Terms of PAL
- stock secured @ policy advances or less if Reg U governed
- one year notes
KL [illegible]

Kenneth L. Lay
CAR Comments
December 1, 1993

Executive Summary

This CAR requests two credit facilities totalling $12.5MM and an $18.5MM PAL for Ken Lay, Chairman and CEO of Enron Corp. The facilities are structured as follows:

Facility A (Purpose Credit):	$10.5MM
Facility B (Non-Purpose Credit):	$2.0MM

The purpose of Facility A is to fund purchases of margin stock, most likely Enron Corp. stock. Lay intends to use a portion of these proceeds to refinance a $5MM loan originally advanced to him by Enron for the purpose of acquiring Enron stock. In addition, Facility A will refinance existing term debt ($1.4MM) advanced to Lay by NationsBank over the past few months and secured by listed stock. The purpose of Facility B will be to finance personal expenses and will be non-purpose credit under Regulation U. Collateral for both facilities will consist of listed stock which will be pledged at the time of each advance; however, Facility A will require a 50% LTV (this loan will be purpose credit as defined by Regulation U), and Facility B will have a 70% LTV. Collateral to be pledged at each advance will be subject to bank approval (City Manager and Credit Policy Executive) based on trading volume, price stability, etc. Pursuant to a collateral maintenance agreement, margin calls will occur at a 75% LTV, upon which Lay will be required to pledge additional shares or reduce the outstanding loan balance to reduce the LTV to 70% (see comments below for related Regulation U issues). This underwriting decision is based on the marketability and collateral coverage of the Enron stock or other listed stock securing this facility. Interest will be payable quarterly and the outstanding principal will be due at maturity, one year from closing. The facility is priced at LIBOR (30,60, or 90 days) plus 175bp with no fees (67% relationship ROE). 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 'maintain'.

Lay became a NationsBank customer in August 1993 and was introduced to the Private Bank by Joe Musolino. The bank has funded approximately $2.4MM to enable Lay to exercise stock options and invest in certain mutual funds. The purpose of this request is to roll this debt into a master facility and expand Lay's credit availability by approximately $6MM based on his significant holdings of Enron stock and options. Of note, the existing one-year, $1MM term loan secured by listed stock, mutual funds and a partnership interest will not be refinanced by this facility. Lay currently has relationships with Texas Commerce Bank ($1.5MM line) and Charter Bank ($5MM line), and he has expressed a desire to expand his relationship with NationsBank. The Energy Banking Group has approximately $125MM in credit exposure to Enron on an unsecured basis (risk rating of 5).

Transaction Analysis

- **Credit Policy Exceptions:** 1) Lay's financial statements do not contain full disclosures such as certification language, contingent liabilities and complete cash flow information. 2) Lay's financial statement is over six months old. Waiver of these credit exceptions is requested based on the marketability and collateral coverage provided by the stock securing this facility. As this relationship grows, RM will attempt to obtain more detailed financial information. Of note, Lay's financial assistant, Sally Keepers, verbally stated to RM that Lay has no contingent liabilities.

- **Use of Proceeds.** Lay intends to use proceeds of these facilities to fund investments in marketable securities and to finance personal expenses. While Lay currently has margin debt secured by NYSE stocks such as Compaq Computer and Eli Lilly, it is likely that he will primarily use this line to finance purchases of Enron stock. Furthermore, Lay intends to refinance a $5MM loan made to him by Enron for the purpose of purchasing Enron stock. The following table details total corporate exposure to Lay and the anticipated usage of these facilities:

	Amount
Facility A:	
Refinance Enron Corp. Loan (secured by Enron stock)	$5,000,000
Refinance NationsBank margin debt	$1,429,600
Add'l Purpose Credit Availability	$4,070,400
Total Facility A	$10,500,000
Facility B:	
Non-Purpose Credit Availability (70% LTV; listed stock)	$2,000,000
Other NationsBank Exposure (secured by various securities)	$1,000,000
TOTAL CORPORATE EXPOSURE	**$13,500,000**

Advances under Facility A will be considered 'purpose credit' as defined by Regulation U. As a result, each advance must have 2 to 1 collateral coverage. However, according to NationsBank counsel (Linda Zimmerman), Reg U does not require additional monitoring unless Lay subsequently requests a release or substitution of collateral. Facility B will have a 70% advance ratio against approved listed stock taken as collateral.

- **Repayment Sources.** Although Lay has substantial cash flow generating ability, the primary repayment source for this loan is the timely liquidation of marketable securities by Lay. Enron has recently been trading near its 52-week high of $37 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 (value of currently exercisable options is approximately $3.4MM).

- **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 240MM shares of Enron Corp. common stock outstanding with a total market value of nearly $8 billion. *(1% = 2.4MM shares @ $33 per share = 79MM)*

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 10/31/93 was approximately 1MM shares. *(Avg. Weekly Volume = 2MM shares @ 33 per share = $66MM)*

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%. Also, Lay recently signed a new three-year employment contract with Enron. Wall Street has rewarded this performance and Enron's stock has recently traded near a 52-week high of $37 (the stock split at $72/sh in August). 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 primary 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 $25MM, 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.

  3) Lay holds Enron stock options with current value of $24MM; as the table below indicates, Lay can currently realize approximately $3MM of this value. All options vest 20% on the date of the grant, plus 20% annually over four years. While the value of these options fluctuates with the price of Enron stock, the options represent another significant source of funds for Lay given the current outlook for Enron stock.

Grant Date	Shares	Price	Vested Shares	Vested Value	Unvested Value
8/23/89	800,000	$12.50	66,400	$1,361,200	$15,038,800
2/11/91	62,400	$13.75	0	$0	$1,201,200
2/10/92	187,500	$15.50	75,000	$1,312,500	$1,968,750
2/9/93	200,000	$27.1875	40,000	$232,500	$930,000
2/9/93	400,000	$27.1875	80,000	$465,000	$1,860,000
				$3,371,200	$20,998,750

- **Multiple Creditors/Margin Calls.** In addition to this proposed credit facility, Lay also has credit facilities at Charter Bank and Texas Commerce in the amount of $5MM and $1.5MM, respectively. These notes are secured by Enron stock and other marketable securities based on a 75% LTV. The following table details Lay's outstanding stock-secured debt and his ability to meet margin calls:

Lender/Outstandings	Collateral Description	Collateral Value	Margin Call (75%)
Charter Bank, $5MM Rev	237M sh Enron Corp.	$7.8MM	$6.7MM
Texas Commerce, $1.5MM Rev	Various margin stock (not Enron Corp.)	$3.0MM	$2.0MM
NationsBank - Existing $1.4MM	66.8M sh Enron Corp.; 9M sh Compaq; 2M sh Eli Lilly	$2.9MM	$1.9MM
NationsBank - Existing $1MM	15.5M sh Enron, various other stocks	$2.0MM	$1.3MM
NationsBank - New $5MM	370M sh Enron	$12.2MM	$6.7MM
Totals		**$27.9MM**	**$18.6MM**

	# of Shares	Value
Total Unrestricted Enron Corp. shares	770,506 shares	$25,426,698
Total Pledged Enron Corp. shares	689,300 shares	$22,746,900
Shares Available to Meet Margin Calls	81,206 shares	$2,679,798
Plus Excess Margin		$9,300,000

As the above tables indicate, Lay has 81M unencumbered Enron shares worth $2.6MM plus $9.3MM in excess margin available to meet margin calls. Enron's stock price would have to decline to $16 ($12MM/770.5M shares) from the current $30-$33 before Lay's ability to meet margin calls would be diminished. Given the strong performance of Enron, a stock price decline of this magnitude is unlikely.

Relationship Summary

- Ken Lay is a high profile executive who leads one of the largest fully integrated natural gas companies in the world. The requested credit facility represents an excellent opportunity to begin a relationship with this important member of Houston's business community. Lay currently has banking relationships with Texas Commerce Bank and Charter Bank.

Cash Flow:

- Mr. Lay's recurring sources of cash totaled $3,958M through January 13, 1993, consisting primarily of his salary ($900M), incentive bonus ($1,665M), deferred income ($404M), long term incentive bonus ($1,453M), and deferred salary ($885M). The incentive bonus is paid to Mr. Lay based on the results achieved by Enron during each year. In addition, Enron provides for a long term incentive bonus in the form of deferred income, based on the performance of the company generally over a four-year period, to compensate the officers of the company for achieving certain results. Mr. Lay also received dividend income of $263M from his Enron stock, rental income of $102M from his investments (primarily apartments) in Houston, Missouri, and Austin, and directors fee income of $57M.

- Recurring uses of cash ($4,474M) consist of estimated taxes ($3,189M), living expenses ($1,213M), and alimony payments ($72M). Mr. Lay's debt service totaled $1,349M of which $607M was for his homes in Houston, Aspen, and Galveston. In addition, interest expense for the note payable to Enron (for the purchase of Enron stock) was $533M, debt service for Mr. Lay's investment properties was $168M, and other debt service (cars/boats) was $41M. The recurring cash uses exceeded recurring sources by $1.9MM, however, this shortfall was covered by exercised stock options as discussed below. It should be noted that living expenses and children expenses are discretionary items that Mr. Lay could reduce if necessary.

- The exercise of Enron Corp. stock options of $6,026M (a non-recurring source of cash) resulted in positive net cash flow of $4,161M. Although recurring cash earnings were unable to cover debt service, Mr. Lay's stock options provided positive net cash flow. It should be noted that the Enron stock options generally provide for a vesting period of four years and an additional six years before expiration. Lay's remaining Enron stock options have a current value of roughly $24MM, of which approximately $3.4MM are currently exercisable.

Liquidity:

- As of 6/21/93, Mr. Lay's liquid assets totaled $25,100M of which Enron Corporation stock accounted for $22,761M, or 90.7%, (only 6% is restricted stock) of total liquid assets. Marketable securities accounted for $1,503M (6%) consisting of Compaq stock ($1,009M) and various other publicly traded stock. In addition, Enron Oil and Gas stock accounted for $632M (2.5%) of total liquid assets. The remaining liquid assets consist of an IRA ($147M), cash ($42M), CVLI ($12M) and savings bonds ($2M). Although Mr. Lay's liquid assets are concentrated in Enron stock (90.7%), his liquidity remains strong due to the marketability of this stock.

Leverage:

- As of 6/21/93, total liabilities were $17,022M consisting primarily of a note payable to Enron Corporation ($7,450M) for the purchase of Enron Corp. stock ($2.5MM is unsecured); a note payable to Charter National Bank ($3,106M); the mortgage on his residence in Houston ($2,606M); and a note payable to TCB-Houston ($1,532M). The mortgages on his vacation homes in Aspen and Galveston accounted for $1,320M and