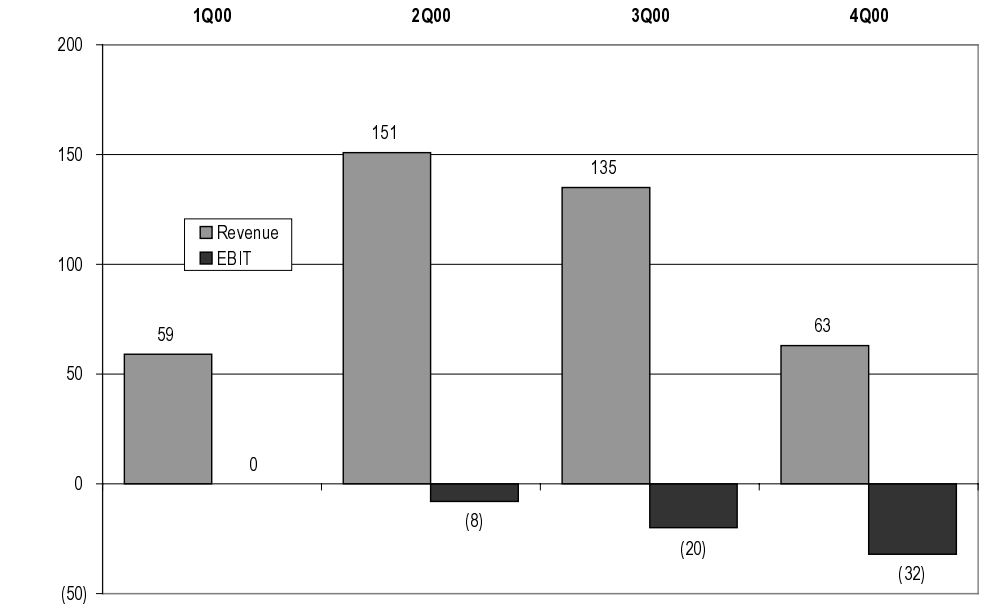
Firms That Plan Ahead and Move into New Markets First Reap the Financial Rewards

Perhaps Enron's greatest strength in the coming years is the fact that it has already existed for several years. Given that the broadband delivery market and the online merchant trading business are expected to demonstrate triple-digit growth over the next several years, and mindful, as well, of Enron's established base of technology and strategic partnerships, exclusive marketing contracts, and global reach, we believe that Enron commands a enormous competitive advantage over any and all competitors. We believe that even if rivals acquire a portion of the global scale and technological know-how necessary to compete, they will be ill-equipped to compete in a market where customers already equate performance and innovation with Enron.

While Difficult to Quantify, Here Is Our Take on the Future of Broadband Services

So far, Enron's Broadband Services has experienced the typical start-up pattern: high revenues, even higher development and construction costs, and negative earnings.

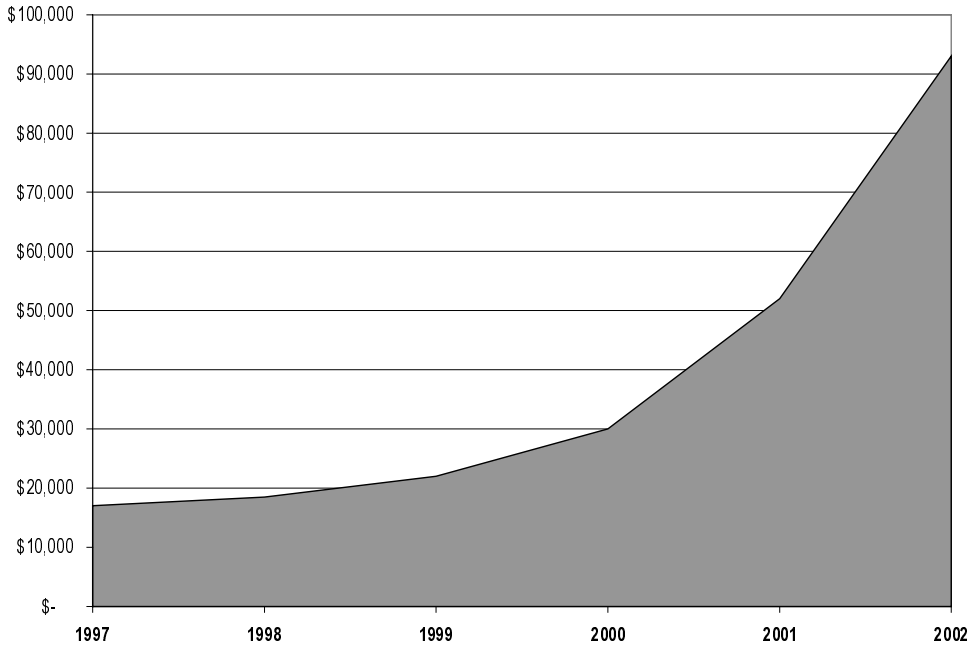
Exhibit 50. Broadband Services. Start-Up Losses Now . . . Exponential Gains Later ($ in millions)



Source: Enron Corp.

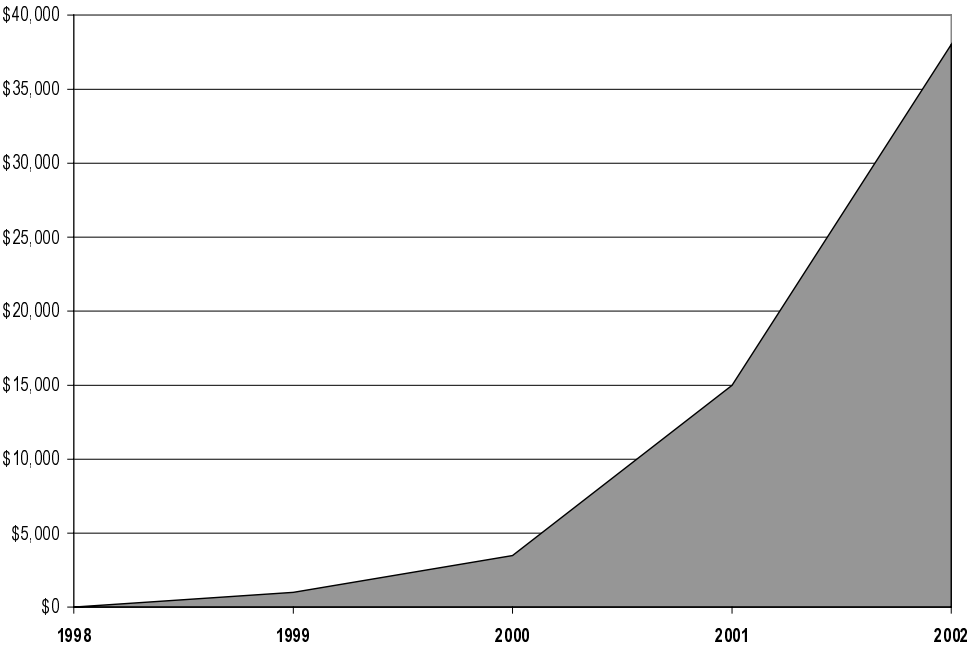
By nearly all accounts (except for the very brave or the very ignorant), there is virtually no definitive, much less consensus, view on the future growth of broadband technologies. We all hear tidbits on how broadband will be used in every household and business by some targeted date, but as the business is so new and the technology is expanding constantly, we believe there is no way to definitely forecast the growth of this new "product." This section will instead focus on several of the main drivers (stated from several different sources) behind the proliferation of broadband and attempt to derive a general direction for its growth.

Exhibit 51. Estimated Total Broadband Services Market ($ in millions)



Source: Epoch Partners.

Exhibit 52. Estimated Total Broadband Solutions Market ($ in millions)



Source: Epoch Partners.

The preceding exhibits, prepared by Epoch Partners, demonstrate their estimates that the total market opportunity for broadband services is approximately $22 billion today, growing to more than $400 billion by 2005 — a growth rate of 60%-plus per year for the next five years. As can be expected, the principal driver of growth in demand for bandwidth is the burgeoning growth of data and Internet traffic. Simply stated, Bear Stearns believes that growth in Internet subscribers x growth in time spent on-line x growth in demand for higher bandwidth connections = exponential

growth in demand for the underlying Internet infrastructure on a global basis. For example, the number of U.S. Internet users grew from 68.9 million in 1999 to 101.5 million in 2000 and is expected to reach nearly 180 million by 2003. Correspondingly, the average time spent on the Internet compounds as the number of users increases — shown by the average hours spent on-line per Internet user increasing from 12 hours per month in 1999 to 19 hours per month in 2000. Based on these projections (and others not detailed here), Bear Stearns expects the number of broadband connections to increase from a present sum of 6.8 million to more than 21 million by 2003. While not exact, Bear Stearns' estimates roughly correspond with the forecasts set forth by Epoch.

While these analyses do not answer many of the basic questions we are asking, they do point us in a general direction — that of tremendous growth in the broadband industry. However, how this translates back into revenue and earnings opportunities for Enron, and ultimately how this adds value to Enron shareholders today, is an extremely difficult/uncertain exercise at this point in time. For purposes of our analysis, we have taken an initially conservative approach (in our opinion) toward placing a present value on this portion of Enron's business. While we regard the business opportunity for Enron as enormous, there are substantial risks involved as the pay-off from the substantial capital investment required is still several years away. Within our valuation of Enron and our $98 per share 12-month price target, the component value of Enron Broadband Services is approximately $4.00 per share. The following exhibit highlights our DCF-based valuation for Enron Broadband Services.

Exhibit 53. Broadband Services — A Future Giant Later But a Low Valuation Now

	1Q00	2Q00	3Q00	4Q00E	2000E	2001E	2002E	2003E	2004E	2005E		
Operating Income (IBIT)	0	(8)	(20)	(32)	(60)	(65)	50	100	200	400		
Depreciation	3	8	52	100	163	196	235	282	338	406	Est. Growth	20%
IBITDA	3	0	32	68	103	131	285	382	538	806		

Discounted Cash Flow: Broadband Services

	1Q00	2Q00	3Q00	4Q00E	2000E	2001E	2002E	2003E	2004E	2005E		
IBITDA	3	0	32	68	103	131	285	382	538	806		
Less Depreciation & Amortization	3	8	52	100	163	196	235	282	338	406		
IBIT	0	(8)	(20)	(32)	(60)	(65)	50	100	200	400		
Provision for Income Taxes	0	(2)	(4)	(6)	(12)	(13)	10	20	40	80	Est. Tax Rate	20%
Unlevered Net Income	0	(10)	(24)	(38)	(72)	(78)	40	80	160	320		
Add Back Depreciation & Amortization	3	8	52	100	163	196	235	282	338	406		
Less Capital Expenditures	71	219	300	300	890	979	1,077	1,185	1,303	1,433	Est. Growth	10%
Less Changes to Working Capital	0	0	0	0	0	0	0	0	0	0		
Free Cash Flow to Debt & Equity	(68)	(221)	(272)	(238)	(799)	(861)	(802)	(823)	(805)	(708)		
Terminal IBITDA Present Value										6,475		
Discount Rate (WACC)										20.00%		
Terminal Growth Rate										10%		
Present Value of Cash Flows					(799)	(718)	(557)	(476)	(388)	(284)		
Terminal IBITDA Multiple										20		

IBITDA Multiple Method

Present Value of Explicit Cash Flows	(3,223)
Present Value of Terminal Value	6,475
Enterprise Value	3,252
Equity Value	3,252
Shares Outstanding	869.6
Per Share Value	$ 3.74

Sensitivity Analysis

I - High Growth Scenario	2001	2002	2003	2004	2005		
IBIT	50	150	300	500	750	PV of Cash Flows	(1,604)
IBITDA	246	385	582	838	1,156	PV of Terminal Value	6,028
Less: Provisions	(773)	(812)	(843)	(865)	(878)	Equity Value	$4,424
Free Cash Flow	(723)	(662)	(543)	(365)	(128)	Per Share Value	$5.09

II - Hyper Growth Scenario	2001	2002	2003	2004	2005		
IBIT	50	200	400	800	1,200	PV of Cash Flows	(1,103)
IBITDA	246	435	682	1,138	1,606	PV of Terminal Value	9,645
Less: Provisions	(773)	(802)	(823)	(805)	(788)	Equity Value	$8,543
Free Cash Flow	(723)	(602)	(423)	(5)	412	Per Share Value	$9.82

Source: Bear, Stearns & Co. Inc.

In summary, while we are inclined to see tremendous future value in the broadband market (and Enron's presence in it), we must recognize that, for now, it yields only a small per-share valuation even after applying generous future growth rates and assumptions. A year from now — after examining such things as Enron's performance in its Blockbuster agreement and its overall broadband operations — we may be inclined to radically change our valuation upward, but for now we will err on the side of caution. With a general downturn in the economy looming, we see the possibility of reduced technological capital expenditures across all lines of industry. In addition, the broadband industry has not fared well during the past year, lagging even the decimated Nasdaq composite index. Given all of these factors, we are inclined to see enormous value in Enron's Broadband Services, but we are not ready to apply a generous valuation for it given its lack of earnings and general lack of historical guidance.

Enron's Transportation and Distribution Group

THE BACKBONE OF THE COMPANY

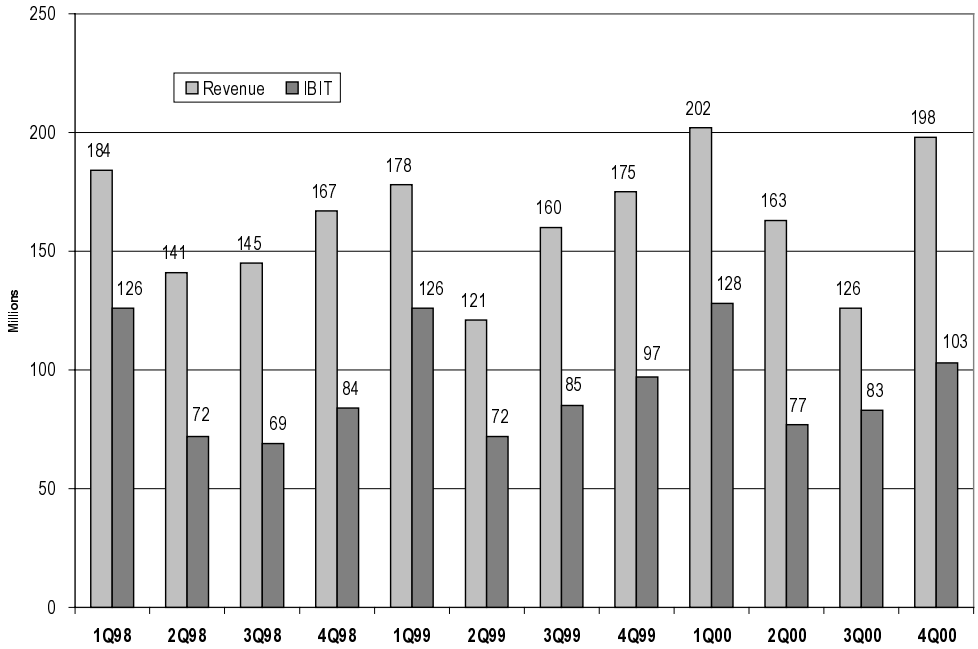
Enron's Transportation and Distribution Group consists of two primary businesses, The Transportation Services Group (Gas Pipeline) and Portland General Electric. The Transportation Services Group includes Enron's interstate natural gas pipelines, primarily Northern Natural Gas Company (Northern), Transwestern Pipeline Company (Transwestern), its 50% interest in Florida Gas Transmission Company (Florida Gas), and its interests in Northern Border Pipeline and EOTT Energy, L.P. Enron entered into an agreement to sell Portland General Electric in late 1999 and is expected to close the transaction before mid-2001. As stated earlier, the sale of this company stems from Enron's strategic commitment to divest those assets that it feels no longer bring maximum value, thereby freeing up capital for more profitable projects and investments. Specifically, since the purchase of Portland General Electric in 1997, the merchant energy services industry has increased substantially in this region and Enron believes it can now achieve greater levels of profitability without owning a regulated electric utility.

TRANSPORTATION SERVICES GROUP

Enron's Most Consistent and Stable Earnings Producer

The Transportation and Distribution Group is a consistent and stable earnings producer for Enron. The company owns or has interests in approximately 32,000 miles of pipeline in 21 states and transports approximately 15% of all U.S. natural gas. During 1999, Transportation and Distribution generated $634 million in revenues versus $637 million in 1998, a 1% decrease. During this same time period, the Transportation Services Group's reported IBIT of $380 million represented an 8% increase over the $351 million reported in 1998. During 2000, the Transportation and Distribution Group saw its IBIT increase nearly 7% over 1999 results, recording $732 million in earnings. Split roughly equally between Gas Pipeline Group and Portland General, earnings in 2000 followed the typical annual cycle of high levels during the first quarter and lower, but steadily increasing, levels throughout the rest of the year. Since we expect Portland General Electric to be sold in 2001, the following exhibit details the top- and bottom-line performance for the Gas Pipeline business only.

Exhibit 54. Transportation Services: Revenue Versus IBIT, 1Q98–4Q00



Source: Enron Corp.

Overall, we see long-term potential in the Transportation Services Group because of the nation's increasing reliance on natural gas for power generation. As stated earlier in this report, we believe gas prices will continue to be high through 2001, opening the door to increased revenues. In addition, long-term domestic gas consumption is expected to increase from the current 21.4 Tcf/year to 25-30 Tcf/year by 2010, depending on the source of information. As mentioned earlier, Bear Stearns leans towards the lower of the 2010 figures because we estimate that no matter how high the demand for natural gas becomes (say 30 Tcf/year), there is not enough infrastructure and/or production assets currently in place to supply this level of consumption.

THE PIPELINE SYSTEM

Northern Natural Gas is Enron's largest pipeline system, with 16,500 miles of pipeline running from Texas to the Great Lakes, serving approximately 90 utility customers and end-users in the upper Midwestern United States. Overall, market capacity has increased by 10% from 1995 to the present daily average of 3.8 Bcf/d. The majority of Northern's revenues are comprised of monthly demand charges that are based on contracted capacity rather than throughput. In addition to the pipeline system, Northern operates three natural gas storage facilities and two LNG storage peaking units. These storage facilities provide Northern with the operational capacity to balance its system on a daily basis and assist in meeting customers' heating season system requirements. Throughout 2000, revenues and total gas transportation rates have been slightly below but have basically followed the annual pattern of winter peaks and third-quarter lows.

Transwestern is a 2,487-mile, bi-directional, interstate pipeline system serving an area between Texas and California. It currently has a daily delivery capacity of 1.5 Bcf/d. A significant benefit of the bi-directional flow is that it increases system flexibility and utilization as a result of any potential oversupply of pipeline capacity

to California. Transwestern is strategically situated where it has access to three large gas basins for its gas supply: the San Juan Basin, the Permian Basin in Western Texas, and the Anadarko Basin in the Texas and Oklahoma panhandles. Currently, all of Transwestern's customers have agreed to set contract rates through 2006. While natural gas transportation volumes have consistently increased over the past four quarters, Transwestern's revenues have been virtually flat for the past three years.

The third part of Enron's pipeline system is Florida Gas. Through a subsidiary, Enron owns a 50% equity stake in the Florida Gas Transmission Company. The Florida Transportation Services system consists of an approximately 4,800-mile pipeline connecting South Texas to a point near Miami, Florida. Florida Gas is of particular importance because it is the only interstate natural Transportation Services serving the Florida peninsula — the fastest-growing power generation market in North America. In addition, this system is strategically located near the Gulf of Mexico supply region, and with its connections to other interstate pipeline systems, Florida Gas can access virtually every producing region in the United States.

To meet the expected demand increase along the Florida peninsula, Florida Gas has undertaken two major expansion projects that will add more than 600 MMcf/d of capacity. These projects are expected to come on-line sometime in mid-2001 or early 2002. For these reasons, we view the Florida Gas Transmission Company as a key revenue driver for the Transportation and Distribution segment. Much like the Transwestern system, revenues have been flat for nearly three years, during which the average transportation volume has shown steady increases.

Northern Border Partners L.P. owns a 70% interest in the Northern Border Pipeline Company. An Enron subsidiary holds a 12.4% interest in the limited partnership and serves as the chief operator of the pipeline. The Northern Border Pipeline runs from the U.S./Canadian border in Montana to Illinois, transporting approximately 23% of all Canadian gas imports to the United States. This 1,214-mile pipeline averages a daily delivery rate of approximately 2.4 Bcf/d. The system is strategically interconnected to transport significant quantities of natural gas, including synthetic gas from a small North Dakota Gasification plant, to markets throughout the United States. Reported revenues and transportation volumes have stayed relatively stable for the past 11 quarters.

On January 11, 2001, Enron announced that it reached an agreement to sell its Houston Pipeline Co. (HPL) to American Electric Power for an undisclosed amount. This intrastate (Texas) pipeline system had been an interconnection between Enron's larger interstate gas transmission systems. Included in this sale were 4,400 miles of pipeline (2.4 Bcf/d throughput) and a gas storage facility (118 Bcf). This deal is expected to close sometime in second-quarter 2001.

Companies mentioned:

Allegheny Energy (AYE-45)
American Electric Power§ (AEP-43)
Avista Corp. (AVA-17)
Azurix Corp. (AZX-8$^{15}/_{16}$)
Bell Canada (BCICF-20)
BellSouth Corp.§ (BLS-40)
Blockbuster Inc.§ (BBI-11)
BP Amoco (BP-51)
Cisco Systems (CSCO-43)
Citigroup§ (C-56)
Compaq Computer (CPQ-22)
Conoco Inc. (COCA-27)
Constellation Energy (CEG-41)
Covad Comms. Gp.§ (COVD-3$^{1}/_{8}$)
Dell Computer (DELL-27)
Duke Energy§ (DUK-75)
Dynegy Inc. (DYN-50)
El Paso Energy Corp. (EPG-62)
Entergy Corp.§ (ETR-37)
EOTT Energy Partners (EOT-15)
Exxon Mobil (XOM-82)
General Electric Co. (GE-46)
IBM Corp.§ (IBM-110)
Inktomi Corp. (INKT-19)
Intel Corp. (INTC-36)
i2 Technologies (ITWO-60)
J.P. Morgan Chase§ (JPM-53)
Lucent Technologies§ (LU-20)
Macerich Co. (MAC-21)
Microsoft Corp. (MSFT-63)
National Fuel Gas Co.§ (NFG-55)
Northern Border Partners (NBP-34)
Nokia Corp. (NOK-38)
Oneok, Inc. (OKE-47)
PG&E Corp.§ (PCG-9$^{15}/_{16}$)
Portland General Electric (PGB-25)
Quebecor World. (IQW-24)
Qwest Communications (Q-47)
Reliant Energy (REI-36)
SBC Communications (SBC-47)
Sempra Energy (SRE-20)
Sierra Pacific Resources§ (SRP-15)
Sonoco Products Co. (SON-23)
Starwood Hotels & Resorts§ (HOT-38)
Sun Microsystems, Inc. (SUNW-33)
Sunoco, Inc. (SUN-30)
Telus Corp. (TU-25)
Texaco Inc. (TX-59)
TransCanada Pipelines (TRP-11)
TXU Corp. (TXU-38)
Verizon Comms.§ (VZ-52)
Williams Cos. (WMB-39)

§ Within the past three years, Bear, Stearns & Co. Inc. or one of its affiliates was the manager (co-manager) of a public offering of securities of this company and/or has performed, or is performing, other banking services, including acting as financial advisor, for which it has received a fee.

Exhibit 55. Enron Corp. — Income Statement ($ in millions, except per share data)

	1998	1999	2000	2001E	2002E	2003E	2004E	2005E
Revenues								
Transportation & Distribution	1,833	2,013	2,955	1,406	720	735	749	764
Gas Pipeline Group	637	634	699	706	720	735	749	764
Portland General	1,196	1,379	2,256	700	0	0	0	0
Wholesale Energy Operations & Services	27,220	35,501	94,906	106,295	119,582	137,519	154,709	170,180
Retail Energy Services	1,072	1,518	4,615	6,000	7,499	9,374	11,718	14,061
Broadband Services	0	0	408	530	1,225	2,205	3,308	4,631
Exploration & Production	750	429	0	0	0	0	0	0
Corporate & Other	385	651	(2,095)	(2,499)	(2,999)	(3,599)	(4,318)	(5,182)
Total Revenues	31,260	40,112	100,789	111,731	126,027	146,234	166,165	184,454
Operating Costs and Expenses								
Cost of Gas, Electricity and Other Products	26,381	34,761	94,288	102,927	116,096	134,711	153,071	169,919
Operating Expenses	2,352	2,996	3,444	4,795	5,385	6,324	7,320	8,096
Costs & Operating Expenses	28,733	37,757	97,732	107,722	121,482	141,034	160,392	178,014
Gross Profit	2,527	2,355	3,057	4,010	4,546	5,200	5,773	6,439
Depreciation, Depletion, and Amortization	827	870	885	1,575	1,825	2,075	2,250	2,550
Total Expenses	29,882	39,310	98,872	109,497	123,507	143,309	162,842	180,764
Total Operating Profit (Loss)	1,378	802	1,917	2,235	2,521	2,925	3,323	3,689
Other Income and Deductions								
Total Other Income & Deductions	204	1,193	829	787	1125	1534	2279	3369
Operating Income Before Interest, Minority Interests, and Income Taxes (IBIT)								
Transportation & Distribution	637	685	732	505	425	446	468	492
Gas Pipeline Group	351	380	391	405	425	446	468	492
Portland General	286	305	341	100	0	0	0	0
Wholesale Energy Operations & Services	968	1,317	2,260	2,712	3,254	3,905	4,491	5,165
Retail Energy Services	(119)	(68)	103	225	416	708	1,168	1,751
Broadband Services	0	0	(60)	(65)	50	100	200	400
Exploration & Production	128	65	0	0	0	0	0	0
Corporate & Other	7	(17)	(289)	(355)	(500)	(700)	(725)	(750)
Total IBIT	**1,582**	**1,995**	**2,746**	**3,022**	**3,646**	**4,459**	**5,602**	**7,058**
IBIT Margin	5.1%	5.0%	2.7%	2.7%	2.9%	3.0%	3.4%	3.8%
IBITDA	**2,409**	**2,865**	**3,631**	**4,597**	**5,471**	**6,534**	**7,852**	**9,608**
IBITDA Margin	7.7%	7.1%	3.6%	4.1%	4.3%	4.5%	4.7%	5.2%
Interest and Related Charges, Net	550	656	838	785	765	745	700	675
Dividends on Preferred Securities of Subsidiaries	77	76	77	80	90	125	80	80
Minority Interests	77	135	154	110	150	100	100	100
IBT	878	1,128	1,677	2,047	2,641	3,489	4,722	6,203
Pretax margin	2.8%	2.8%	1.7%	1.8%	2.1%	2.4%	2.8%	3.4%
Income Tax Expense (Benefit)	175	104	411	409	528	698	944	1,241
Tax Rate	19.9%	9.2%	25%	20%	20%	20%	20%	20%
NI Before Accounting Changes	703	1,024	1,266	1,637	2,112	2,791	3,778	4,962
Accounting Changes, Net of Tax	0	(131)	0	0	0	0	0	0
Net Income	**703**	**893**	**1,266**	**1,637**	**2,112**	**2,791**	**3,778**	**4,962**
Preferred Stock Dividends	17	66	83	80	80	80	80	80
Earnings on Common Stock	**686**	**827**	**1,183**	**1,557**	**2,032**	**2,711**	**3,698**	**4,882**
Earnings per Share of Common Stock								
Diluted								
Diluted EPS Before Accounting Changes	**$ 1.01**	**$ 1.19**	**$ 1.47**	**$ 1.75**	**$ 2.05**	**$ 2.58**	**$ 3.32**	**$ 4.13**
Average Number of Common Shares								
Basic	642.40	705.30	747.80	791.00	838.46	888.77	942.09	998.62
Diluted	695.30	769.00	787.70	890.70	992.00	1,051.52	1,114.61	1,181.49

Source: Company reports; Bear, Stearns & Co. Inc. estimates.

Exhibit 56. Enron Corp. — Balance Sheet ($ in millions)

	1998	1999	2000E	2001E	2002E
ASSETS					
Current Assets					
Cash and cash equivalents	111	288	1,447	1,947	2,544
Trade receivables	2,060	3,030	6,494	6,819	7,160
Other receivables	833	518	1,181	1,240	1,302
Assets from price risk management activities	1,904	2,205	7,294	8,023	8,826
Inventories	514	598	1,942	2,039	2,141
Other	511	616	1,198	1,258	1,321
Total current assets	5,933	7,255	19,556	21,326	23,294
Investments and Other Assets					
Investments	4,433	5,036	5,376	5,645	5,927
Assets from price risk management activities	1,941	2,929	7551	8,306	9,137
Goodwill	1,949	2,799	3719	4,016	4,338
Other	4,437	4,681	6475	6,993	7,552
Total investments and other assets	12,760	15,445	23,121	24,960	26,954
Property, Plant, and Equipment					
Natural gas transmission	6,936	6,948	6,158	5,158	3,761
Electric generation and distribution	2,061	3,552	4,284	620	632
Construction in progress	989	1,491	1,382	1,451	1,524
Oil and gas, successful efforts method	4,814	690	720	734	749
Other	992	1,231	1885	2,073	2,281
	15,792	13,912	14,429	10,037	8,947
Less accumulated depreciation	5,135	3,231	3,408	2,297	1,750
Property, plant, and equipment, net	10,657	10,681	11,021	7,739	7,197
Total Assets	**29,350**	**33,381**	**53,698**	**54,026**	**57,445**
LIABILITIES AND SHAREHOLDERS' EQUITY					
Current Liabilities					
Accounts payable	2,380	2,154	5,457	5,730	6,017
Liabilities from price risk management activities	2,511	1,836	6,264	6,578	6,906
Short-term debt	0	1,001	3,117	3,117	3,117
Other	1,216	1,768	2,408	2,408	2,408
Total current liabilities	6,107	6,759	17,247	17,833	18,448
Long-term debt	7,357	7,151	10,664	7,517	7,118
Deferred credits and other liabilities					
Deferred income taxes	2,357	1,894	1,585	1,664	1,747
Liabilities from price risk management activities	1,421	2,990	7,497	8,247	9,071
Other	1,916	1,587	2,311	2,426	2,547
Total deferred credits and other liabilities	5,694	6,471	11,392	12,336	13,366
Total Liabilities	19,158	20,381	39,303	37,686	38,932
Minority interests	2,143	2,430	1,889	1,889	1,889
Preferred securities of subsidiaries	1,001	1,000	904	904	904
Shareholders' Equity					
Cumulative second preferred convertible stock	132	130	127	127	127
Mandatorily convertible junior preferred stock	0	1,000	1,000	1,000	1,000
Common stock	5,117	6,637	8,003	8,163	8,326
Retained earnings	2,226	2,698	3,603	5,410	7,443
Accumulated other comprehensive income	(162)	(741)	(958)	(977)	(997)
Common stock held in treasury	(195)	(49)	(18)	(18)	(19)
Restricted stock and other	(70)	(105)	(155)	(158)	(161)
Total shareholders' equity	7,048	9,570	11,602	13,547	15,719
Total Liabilities and Shareholders' Equity	**29,350**	**33,381**	**53,698**	**54,026**	**57,445**

Source: Company reports; Bear, Stearns & Co. Inc. estimates.

Exhibit 57. Enron Corp. —Statement of Cash Flows ($ in millions)

	1997	1998	1999	2000E	2001E	2002E
Cash Flows From Operating Activities						
Net income	105	703	893	1,266	1,637	2,112
Cumulative effect of accounting changes	0	0	131	0	0	0
Depreciation, depletion, and amortization	600	827	870	1,231	1,575	1,825
Impairment of long-lived assets	0	0	441	(319)	0	0
Deferred income taxes	(174)	87	21	31	25	25
Equity in earnings	0	(97)	(309)	(264)	0	0
Gains on sales of assets and investments	(195)	(82)	(541)	(90)	250	0
Changes in components of working capital	(65)	(233)	(1,000)	(438)	(482)	(530)
Net assets from price risk management activities	201	350	(395)	0	0	0
Merchant assets and investments:						
Realized gains on sales	(136)	(628)	(756)	50	50	50
Proceeds from sales	339	1,434	2,217	750	1,000	1,000
Additions and unrealized gains	(308)	(721)	(827)	(1,500)	(750)	(750)
Other operating activities	(258)	0	483	900	0	0
Net Cash Provided by Operating Activities	**109**	**1,640**	**1,228**	**1,617**	**3,306**	**3,732**
Cash Flows from Investing Activities						
Capital expenditures	(1,392)	(1,905)	(2,363)	(2,050)	(2,250)	(2,400)
Equity investments	(700)	(1,659)	(722)	(1,060)	(750)	(800)
Proceeds from sales of investments and other assets	473	239	294	750	3,500	1,500
Acquisition of subsidiary stock	0	(180)	0	(750)	0	0
Business acquisitions, net of cash acquired	(82)	(104)	(311)	(550)	0	0
Other investing activities	(445)	(356)	(405)	(150)	0	0
Net Cash Used in Investing Activities	**(2,146)**	**(3,965)**	**(3,507)**	**(3,810)**	**500**	**(1,700)**
Cash Flows from Financing Activities						
Issuance of long-term debt	1,817	1,903	1,776	2,750	2,000	2,000
Repayment of long-term debt	(607)	(870)	(1,837)	(650)	(4,500)	(1,000)
Net increase (decrease) in short-term borrowings	464	(158)	1,565	1,750	1,000	1,000
Issuance of company-obligated preferred securities of subsidiaries	372	8	0	0	(100)	0
Issuance of common stock	0	867	852	0	200	0
Issuance of subsidiary equity	555	828	568	0	0	0
Dividends paid	(354)	(414)	(467)	(394)	(445)	(496)
Net (acquisition) disposition of treasury stock	(422)	13	139	0	0	0
Other financing activities	24	89	(140)	0	0	0
Net Cash Provided by Financing Activities	**1,849**	**2,266**	**2,456**	**3,456**	**(1,845)**	**1,504**
Increase (Decrease) in Cash and Cash Equivalents	**(188)**	**(59)**	**177**	**1,263**	**1,960**	**3,536**
Cash and Cash Equivalents, Beginning of Year/Period	**256**	**170**	**111**	**288**	**1,551**	**3,512**
Cash and Cash Equivalents, End of Year/Period	**68**	**111**	**288**	**1,551**	**3,512**	**7,048**

Source: Company reports; Bear, Stearns & Co. Inc. estimates.

Exhibit 58. Enron Corp. — Discounted Cash Flow Analysis ($ in millions, except per share data)

	1998	1999	2000E	2001E	2002E	2003E	2004E	2005E
IBITDA	2,409	2,865	3,631	4,597	5,471	6,534	7,852	9,608
Depreciation & Amortization	827	870	1,231	1,575	1,825	2,075	2,250	2,550
Operating Income (IBIT)	1,582	1,995	2,746	3,022	3,646	4,459	5,602	7,058
Provision for Income Taxes	316	399	549	604	729	892	1,120	1,412
Unlevered Net Income	1,266	1,596	2,197	2,417	2,916	3,567	4,482	5,646
Add Back Depreciation & Amortization	827	870	1,231	1,575	1,825	2,075	2,250	2,550
Less Capital Expenditures	(3,564)	(3,085)	(3,110)	(3,000)	(3,200)	(3,350)	(3,450)	(3,550)
Less Changes to Working Capital	(233)	(1,000)	(438)	(1,000)	(1,000)	(1,000)	(1,000)	(1,000)
Free Cash Flow to Debt & Equity	(1,704)	(1,619)	(120)	(8)	541	1,292	2,282	3,646
Terminal IBITDA Present Value								82,992
Discount Rate (WACC)								6.80%
Terminal Growth Rate								4.5%
Growth Rate Terminal Value								165,949
Total			(120)	(8)	541	1,292	2,282	169,595
Discount Factor			0	1	2	3	4	5
Present Value of Cash Flows at Discount Rate			(120)	(7)	475	1,061	1,754	2,625
Present Value of Growth Rate Terminal Value								119,452
Terminal IBITDA Multiple								12

Method 1 - IBITDA Multiple

		% of Enterprise Value
Present Value of Explicit Cash Flows	5,787	6.5%
Present Value of Terminal Value	82,992	93.5%
Enterprise Value	88,779	100.0%
- Debt	10,664	
- Minority Interest	1,889	
+ Cash	697	
Equity Value	76,923	
Diluted Shares Outstanding	869.6	
Per Share Value	**$ 88.46**	

Method 2 - Free Cash Flow

		% of Enterprise Value
Present Value of Explicit Cash Flows	5,787	4.6%
Present Value of Terminal Value	$119,452.42	95.4%
+ MV of Equity Investments	0	100.0%
+ MV of Nonoperating Investments	0	
+ Other	0	
= Enterprise Value	$125,239.74	
- MV of Net Debt (Long-Term Debt)	21,825	
- Capitalized Off-Balance Sheet Leases	0	
- Pension & Other Non-Funded Liability	($156.00)	
- Redemption Value of Put Options	0	
- BV of Minority Interest	1,893	
- MV of Options Outstanding	$ 7,145.16	
- Cash & Cash Equivalents	$ 697.00	
= Equity Value	$93,835.58	
Diluted Shares Outstanding	869.6	
Equity Value per Share	**$107.91**	

Source: Company reports; Bear, Stearns & Co. Inc. estimates.

Exhibit 59. Enron Corp. — Discounted Cash Flow Sensitivity Analysis: Free Cash Flow Method ($ in millions, except per share data)

Equity Value Sensitivity Analysis (Free Cash Flow Method)

Growth Rate \ WACC	3%	4%	5%	6%	6.80%	7%	8%	9%	10%	11%	12%	13%	14%	15%
0%	$ 79,230.4	$ 49,310.1	$ 31,524.2	$ 19,796.5	$ 13,003.9	$ 11,523.6	$ 5,404.1							
1%	$ 133,226.8	$ 75,284.7	$ 46,523.7	$ 29,424.2	$ 20,119.9	$ 18,147.0	$ 10,190.2	$ 4,303.3						
2%	$ 295,215.8	$ 127,234.0	$ 71,522.9	$ 43,865.6	$ 30,203.2	$ 27,419.8	$ 16,571.7	$ 8,916.1						
3%		$ 283,082.0	$ 121,521.3	$ 67,934.7	$ 45,598.8	$ 41,328.9	$ 25,505.8	$ 15,066.6	$ 7,698.2					
4%			$ 271,516.5	$ 116,072.9	$ 72,006.3	$ 64,510.7	$ 38,906.8	$ 23,677.3	$ 13,628.0	$ 6,533.4				
4.5%			$ 571,506.8	$ 164,211.1	**$ 93,835.6**	$ 83,056.2	$ 48,479.0	$ 29,417.7	$ 17,401.6	$ 9,173.0	$ 3,212.1			
5%				$ 260,487.5	$ 127,817.9	$ 110,874.4	$ 61,241.9	$ 36,593.3	$ 21,929.8	$ 12,252.5	$ 5,419.1			
6%					$ 323,826.7	$ 249,965.5	$ 105,912.2	$ 58,120.0	$ 34,382.6	$ 20,259.1	$ 10,936.7	$ 4,352.7		
7%							$ 239,922.9	$ 101,173.4	$ 55,137.1	$ 32,269.1	$ 18,661.2	$ 9,677.5		
8%								$ 230,333.5	$ 96,646.1	$ 52,285.8	$ 30,247.9	$ 17,132.2	$ 8,472.0	
9%									$ 221,173.1	$ 92,319.1	$ 49,559.2	$ 28,314.2	$ 15,668.6	$ 7,317.6
10%										$ 212,418.9	$ 88,181.8	$ 46,950.9	$ 26,463.4	$ 14,267.1
11%											$ 204,049.5	$ 84,224.3	$ 44,454.7	$ 24,691.3
12%												$ 196,044.7	$ 80,437.4	$ 42,065.0
13%													$ 188,385.6	$ 76,812.3
14%														$ 181,054.4
15%														

Discounted present value for the company based on our assumption of a 4.5% perpetual growth rate and a calculated 6.8% discount rate (WACC)

Equity Value per Share Sensitivity Analysis

Growth Rate \ WACC	3%	4%	5%	6%	6.80%	7%	8%	9%	10%	11%	12%	13%	14%	15%
0%	$ 91.11	$ 56.70	$ 36.25	$ 22.77	$ 14.95	$ 13.25	$ 6.21							
1%	$ 153.20	$ 86.57	$ 53.50	$ 33.84	$ 23.14	$ 20.87	$ 11.72	$ 4.95						
2%	$ 339.48	$ 146.31	$ 82.25	$ 50.44	$ 34.73	$ 31.53	$ 19.06	$ 10.25						
3%		$ 325.53	$ 139.74	$ 78.12	$ 52.44	$ 47.53	$ 29.33	$ 17.33	$ 8.85					
4%			$ 312.23	$ 133.48	$ 82.80	$ 74.18	$ 44.74	$ 27.23	$ 15.67	$ 7.51				
4.5%			$ 657.21	$ 188.84	**$ 107.91**	$ 95.51	$ 55.75	$ 33.83	$ 20.01	$ 10.55				
5%				$ 299.55	$ 146.98	$ 127.50	$ 70.43	$ 42.08	$ 25.22	$ 14.09	$ 6.23			
6%					$ 372.39	$ 287.45	$ 121.79	$ 66.84	$ 39.54	$ 23.30	$ 12.58	$ 5.01		
7%							$ 275.90	$ 116.34	$ 63.41	$ 37.11	$ 21.46	$ 11.13		
8%								$ 264.87	$ 111.14	$ 60.13	$ 34.78	$ 19.70	$ 9.74	
9%									$ 254.34	$ 106.16	$ 56.99	$ 32.56	$ 18.02	$ 8.41
10%										$ 244.27	$ 101.41	$ 53.99	$ 30.43	$ 16.41
11%											$ 234.65	$ 96.85	$ 51.12	$ 28.39
12%												$ 225.44	$ 92.50	$ 48.37
13%													$ 216.63	$ 88.33
14%														$ 208.20
15%														

Source: Bear, Stearns & Co. Inc. estimates.

Exhibit 60. Enron Corp. — Discounted Cash Flow Sensitivity Analysis: IBITDA Method ($ in millions, except per share data)

Equity Value Sensitivity Analysis (IBITDA Method)

	WACC	3%	4%	5%	6%	6.80%	7%	8%	9%	10%	11%	12%	13%	14%	15%
Terminal IBITDA Multiple	2	$ 10,507.2	$ 9,725.5	$ 8,987.6	$ 8,290.6	$ 7,763.3	$ 7,632.1	$ 7,009.4	$ 6,420.4	$ 5,862.9	$ 5,335.1	$ 4,835.0	$ 4,361.0	$ 3,911.5	$ 3,485.1
	3	$ 18,795.2	$ 17,622.5	$ 16,515.7	$ 15,470.3	$ 14,679.3	$ 14,482.4	$ 13,548.4	$ 12,664.9	$ 11,828.8	$ 11,037.0	$ 10,286.8	$ 9,575.8	$ 8,901.6	$ 8,261.9
	4	$ 27,083.1	$ 25,519.6	$ 24,043.8	$ 22,649.9	$ 21,595.3	$ 21,332.8	$ 20,087.5	$ 18,909.5	$ 17,794.6	$ 16,738.8	$ 15,738.7	$ 14,790.7	$ 13,891.7	$ 13,038.8
	5	$ 35,371.0	$ 33,416.7	$ 31,571.9	$ 29,829.6	$ 28,511.3	$ 28,183.2	$ 26,626.5	$ 25,154.0	$ 23,760.4	$ 22,440.7	$ 21,190.5	$ 20,005.5	$ 18,881.8	$ 17,815.7
	6	$ 43,659.0	$ 41,313.8	$ 39,100.0	$ 37,009.3	$ 35,427.3	$ 35,033.5	$ 33,165.6	$ 31,398.6	$ 29,726.2	$ 28,142.6	$ 26,642.3	$ 25,220.3	$ 23,871.9	$ 22,592.6
	7	$ 51,946.9	$ 49,210.9	$ 46,628.2	$ 44,188.9	$ 42,343.2	$ 41,883.9	$ 39,704.6	$ 37,643.1	$ 35,692.0	$ 33,844.5	$ 32,094.2	$ 30,435.2	$ 28,862.0	$ 27,369.4
	8	$ 60,234.9	$ 57,107.9	$ 54,156.3	$ 51,368.6	$ 49,259.2	$ 48,734.3	$ 46,243.7	$ 43,887.6	$ 41,657.8	$ 39,546.4	$ 37,546.0	$ 35,650.0	$ 33,852.1	$ 32,146.3
	9	$ 68,522.8	$ 65,005.0	$ 61,684.4	$ 58,548.2	$ 56,175.2	$ 55,584.7	$ 52,782.7	$ 50,132.2	$ 47,623.6	$ 45,248.2	$ 42,997.9	$ 40,864.9	$ 38,842.2	$ 36,923.2
	10	$ 76,810.8	$ 72,902.1	$ 69,212.5	$ 65,727.9	$ 63,091.2	$ 62,435.0	$ 59,321.8	$ 56,376.7	$ 53,589.4	$ 50,950.1	$ 48,449.7	$ 46,079.7	$ 43,832.3	$ 41,700.1
	11	$ 85,098.7	$ 80,799.2	$ 76,740.6	$ 72,907.6	$ 70,007.2	$ 69,285.4	$ 65,860.8	$ 62,621.3	$ 59,555.3	$ 56,652.0	$ 53,901.5	$ 51,294.5	$ 48,822.4	$ 46,476.9
	12	$ 93,386.7	$ 88,696.2	$ 84,268.8	$ 80,087.2	**$ 76,923.2**	$ 76,135.8	$ 72,399.8	$ 68,865.8	$ 65,521.1	$ 62,353.9	$ 59,353.4	$ 56,509.4	$ 53,812.5	$ 51,253.8
	13	$ 101,674.6	$ 96,593.3	$ 91,796.9	$ 87,266.9	$ 83,839.2	$ 82,986.2	$ 78,938.9	$ 75,110.4	$ 71,486.9	$ 68,055.8	$ 64,805.2	$ 61,724.2	$ 58,802.5	$ 56,030.7
	14	$ 109,962.6	$ 104,490.4	$ 99,325.0	$ 94,446.5	$ 90,755.2	$ 89,836.5	$ 85,477.9	$ 81,354.9	$ 77,452.7	$ 73,757.7	$ 70,257.0	$ 66,939.1	$ 63,792.6	$ 60,807.6
	15	$ 118,250.5	$ 112,387.5	$ 106,853.1	$ 101,626.2	$ 97,671.2	$ 96,686.9	$ 92,017.0	$ 87,599.4	$ 83,418.5	$ 79,459.5	$ 75,708.9	$ 72,153.9	$ 68,782.7	$ 65,584.4

Enron's equity valuation using a terminal IBITDA multiple of 12x and a calculated discount rate (WACC) of 6.8%.

Equity Value per Share Sensitivity Analysis

	WACC	3%	4%	5%	6%	6.80%	7%	8%	9%	10%	11%	12%	13%	14%	15%
Terminal IBITDA Multiple	2	$ 12.1	$ 11.2	$ 10.3	$ 9.5	$ 8.9	$ 8.8	$ 8.1	$ 7.4	$ 6.7	$ 6.1	$ 5.6	$ 5.0	$ 4.5	$ 4.0
	3	$ 21.6	$ 20.3	$ 19.0	$ 17.8	$ 16.9	$ 16.7	$ 15.6	$ 14.6	$ 13.6	$ 12.7	$ 11.8	$ 11.0	$ 10.2	$ 9.5
	4	$ 31.1	$ 29.3	$ 27.6	$ 26.0	$ 24.8	$ 24.5	$ 23.1	$ 21.7	$ 20.5	$ 19.2	$ 18.1	$ 17.0	$ 16.0	$ 15.0
	5	$ 40.7	$ 38.4	$ 36.3	$ 34.3	$ 32.8	$ 32.4	$ 30.6	$ 28.9	$ 27.3	$ 25.8	$ 24.4	$ 23.0	$ 21.7	$ 20.5
	6	$ 50.2	$ 47.5	$ 45.0	$ 42.6	$ 40.7	$ 40.3	$ 38.1	$ 36.1	$ 34.2	$ 32.4	$ 30.6	$ 29.0	$ 27.5	$ 26.0
	7	$ 59.7	$ 56.6	$ 53.6	$ 50.8	$ 48.7	$ 48.2	$ 45.7	$ 43.3	$ 41.0	$ 38.9	$ 36.9	$ 35.0	$ 33.2	$ 31.5
	8	$ 69.3	$ 65.7	$ 62.3	$ 59.1	$ 56.6	$ 56.0	$ 53.2	$ 50.5	$ 47.9	$ 45.5	$ 43.2	$ 41.0	$ 38.9	$ 37.0
	9	$ 78.8	$ 74.8	$ 70.9	$ 67.3	$ 64.6	$ 63.9	$ 60.7	$ 57.6	$ 54.8	$ 52.0	$ 49.4	$ 47.0	$ 44.7	$ 42.5
	10	$ 88.3	$ 83.8	$ 79.6	$ 75.6	$ 72.6	$ 71.8	$ 68.2	$ 64.8	$ 61.6	$ 58.6	$ 55.7	$ 53.0	$ 50.4	$ 48.0
	11	$ 97.9	$ 92.9	$ 88.2	$ 83.8	$ 80.5	$ 79.7	$ 75.7	$ 72.0	$ 68.5	$ 65.1	$ 62.0	$ 59.0	$ 56.1	$ 53.4
	12	$ 107.4	$ 102.0	$ 96.9	$ 92.1	**$ 88.5**	$ 87.6	$ 83.3	$ 79.2	$ 75.3	$ 71.7	$ 68.3	$ 65.0	$ 61.9	$ 58.9
	13	$ 116.9	$ 111.1	$ 105.6	$ 100.4	$ 96.4	$ 95.4	$ 90.8	$ 86.4	$ 82.2	$ 78.3	$ 74.5	$ 71.0	$ 67.6	$ 64.4
	14	$ 126.5	$ 120.2	$ 114.2	$ 108.6	$ 104.4	$ 103.3	$ 98.3	$ 93.6	$ 89.1	$ 84.8	$ 80.8	$ 77.0	$ 73.4	$ 69.9
	15	$ 136.0	$ 129.2	$ 122.9	$ 116.9	$ 112.3	$ 111.2	$ 105.8	$ 100.7	$ 95.9	$ 91.4	$ 87.1	$ 83.0	$ 79.1	$ 75.4

Source: Bear, Stearns & Co. Inc. estimates.