

**ENE: RECENT 1:1 MEETING WITH MGMT LEAVES US WITH MORE POSITIVE OUTLOOK, BUT WE ARE LOWERING PRICE TARGET TO \$55 ON REVISED SUM-OF-PARTS MODEL**

<b>Enron Corp</b>	<b>ENE   \$44.88   NYSE</b>
M. Carol Coale • 713.646.5433 • carol_coale@prusec.com	Current: <b>Buy</b>
	Risk: <b>Moderate</b>
	Target: <b>\$55.00</b>
	Industry: <b>Market Outperform</b>

The senior analyst(s) does not have a material position in ENE.

	FY	EPS	P/E	1Q	2Q	3Q	4Q
Actual	12/00	\$1.47A	30.5X	\$0.40A	\$0.34A	\$0.34A	\$0.41A
Current	12/01	\$1.80E	24.9X	\$0.47A	\$0.44E		
Prior		\$1.80E	24.9X	\$0.47A	\$0.44E		
Current	12/02	\$2.10E	21.4X				
Prior		\$2.10E	21.4X				

Avg. Volume: 4,800,000  
Market Cap: \$33,485 m  
Shares: 748.10 m

Div/Yield: 0.50/1.11%  
52w Range: 90.80-42.40

EPS Growth: 12.00%  
P/E / Growth: 2.1x

*Enron Corp (ENE), headquartered in Houston, TX, produces electricity and natural gas, develops, constructs, and operates energy facilities worldwide, and delivers both physical commodities and financial and risk management services to customers. The company is also developing an intelligent network platform to facilitate an online business.*

**HIGHLIGHTS**

- In our view, ENE's stock performance has been hampered 1) EPS quality; 2) management credibility; 3) CA operational and political exposure; 4) international portfolio risk; 5) excessive insider selling.
- In a 1:1 meeting with CEO, Jeff Skilling, management plans to discontinue the use of its affiliated partnership to monetize significant assets/investments and limit the sale of pre-registered stock under safe harbor requirements.
- While CA has singled out ENE as the villain in the state's energy crisis, we believe this is centered on the close relationship between ENE Chairman Ken Lay and the Bush administration making ENE the symbolic target of Democrat-Republican warfare.
- Regarding the \$9B of refunds of "overcharges" sought by Gov. Davis against the power suppliers, ENE's exposure is minimal about \$39 million, reflecting low volumes of physical power sales.
- Also, ENE has little earnings exposure to natural gas prices, except for the impact on marketing margins, and should meet/beat 2Q01 EPS estimates.
- Despite the more positive outlook, we are lowering our price target to \$55 on more conservative sum-of-parts valuation.

**DISCUSSION**

In a brief meeting with Enron Corp.'s CEO, Jeff Skilling, on Monday, 6/25/01, our takeaways were:

1. The company has little direct earnings exposure in California, as evidenced by the recent allegations of energy overcharges by California governor, Gray Davis, which estimates Enron's exposure at \$39 million out of a total of \$9 billion.
2. Enron is addressing earnings quality concerns regarding the use of its affiliated limited partnership, LJM Cayman, as the "cover" for significant asset and investment monetizations by discontinuing future transactions through this financing vehicle.

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3. Management sold a surprising number of shares/options in the first half of 2001, which it claims were pre-registered sales in advance of the stock price decline. Skilling claims to have halted the sale of his pre-registered sales.
4. Sporting a cut on his forehead related to a recent "pie" incident in California, Skilling believes that Enron has been a political target in that state because of its friendship with the Bush administration. From an earnings standpoint, however, Enron was not the largest profiteer in the inefficient market that persisted in California over the past year. (For those interested, the pie thrown at Skilling was a blueberry pie, crammed into his face by a radical protester in San Francisco).
5. Enron's "asset-lite" strategy appears to be advantageous in an environment of falling commodity prices as several of its peers may be facing asset write downs of power plants that were purchased at above-market prices over the past few years.
6. Although Enron is likely to meet or beat consensus expectations for 2Q01 EPS of \$0.42, we are lowering our price target to \$55 from \$74 based on more conservative assumptions in our sum-of-the-parts valuation. Our estimate of \$0.44 is above consensus but is modeled independently of management guidance.

We are assessing a lower multiple of 10x EBITDA from wholesale operations (excluding an estimated \$300 contribution from international activities), down from our previous multiple of 15x. This is based on the decline in premium valuation for the merchant power providers, the increased operational risk in the power sector in and outside of California, and the potential negative impact of the weak U.S. economy on overall energy trading patterns. We are maintaining our Buy rating on the Enron as it is trading at the bottom of its 52-week range although our view of the entire natural gas/power sector continues to be cautious. Political uncertainty surrounding the California situation and the current status of electricity deregulation across the U.S. could hamper near-term stock performance, although Enron and its peers are among the few companies in the S&P 500 that are likely to post 20% earning growth this year and in 2002. Unfortunately, these strong underlying fundamentals have been outweighed by fears of deregulation and government intervention, although we believe that once the smoke clears, Enron will afford a tremendous buying opportunity. The bad news is that the smoke may not clear for another year or so until the California gubernatorial elections commence in November 2002.

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