

Kenneth L. Lay  
CAR Comments  
August 10, 1993

Executive Summary

This CAR requests a \$6MM confirmed line of credit to Ken Lay, Chairman and CEO of Enron Corp. The majority of the proceeds of the loan will be used to refinance a loan made by Enron to enable Lay to purchase \$5MM in Enron stock. Since this will be a purpose loan under Regulation U, Lay will pledge 185M shares of unrestricted Enron Corp. common stock currently worth \$12.6MM for a 50% LTV (\$68-1/4 per share as of 8/9/93). Mr. Lay will be required to pledge additional shares or reduce the outstanding balance should the LTV exceed 75% (Regulation U does not require additional monitoring if LTV requirements based on the total commitment are met at closing). Enron is a large capitalization stock with sufficient trading volume on the NYSE to enable Lay to liquidate shares to repay this debt. This underwriting decision is based on the marketability and collateral coverage of the Enron stock securing this facility. Interest will be payable monthly and the outstanding principal will be due at maturity, one year from closing. The facility is priced at NationsBank Prime - 1/2% with no fees. The recommended risk rating is '4' based on the collateral (consistent with Credit Policy guideline for risk ratings on loans secured by readily marketable stock) and the exposure strategy is 'increase'. Lay is not currently a customer of NationsBank and was introduced to the Private Bank by Joe Musolino. The Energy Banking Group has approximately \$125MM in credit exposure to Enron on an unsecured basis (risk rating of 5).

*If 75% LTV is exceeded +  
margin call made, B'er should  
return new LTV to 70%. M107*

Transaction Analysis

- **Credit Policy Exceptions:** 1) Lay's financial statements have not been prepared on NationsBank forms containing certification language and contingent liability disclosure. 2) While Lay's balance sheet is current, cash flow information is 180 days old. Waiver of these credit exceptions is requested based on the marketability and collateral coverage provided by the Enron stock securing this facility. Furthermore, Lay's financial assistant, Sally Keepers, verbally stated to RM that Lay has no contingent liabilities.
- **Use of Proceeds.** Enron advanced Lay \$5MM in 1989 for the purpose of acquiring Enron stock. The initial advance under the requested facility would be used to retire this Enron loan, and the shares securing the Enron loan will be transferred to NationsBank. As a result, this facility is a purpose loan under Regulation U and is subject to a maximum initial LTV of 50%. It is assumed that the balance of the loan proceeds will be used to purchase margin stock as well.
- **Repayment Sources.** Although Lay has substantial cash flow generating ability, the primary repayment source for this loan is the timely liquidation of Enron stock by Lay. Enron has recently been trading near its 52-week high of \$68-1/2 as a result of strong earnings growth, and average trading volumes should allow Lay to liquidate shares in an orderly manner. Enron is a fully integrated natural gas company whose interests in gas pipelines, exploration and production, natural gas liquids and power generation provide diversification.

Secondary sources of repayment include Lay's earnings from his employment at Enron and the substantial value of Lay's unexercised Enron stock options.

BOA/FBI/LAY: 29909

- **Collateral/Rule 144.** Lay beneficially owns less than 1/2% of Enron's outstanding shares. However, due to Lay's position as Chairman and CEO, he must follow the control restrictions of Rule 144. After satisfying the standard public reporting requirements, the number of shares Lay may sell during any three month period may not exceed the greater of the following:

- 1) **1% of the shares of the class outstanding.** There are approximately 119MM shares of Enron Corp. common stock outstanding with a total market value of over \$8 billion. ( $1\% = 1.19\text{MM shares @ }68\text{-}1/2 \text{ per share} = 81\text{MM}$ )
- 2) **Average weekly trading volume as reported on all national securities exchanges during the previous four-week period.** Per Bloomberg reporting system, the average weekly trading volume for the previous four weeks ending 7/30/93 was approximately 1MM shares. ( $\text{Avg. Weekly Volume} = 1\text{MM shares @ }68\text{-}1/2 \text{ per share} = \$68.5\text{MM}$ )
- 3) **Average weekly trading volume reported in the consolidated reporting system during the previous four-week period.** Same as item two above.

**Key Critical Issues:**

- **Concentration of Wealth/Income.** Lay's wealth is concentrated in Enron common stock and his recurring cash flow is dependent upon his employment at Enron. This risk is mitigated by the strong performance of Enron under Lay's leadership in addition to the conservative advance ratio of 50%. Wall Street has rewarded this performance and Enron's stock is trading near a 52-week high of \$68-1/2. The company is expected to continue to perform well due to its diversification across most segments of the natural gas business in addition to the strengthening of natural gas prices.
- **Single Repayment Source.** Given the concentration of Lay's wealth in Enron, liquidation of Enron stock pledged as collateral is the repayment source for this loan. Enron's stock has significantly appreciated over the past year and now trades at a premium to its peer group (Enron's P/E is 23 versus 18-20 for the gas pipeline industry). While the stock has been less volatile than the market (beta is .85), the recent price appreciation makes the stock vulnerable to a potential correction. This risk is mitigated by the conservative 50% advance ratio for this credit facility and the fundamental strengths of Enron that are driving the price appreciation (strong earnings growth, attractiveness of the natural gas industry).
- **Negative Cash Flow.** As detailed in the attached cash flow worksheet, Lay had negative cash flow on a recurring basis in 1992. This cash flow shortfall (\$1.9MM) was covered through the exercise of stock options for \$6MM. The risk of negative recurring cash flow is mitigated by the following:
  - 1) Lay's unrestricted ownership of Enron stock is currently worth \$24MM, representing a significant source of liquidity to meet potential cash flow shortfalls.
  - 2) A large portion of Lay's reported cash uses is discretionary in nature and could be reduced if necessary.

