

Kenneth L. & Linda P. Lay
CAR Comments
9/4/97

Policy Exceptions:

B24) PFS not on NB certified form, lacks contingent liabilities and is not signed by Linda P. Lay - a waiver is requested based on our favorable experience with both the Lays and the Enron Corporation. In addition, we are properly secured by a high-quality portfolio of diversified securities, primarily Enron (59.3% of collateral) and Compaq Computers (30.9%). The RM has received a verbal confirmation verifying no other contingencies other than with NB.

Pricing Exceptions:

No fee on committed lines - the pricing exceptions are mitigated by a projected ROE of 39.23% and our extensive relationship with the Borrower and Enron. PCG relationship is projected to generate \$251,167 in total relationship earnings.

Executive Summary

This CAR seeks to renew 2 existing facilities to Kenneth & Linda Lay:

\$30mm CLN - this facility was used to consolidate several different lines last year and will continue to be used to fund business investments and personal expenses. This line is secured with Marketable Securities, primarily shares of Enron Corporation and Compaq Computers pledged by KLL & LPL Investments, a family limited partnership. There is currently \$29,920m o/s on this line versus \$31,193m in collateral value (\$44.6mm MV);

1. **\$750m CLN** - this unsecured line is also used by Lay for business investments. There is currently \$400m o/s on this line.

Pricing for the stock secured facility will continue at Libor +100bp with 30, 60, 90, 180 or 360 day options. Unsecured line will continue at Prime - ½. Repayment for both facilities will continue to be interest only payable quarterly with full principal due at maturity. The stock secured facility will continue to have a 70% advance and a 75% margin call which is governed by a collateral maintenance agreement. The secured facility will be risk rated a 4 while the unsecured line will be risk rated a 5. CES will continue at "Maintain" with TCE after this renewal to be \$41,134m.

In addition to the above lines, these CAR comments will also serve to:

3. Renew a **\$2,750m CLN** for KLL & LPL Investments (see separate CAR) - KLL & LPL Investments (KLI) is the Lay's family limited partnership which received a large portion of his assets in 1994 as an estate planning tool. In addition to Ken & Linda, the Lay's five children are also General Partners, although Ken & Linda are the only ones to have any control over the assets. This line is secured with Marketable Securities, primarily shares of Eli Lilly & Co., and the line is underwritten based on the strength of the Lays and the liquid collateral. There is currently \$2,087m o/s on this line versus \$2,102m in collateral value. The Lays fully guarantee this line;
4. Renew a **1 year PAL** in the amount of \$42mm which was in effect during this past year and will continue to be used to proactively manage the relationship; and
5. Provide TERFs for the Lay's **\$4.5mm CJM** and their **\$1,578m CJM**

Transactional Analysis Critical Issues

- Leverage is 1.18x NB's adjusted net worth (\$40mm/\$34mm) - although a significant portion of Mr. Lay's marketable securities are pledged, the risk is mitigated by Lay's significant cash flow generating ability as well as his remaining liquidity. Lay reports 1996 income of \$8.2mm which is a combination of salary/bonus of approximately \$3mm and exercising of stock options (\$4mm- \$5mm annually or approximately 150m to 200m shares). He typically exercises this amount annually although he has the ability to do more or less as the situation requires. He can continue to exercise this amount over the next several years especially as Enron continues to grant more options, typically 200m to 300m per year (assumes that Enron's share price continues to appreciate). Although estimated unencumbered liquidity is approximately \$10mm, this does not include his Enron and Compaq stock options which have an approximate market value of \$33mm. Lay has stated to the RM that he intends to reduce his leverage from the current 35% of assets to 25%-30% of assets over the next 2-3 years. Lay's liquidity consists of the following:
 - 1) Lay's primary liquidity consists of large capitalization stocks and mutual funds which are currently worth an estimated \$61,080m (owned either directly by the Lays or the family limited partnership). Potential exposure (stock secured and unsecured debt) reliant on this liquidity is approximately \$33,500m which represents the three NB loan's being renewed. Current liquidity covers stock reliant debt 1.93x(\$64.5mm/\$33.5mm);
 - 2) The value of Lay's currently exercisable Enron and Compaq stock options is approximately \$33mm (pre-tax). The estimated tax deferred liability is \$13.1mm.
net value (Current price less option price)
 - 3) Lay also has other semi-liquid assets, primarily \$3.5mm of deferred income from Enron. While this is clearly less liquid than marginable stock, it does represent a solid additional source of liquidity which could be used to retire debt.
- Ken Lay has an asset and income concentration in Enron Corporation - cash flow is dependent on his ability to exercise the Enron options - both his wealth and recurring income is concentrated in Enron common stock, options and his employment with the company. As seen on the attached cash flow worksheet, Ken Lay relies on his stock options to accommodate his lifestyle and meet debt service (approx \$4mm to \$5mm per year). The risk is mitigated, however, by the strong performance of Enron under Lay's leadership. As evidence of Enron's confidence in Lay, the board of directors recently renewed Lay's employment contract with Enron for five years, which included a 1.2mm share stock option grant. The company is expected to continue to perform well due to its diversification across most segments of the natural gas business. The recent merger between Enron and Portland General provides a number of strategic assets necessary for Enron to realize its ambitious wholesale electric marketing and retail natural gas and electric marketing goals. Although the 2nd quarter earnings have reflected a significant downturn in earnings of \$-1.71 per share, this is largely a result of a one time charge of \$1.80 per share to settle a dispute in the North Sea and a \$.30 per share write down of some plant equipment. Actual EPS would have been \$.40 per share versus \$.46 year ago. Merrill Lynch reports that Enron's business fundamentals and growth prospects remain strong (Long term Buy).
- Risk of ability to meet margin calls - the current value of collateral provides adequate capacity to meet margin calls (\$45.9mm/\$33.5mm). Lay's unencumbered liquidity, \$10mm, is sufficient to meet a 23% drop in collateral value to return margin to a 70% advance rate. Furthermore, Lay has \$33mm in option value that is realizable (gross). Lay has stated that, in