Transco Energy Company - An Assessment of the Company's Restructuring and Its Future.

In late 1992 Ammonite was retained by a significant shareholder in the former Transco Energy Company (acquired by The Williams Companies in 1995) to evaluate the restructuring of the major gas transmission and production company after it was nearly forced into bankruptcy. Six Ammonite consultants worked on the project. The equity position of our client was such that we were able to meet with senior Transco management in the course of the study.

The scope of the Ammonite study was as set forth below in the report introduction:

In December, 1992, Ammonite Resources was retained to examine the status of the Transco restructuring. The assignment called for an evaluation of the strategic plan for repositioning Transco as a gas industry leader; the effectiveness of that plan; analysis of the evolving financial condition of the company; and an assessment of the prospects for future growth of Transco in its core businesses. In order to understand and appreciate the industry environment in which Transco operates and must react, the assignment also included an overview of the principal gas supply, market demand, and regulatory factors which affect the natural gas industry, and a review of the industry competitors of Transco.

Restructuring of a multi-market sector and heavily debt burdened company like Transco would be difficult under the most stable business conditions. Transco, however, has had to implement its strategic plan at a time when the natural gas industry has excess supply; when gas prices are highly volatile, varying more than 50% annually; and during a period when federal regulatory changes have fundamentally altered the way the gas industry conducts its business.

The conclusion to Ammonite's report on Transco is reproduced below:

Conclusion

Transco Energy has one of the finest pipeline infrastructures and customer franchises in the United States. In addition, the Northeast markets served by Transco's pipelines have significant growth potential for natural gas consumption. Despite this strategic advantage, poor investment decisions made by Transco management, together with fundamental changes within the energy production and pipeline industries, during the 1980's and continuing into 1991, nearly caused bankruptcy of the company. Between 1989 and the second quarter of 1992, Transco's common stock lost 80% of its value, plummeting from $50 per share to a low of $9.50 per share.

An entirely new, capable and responsive senior management team has done a remarkable job over the past 17 months in implementing a strategic plan to restructure Transco and restore long term profitability and growth. There are however, a number of substantial financial and operational hurdles which remain:

Successfully close the Magnolia-Torch Energy transaction without incurring a loss.

Consummate a sale of the Coal operations which maximizes the cash proceeds and minimizes or delays any loss on the sale.

Eliminate the operating losses, and rebuild the staff and customer confidence in the Gas Marketing segment.

Resolve the nearly $1 billion of litigation and royalty claims filed against the pipeline subsidiaries without exceeding the provisions made for these suits.

Reduce total debt of the company.

Based on our in-depth analysis of Transco Energy and its individual operating divisions, it is Ammonite's opinion that Transco will be able to successfully resolve most of these remaining financial and operational issues. The improvement in the company's financial position is sufficient that Transco should not have to seek bankruptcy protection from its creditors, and the quarterly common stock dividend appears to be secure.

By the end of 1993 Transco should have completed most of the restructuring process begun in November, 1991. Ammonite estimates earnings should increase over the next three years to about $1.50 per share, and the common stock price is projected to rise to roughly $25 by 1995. Beyond 1995, however, Ammonite does not see much growth potential in earnings, or significant changes in the stock price of Transco. The regulated rate of return on the investment in pipelines, limited earnings contributions from the company's non-regulated businesses, and the continuing debt burden, will result in Transco Energy being a relatively static long-term investment compared with its financially stronger competitors in the interstate gas pipeline industry.

Ammonite's client shared our report with Transco, and we received a letter from John P. DesBarres, Chairman and CEO, which stated the following:

"I'm pleased that you were able to meet with Bob Best, John Clarke and Bob Christe in the course of your study. They have been key players in our efforts to restore Transco's financial strength and profitability, and I hope that you found their insights and opinions valuable. We

certainly appreciate the comments you shared with us from customers, analysts and other industry participants.

Obviously, we agree with your assessment of the significant value of our pipeline franchise; likewise, we acknowledge the gravity of the challenges that remain, but are confident that we are making regular progress on all fronts.

Again, many thanks for sharing your report with us. Don't hesitate to call if we can be of help in any further analysis or review. You're on our mailing lists and should continue to regularly receive news and information from us. I hope to have the opportunity to visit with you and your associates in the near future."

In February, 1995, we received a letter from a senior executive of Transco while merger negotiations with The Williams Companies were in progress. He wrote:

"Given recent events, I pulled your report on Transco from early 1993 to review your conclusions at the time. It's safe to say that your cautious approach to investment in the company was appropriate. We did not quite live up to the projections of earnings and value, and that was due primarily to the issues you raised as red flags in your assessment: coal, coalbed methane, and marketing, among others."