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Debt-Laden Energy Companies Look to Mop Up Balance Sheets

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Coming soon to the U.S. energy industry: a fire sale for everything from power plants to oil and gas reserves.

In an effort to lighten up debt-heavy balance sheets, some of the industry's biggest players hope to ditch assets, reversing a recent trend that had the energy industry bulking up to take advantage of deregulation.

The biggest sellers, including **Enron Corp.**, **El Paso Corp.**, **Dynegy Inc.**, **Mirant Corp.** and **Williams Cos.**, were among the biggest buyers as recently as a couple of years ago.

But that was before visions of a marketplace dominated by a handful of energy superstars evaporated. Since then, prices for electricity and natural gas have plummeted, investors are fleeing and debt holders are worried about credit exposure caused by Enron's spectacular collapse.

Houston-based Enron, until recently the biggest electricity and natural-gas trader, filed last month for protection under Chapter 11 of the federal Bankruptcy Code while it seeks to reorganize. Its rivals now are slimming down to please skittish investors and credit-rating agencies that think debt levels have gotten out of hand.

Atlanta-based Mirant, for example, has said it intends to sell electricity plants in

Massachusetts acquired a few years ago. But "almost anything would be considered for sale, for the right price," says spokesman Chuck Griffin.

Across the industry, foreign and domestic power plants, North American oil and gas reserves and production facilities, as well as marginally profitable assets like a soda-ash plant in Colorado and a New Jersey refinery, are on the block. Among the biggest offerings: a collection of mostly natural-gas-producing properties that El Paso says it will divest itself of. The fields are in the shallow-water Gulf of Mexico, and in Oklahoma, Arkansas and Kansas.

Some U.S. firms are expected to scout out oil and gas properties that will enhance operations they already own. European shoppers will be looking at individual electricity plants that can make good profits in the deregulated markets of New York, New England, the Mid-Atlantic and California. The Europeans until recently had shown a preference for acquiring complete companies rather than single cast-off plants.

European companies long have yearned for a stronger U.S. presence, but until now the price of expansion has been prohibitive. The European firms "keep saying they're interested and they haven't used the cash on anything else," says energy analyst Barry Abramson at UBS Warburg in New York. With their strong balance sheets, the European firms also have untapped borrowing capacity.

Among the likely buyers mentioned: Big German energy concerns **E.On** AG and **RWE** AG, which recently acquired American Water Works, owner of regulated water utilities throughout the U.S.; Tractabel North America Inc., the energy arm of Paris-based **Suez** that already is building power plants in Washington and Texas; and Britain's **Powergen** PLC, which bought LG&E Energy Corp. last year.

There are plenty of U.S. companies, too, with the financial strength to make deals. Many of these bottom fishers still own traditional utilities that throw off sizable sums of cash that can bankroll investments by unregulated affiliates. Their balance sheets haven't been stretched out of shape, giving them lots of borrowing capacity, unlike the sellers that often have debt-to-capital ratios of 65%. In this camp: **American Electric Power**, Columbus, Ohio; **TXU** Corp., Dallas; **Duke Energy** Corp., Charlotte, N.C.; **Dominion Resources** Inc., Richmond, Va.; **Entergy** Corp., New Orleans; **FPL Group**, Juno Beach, Fla., and **Public Service Enterprise Group** Inc., Newark, N.J.

Like other Texas utilities, TXU is divesting itself of plants in its home state, to stay below market-concentration limits that are part of a state electricity deregulation plan that took effect Tuesday. TXU is using proceeds to retire debt and pick up assets elsewhere.

A handful of independent exploration and production companies with low debt and healthy cash reserves are expected to be bidders for domestic oil and gas properties. Two Houston-based companies, **Anadarko Petroleum** Corp. and **Apache** Corp., and smaller players like **XTO Energy** Inc. of Fort Worth, Texas, **Tom Brown** Inc.,

Midland, Texas, and **Pure Resources Inc.**, also Midland, could be strong contenders.

Apache, in particular, will be a prime player in the scramble for such properties, analysts predict. The concern, headed by founder Raymond Plank, has consistently pursued a strategy of acquiring cast-off assets from major oil companies when prices are low.

Apache has a debt-to-capitalization rate of 37%, near a historic low, and has said it will cut its capital spending by 60% next year. But Apache could pull off a \$1 billion deal without badly hurting its balance sheet, says Fadel Gheit, an analyst at Fehnestock & Co. Mr. Plank "is a serial opportunistic acquirer" who "won't pass up a good deal," the analyst says.

An Apache spokesman declines to say if Apache is interested in the El Paso properties. "If [commodity] prices stay down, we expect acquisition opportunities to arise, and we may become active in the acquisition market in that instance," he says.

El Paso is also putting a 150,000-barrel-a-day New Jersey refinery and some coal mines on the auction block. The company says it wants \$500 million for both the refinery and the coal mines. An executive at **Valero Energy Corp.**, an independent refining and marketing company based in San Antonio, says his company "would take a look" at the plant. Meanwhile, Valero is closing a \$4 billion acquisition of Ultramar Diamond Shamrock Corp.

Analysts are betting **Kinder Morgan Inc.**, a Houston-based energy company with natural gas and oil pipelines, product terminals and electric-generating plants, could pry away some production assets from the selling companies. Kinder Morgan, which was founded in part by former Enron President Richard Kinder, has been growing steadily by using a partnership structure to acquire assets. Profits are shared by company and outside investors in Kinder Morgan Energy Partners LP, which has purchased \$6 billion of assets since it was formed five years ago.

Williams says it is looking to avoid having to sell off exploration and production assets as part of plans to liquidate as much as \$750 million of its portfolio of oil and gas assets. Oil and gas reserves are "not on the list and I don't think they will be," says Phil Wright, president and chief executive of Williams Energy Services, a unit of Williams.

Williams plans to prune its portfolio by shedding a plant in Colorado that mines soda ash for use in the production of baking soda and glass. "Soda ash just doesn't make any sense," for a company with an "energy and trading thrust," says Fredric E. Russell, a Tulsa, Okla., money manager with his own firm that owns 81,000 Williams shares.

The plant is likely to be sold at a distressed price since chemical companies' profit margins are in the dumps due to excess supply. Williams already said it would take a fourth-quarter loss of \$120 million to \$170 million related to the plant.

Monday's Market Activity

Far from showing signs of exhaustion, the monthlong silver rally achieved what analysts called a technical breakout -- or breaching of previous price ranges -- on Monday. March-deliver silver on the Comex division of the New York Mercantile Exchange made a gain of nine cents, to \$4.588 a troy ounce, after backing off an intraday high of \$4.6350. "There were a fair number of people that were anticipating sales before the end of the year, but now we have a technical breakout. Once the technical breakout kicked in, [speculative] funds have got to go [along with it]," Frank McGhee, a dealer at Alliance Financial LLC in Chicago, said.

"It's a thin market. It doesn't take much. There's nobody to stand up to it. [Trading] desks are closed," he added.

Leonard Kaplan, president of Prospector Asset Management in Evanston, Ill., disagreed, saying that window-dressing more commonly occurs in the stock market than in commodities trading.

"It's possible to goose the price a little higher on the close, but the rally occurred well before the close," he noted. "I don't believe the funds have the [nerve] to buy it sharply before a holiday just to make their portfolios look a% or two stronger for the end of the year."

In addition to the funds, Kaplan cited trade houses as quite active buyers Monday. Pre-placed purchase orders, or buy stops, had also been triggered in the March contract between \$4.52 and \$4.53 an ounce, he said.

Short-term silver lease rates, while down slightly from the peak seen before the Christmas holiday, remain robust, with the 30-day maturities bid at 11.5% and offered at 16.5% Monday, according to Kaplan.

Most market watchers have been at a loss to explain why lease rates have soared and stayed firm over the past month, which has led some to speculate that rates reflect a lack of lending liquidity as loans are called in for the end of the year.

But if lending picks up markedly with the start of the new year, lease rates are expected to plummet, dragging silver prices down in their wake.

Silver's risk/reward profile is also less enticing to buyers at current price levels than it was 30 cents lower, Kaplan noted.

"It's a little bit rich here. I prefer to see some stabilization before I buy more or I'd like to see the gold market break out as well and get above \$282, and that has yet to happen," he said. February gold on Comex ended at \$279 an ounce.

But McGhee at Alliance said he was encouraged to see silver running from the bottom

of a trading channel to the top in just a day and a half and anticipated it advancing still higher toward \$4.65-\$4.70 an ounce, an area he identified as resistance, or an important level to rise above.

One factor behind the higher prices across the precious metals was the desire to remain long, or maintain bets on higher prices, before major holidays, due to the looming threat of further terrorist actions, McGhee explained. If escalating border tensions between India and Pakistan over the disputed Kashmir province explode into another full-scale war, it will likely be detrimental, not positive, for silver, however. Political destabilization in the region would hurt the Indian rupee and depress Indians' buying power, Kaplan predicted.

Meanwhile, copper futures on Comex fell hard on aggressive fund selling. The March contract dropped 1.85 cents to 65.90 cents a pound. "It was funds selling in a relatively illiquid market," a New York-based broker said.

And natural-gas futures on Nymex fell on selling by funds, high storage levels and a warming trend. The February contract dropped 20.4 cents at \$2.57 million British thermal units.

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