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. <u>Current liquidity</u> 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 the event of a margin call, he would liquidate Enron savings & ESOP ($3.1mm) deferred income plans ($3.5mm) exercise options, and sell Enron stock, if necessary.

- **Death, Estate Taxes, Etc.** The creation of the family partnership completed the majority of Lay's estate planning. He currently has $47mm in life insurance policies (mostly second-to-die policies) which is sufficient to pay off all debt.

Relationship Analysis:
Ken Lay is the Chairman and CEO of Enron Corporation, a large Energy Group customer. He is a high-profile executive who leads one of the largest fully integrated natural gas companies in the world. Lay has been with Enron since 1985 and has been Chairman and CEO for over five years. Lay is also a Director of Eli Lilly and Company, Compaq Computer Corporation, Enron Oil & Gas Company, EOTT Energy Corp., and Trust Company of the West. Lay currently has other banking relationships with Compass Bank and Texas Commerce Bank. His former relationship with Charter Bank has been rolled into our pool of facilities since the recent acquisition.

Financial
Ken Lay has an employment contract from Enron which provides for a fixed annual salary of $990m through February 2000. His total compensation package, however, was approximately $2mm over base salary in 1996. This compensation is based on both company performance and return to stockholders. Although the borrower's liquid position has been discussed, he also reports $8mm in primary residences, $3.5mm in investment properties and $3mm in retirement assets. Only debt is that issued by NB consisting of the unsecured and stock secured lines of credit and first mortgages.

KLL & LPL Family Limited Partnership

For estate planning purposes, Lay transferred a large portion of his assets in 1994 to KLL & LPL Investments, Ltd., a Texas limited partnership. Ken and Linda Lay are the managing and general partners. Ken's five children are also general partners. However, only Ken and Linda have any control over the assets. The partnership has the authority to both pledge assets and guarantee Lay's personal debt. Lay's counsel, Baker & Botts, has provided us with a satisfactory legal opinion regarding consideration issues. Counsel representing NationsBank, Sewell & Riggs, has reviewed the partnership documents and has not noted any major issues. Covenants will remain on KLL & LPL Investments, Ltd., which require that the partnership will not dissolve or transfer assets, nor will they incur additional debt without bank approval. This is important for both facilities as KLL & LPL own most of the securities pledged against ken Lay's line.

Enron Stock Analysis

Enron Corporation is one of only a few vertically integrated natural gas companies offering worldwide service. Enron's interests include gas pipelines, exploration and production, natural gas liquids, processing, marketing, and power generation. The stock currently contributes 53.3% of our collateral value.

Stock Price & Trading volume - on August 26, 1997, Enron closed at $37 1/4 per share, with a 52-week high of $47½ per share (11/25/96) and a 52-week low of $35 per share (8/18/97). Enron's current market capitalization is $11.2b. The stock's beta is 0.85 (somewhat <u>less</u> volatile than the market as a whole). Enron's stock is "liquid" with an average daily trading volume of 1mm shares/day, up from 600m shares/day one year ago.

Rule 144 restrictions - the Enron stock held as collateral is subject to Rule 144 restrictions due to Mr. Lay's position as Chairman and CEO of the company ("control" stock). However, the stock has been owned by our sponsor for more than three years, and no Rule 144 restrictions would apply to NB. According to a stock volume analysis, the entire collateral pool of Enron shares (707m shares) could be liquidated in less than 2 net trading days.

Analyst Coverage - the company's stock is traded on the NYSE, and is a member of the following indexes: S&P 500, S&P Natural Gas, NYSE Utilities and the Russell 1000 & 3000 Industrials. First Interstate Bank of Texas operates as the company's transfer agent, and the stock is followed by all the major brokerage firms (see below and attached). The majority of the brokerage houses rate Enron with a positive recommendation:

Howard, Weil	Accumulate	8/19/97	Goldman Sachs	Recommend	7/16/97
Jeffries & Co.	Buy	7/16/97	Painewebber	Neutral	7/15/97
Salomon Bros	Hold	5/1/97	Morgan Stanley	Outperform	12/18/96

Company performance - Enron's strategy of growth through vertical integration has allowed it to experience five years of solid performance over which compounded earnings per share have grown at a rate of 20% annually. Although the first half of 1997 has reported disappointing results due to the aforementioned non-recurring items, Valueline is optimistic that a strong second half may more than offset the earnings shortfall to date. Merrill Lynch projects a slight decrease in EPS from $2.31 in 1996 to $2.25 for 1997 but back up to $2.55 for 1998. Merrill anticipates the stock to reach $43.25 over the next 12 to 18 months.

Compaq Stock Analysis

Compaq Computer Corp. is one of the world's largest manufacturers of personal computers. With a market capitalization of over $15b and average daily trading volume of over 9mm shares, Compaq stock is high quality collateral. The stock currently contributes 30.9% of our collateral value.

Stock Price & Trading volume - on Sept. 5, 1997, Compaq closed at $69 5/8 per share, its 52-week high with its 52-week low at $22 3/4 (9/6/96). Compaq's current market capitalization is $52b with a beta of 1.13 (somewhat <u>more</u> volatile than the market as a whole) and this stock has been one of the leaders in the market's recent strong performance. Compaq's stock is "liquid" based on the average daily trading volume of 9.3mm shares/day.

Rule 144 restrictions - the Compaq stock held as collateral is subject to Rule 144 restrictions due to Mr. Lay's position on the Board of Directors for Compaq ("control" stock). The stock has been owned by our sponsor for more than three years, and no Rule 144 restrictions would apply to NB. According to a stock volume analysis, the entire collateral pool of Compaq shares (247m shares) could be liquidated in less than 1 net trading day.

Analyst Coverage - the company's stock is traded on the NYSE, and is a member of the following indexes: S&P 500, NYSE Composite, S&P Industrials, S&P High Tech and the Russell 1000 & 3000 Industrials. L. F. Rothschild is the lead Manager and the stock is followed by all the major brokerage firms who almost all report a recommend or buy rating (see below and attached):

Deutsche Morgan	Buy	8/27/97	Robertson Steph	Buy	8/22/97
Donaldson Lufkin	Recommend	8/7/97	Alex Brown	Strong Buy	7/11/97
Bear Stearns	Buy	7/10/97	Morgan Stanley	Outperform	5/29/97

Company performance -

On July 28th, Compaq shares split 5 for 2. Second quarter unit sales were up 42% versus year ago which is approximately 3x the industry growth rate. Although the competition from rivals such as Dell, IBM and Hewlett Packard is tremendous which may require competitive price cutting,

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acquisitions should help Compaq further penetrate the fast growing enterprise network market. In June, Compaq purchased Microcom, a remote access hardware maker, and also agreed to purchase Tandem Computers for 73 million shares ($3b).

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