

CMS Energy (Ticker Symbol: CMS)

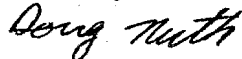
Greetings from LFS



Dear Clients and Friends:

Here is my quarterly newsletter, **Invest**. The goal of **Invest** is to keep you abreast of what is happening in the financial market, inform you about new investments and keep you informed about your current investments. I welcome any questions, comments or suggestions.

Sincerely,



Douglas Ruth

Invest

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Abstract:

CMS misallocated its stockholders' capital. The company expanded too quickly both domestically and internationally, and underestimated the risk of international business. Investors are very nervous fearing, that CMS may be the next Enron.

CMS is being "squeezed" by several entities at the same time:

1. Its banks
2. The rating agencies
3. The Securities and Exchange Commission (SEC)
4. Its auditors

In May 2002, it was disclosed that the company overstated the revenues of its Marketing Services and Trading Division. The cash flow and profits were not affected by the higher revenue level.

The company increased the expense level by the same amount as the higher revenue. In the end, there was no economic benefit for the company. The industry calls this type of transaction "round-tripping." Round-tripping is prohibited in the securities markets but is legal in the unregulated wholesale power market. Round-tripping is done for two reasons:

1. It can boast the benchmark price for a commodity, thereby increasing the price for later deals.

2. It also can make a market for a contract appear more liquid than it really is. This can exaggerate the importance of a market player by creating the appearance that huge volumes are being traded.

In May 2002, CMS agreed to restate its sales for 2000 and 2001 to eliminate the excess revenues and expenses from the Income Statement.

The squeezing by the various entities mentioned previously is putting pressure on the company's stock and bond prices and has pushed them down. I believe a large portion of this pressure will be relieved in the next 30 to 120 days and both the stocks and bonds will recover from their lows. Currently, investors can buy bonds with 3 to 6 year maturities that yield 9 – 13%. This is where I believe the best investment opportunity is.

CMS Time Line:

Item	Date	Description
1	May 9, 2002	CMS disclosed that the company overstated the revenues of its Marketing Services and Trading Division (MST). The actual cash flow and profits were not affected by the higher revenue level.
2	May 10, 2002	The SEC asked CMS to provide information about what happened. This is similar to being contacted by the Internal Revenue Service and having them ask about your tax return
3	May 15, 2002	CMS disclosed that revenues and expenses were overstated by \$1 billion in 2000 and \$3.4 billion from January through September 30, 2001.
4	May 16, 2002	Tamela Pallas, head of the CMS MST unit, resigned.
5	May 24, 2002	<ul style="list-style-type: none"> William T. McCormack Jr., Chairman and C.E.O., resigned.
6		<ul style="list-style-type: none"> Kenneth Whipple, retired Executive President of Ford, was hired. Mr. Whipple, age 67, was named temporary Chairman and C.E.O. He has a Bachelor's Degree in Business and Engineering from Massachusetts Institute of Technology.
7	June 11, 2002	<ul style="list-style-type: none"> Moody's Rating Agency cut the rating of CMS debt.
8		<ul style="list-style-type: none"> Arthur Andersen, the company's auditor, disclosed that investors should not rely on CMS financial statements because of the overstated revenues. Note that CMS announced that Ernest & Young was replacing Andersen on May 23, 2002.
9	June 12, 2002	CMS asked that the bank extend a \$450 million loan for an additional 4 weeks. By that time the company should have audited financial statements.
10	June 17, 2002	<ul style="list-style-type: none"> The \$450 million in bank debt mentioned above becomes due unless the extension is granted.
11		<ul style="list-style-type: none"> Extension was granted to June 12, 2002.

The Facts:

The "squeezing" is an over-reaction to past events. At the end of the day, the Marking Services and Trading (MST) portion of CMS represents a relatively small portion of the company.

CMS Energy Corporation			
Consolidated Statements of Income			
	Year Ended 12-31		
	In \$Millions		
Pretax Operating Income (Loss)	1999	2000	2001
Electric utility	\$494	\$481	\$339
Gas utility	132	98	99
Natural gas transmission	148	227	207
Independent power production	160	192	121
Oil and gas exploration and production	17	31	74
Marketing, services and trading	4	14	71
Other	20	(11)	18
Loss and reduced asset valuations	(84)	(329)	(628)

It appears that CMS is guilty of using poor judgment but did not necessarily violate security laws. It is interesting to note that Moody's Investors Service recognized CMS' new strategic plan in October 2001. Now, the company's balance sheet is improving and Moody's downgraded the company's debt. I do not agree with Moody's action.

Understanding CMS' relationship with Arthur Andersen is interesting:

CMS, like many companies, decided to replace Andersen because of that company's problems with Enron.

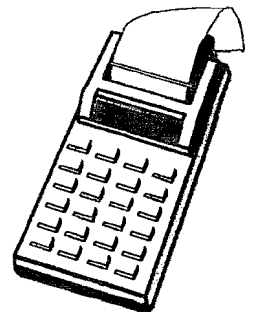
CMS discloses that MST division revenues and expenses were overstated.

Andersen tells the public that the financial statements cannot be relied upon because of the overstatement.

CMS hires the "white knight" accounting firm of Ernest & Young who will certify that the financial statements are now accurate.

After the financial statements are certified, I believe CMS bank debt will be renewed. If the debt is not renewed, the company has several alternatives such as asset-based lending.

Finally, when the banking situation is resolved it should take some of the pressure off CMS stock and bond prices.



CMS is an operating company with some very strong assets. CMS management is under pressure to improve both the operating results and deleverage the company's balance sheet. Several factors are currently in CMS' favor:

- Interest rates remain low.
- The domestic oil and gas businesses are unusually good compared to recent years, with the demand exceeding the supply. This, in turn, increases the value of CMS assets.
- The company has financial flexibility. CMS has the ability to issue additional common stock, preferred stock or debt.

The passage of time should produce results. Patience is required. Investors can participate in CMS by buying stock, bonds or preferred stock. I believe the bonds may be the best choice, but the other two items should also produce a satisfactory return. CMS bonds offer the opportunity for both high current income and appreciation. The key point on which investors should focus is the debt to equity ratio. CMS is selling assets to reduce the debt level and it is working. The debt level was lower at the end of the first quarter 2002 than it was at the end of 2001.

Section I

Overview:

CMS Energy, formed in Michigan in 1987, is an integrated energy company operating in the U.S. and in selected growth markets around the world. CMS has been in business since 1886. CMS Energy has a strong asset base, supplemented with an active marketing, services and trading capability. Its two principal subsidiaries are Consumers and Enterprises:

Consumers is a public utility that provides natural gas and/or electricity to almost 6 million of the 10 million residents in 68 Michigan lower peninsula counties. The company has 1.7 million electric customers and 1.6 million gas customers.

Enterprises, through subsidiaries, is engaged in several energy business in the U.S. and in selected international growth markets.

The key assets, in addition to Consumers Energy, are:

- A 15,000-mile interstate natural gas pipeline system that serves the central and northern U.S.
- The nation's largest operating liquefied natural gas (LNG) import terminal.
- The capability to generate 8,000 megawatts of both non-utility and utility power.
- A successful gas and oil exploration and production company.

- In 2001, CMS Energy's consolidated operating revenue was \$9.6 billion.

The Problem:

For a very long time period, (I am talking decades) the management of CMS was happy to simply provide gas and electricity to the people of Michigan. What's the matter with that? The answer is: Nothing!

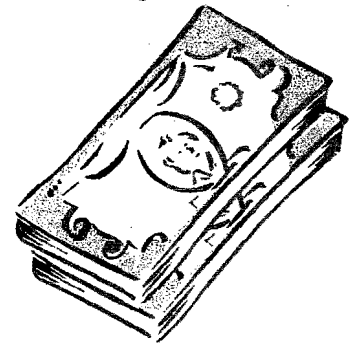
Customers could count on the company to provide reliable service and the company's employees had good jobs with the chance for advancement. The stockholders earned a fair return on their investment. The "silly" people in charge of managing CMS found this business model boring, which it probably was.

Nationwide, utility companies are slow growers. Utilities can grow revenues and earnings in three different ways:

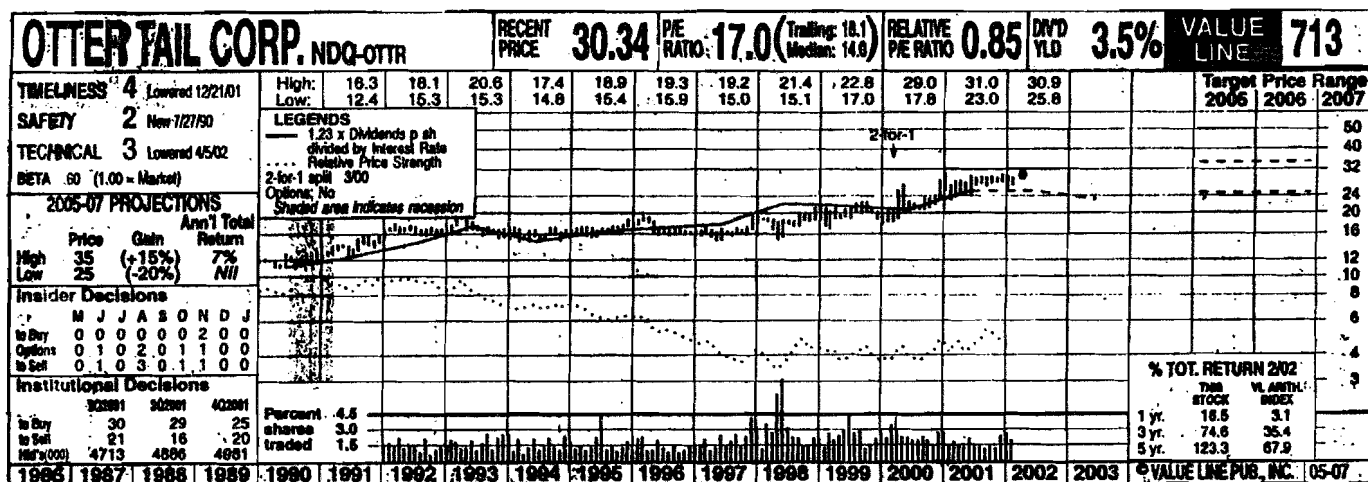
- Securing more customers (increased population).
- Having customers consume more electricity, gas or telephone service.
- Raising prices.

Utilities are capital-intensive businesses. Large sums of money must be regularly reinvested simply to maintain the status quo.

Conservative utilities work hard on expense control. Ultimately, some sales and earnings growth can be achieved by securing more customers, increasing consumption, and increasing prices. It is common to meet individuals who have invested in their local utilities and their investments have done quite nicely when you look at the results over an extended time period.



A sense of a conservative utility versus an aggressive utility can be viewed by comparing the performance of CMS Energy to Otter Tail Corporation:



Some of the statistics from CMS' Consumers Energy appear below. You can see the business is flat. On the other hand, it is very predictable and stable. You can see from the chart below that the number of customers is growing at the rate of about 1.5% per year. You can also see that the customers' consumption is barely increasing. In fact, in 2001, the consumption of gas decreased from 2001 versus 2000. This is partially explained by the extremely mild winter during 2001. Finally,

you can see that the price of electricity has barely budged.

Natural gas is similar with the exception of 2001. You probably remember the tremendous spike in gas rates in 2001. Ultimately, prices dropped pretty dramatically. Hindsight being 20-20, the rarity of this type of spike can now be explained as something similar to a 100-year flood.

Consumers Energy Company Selected Financial Information

	1997	1998	1999	2000	2001
Operating Income (in millions)	\$3,769	\$3,709	\$3,874	\$3,935	\$4,014
Cash from Operations (in millions)	\$761	\$637	\$791	\$468	\$517
Book Value per Common Share at Year-End	\$20.38	\$21.94	\$23.87	\$24.09	\$21.99
Number of fulltime equivalent employees at year end: Consumers	8,640	8,456	8,736	8,748	8,477
Electric Statistics:					
Sales (billions of kWh)	37.9	40.0	41.0	41.0	39.6
Customers (in thousands)	1,617	1,640	1,665	1,691	1,712
Average sales rate per kWh	\$0.0657	\$0.065	\$0.0654	\$0.0656	\$0.0665
Gas Statistics:					
Sales and transportation deliveries (bcf)					
Customers (in thousands)	420	360	389	410	367
Average sales rate per mcf	\$4.44	\$4.56	\$4.52	\$4.39	\$5.34

Consumers Energy Accomplishments:

In the second quarter of 2002, CMS sold its electric transmission system. The management of CMS wanted to transform the company from a stodgy, boring company into a dynamic growth company. Utilities were being deregulated in the U.S while internationally utilities were being privatized. CMS management believed that change created opportunity. They believed that they could create a leading international energy infrastructure company, which developed and operated energy facilities and provided energy services in all major world growth markets. CMS could provide a complete range of services from wellhead to burner-tip.

The company believed that it had two advantages over the competition:

Energy Value Chain -- Expertise: CMS had the expertise to complete every task involved in energy. The company could tailor services to a specific market need. CMS could offer them separately such as building a single power plant or pipeline, or putting them together in a chain of energy assets. This integrated energy value chain – the ability to provide a complete range of services – differentiated, and still differentiates, CMS from other energy companies. Each task would add value. The company would be paid for this additional value creation.

Knowledge base: CMS had a rich knowledge base, gained from operating Consumers Energy Company for over 100 years. This knowledge included skills in engineering, financing, construction, management and operation.

The Energy Value Chain:

Exploration and Production: CMS had the ability to both find energy and produce wells that could extract the raw energy. The company has had success in the U.S. Gulf Coast and has expanded its drilling focus into the mid-continent and the Rocky Mountain regions.

Gathering, Processing And Storage: After natural gas is found, it must be gathered from the wells and delivered to transport pipelines. CMS Field Services Operations, the Fort Union and Big Horn gathering systems perform this function.

Transportation: After the oil is found it is transported using the company's Panhandle and Truckline piping system.

Generation: CMS has the ability to generate power in both North America and other countries throughout the world.

Marketing And Energy Management: Extra energy, or the commodities of gas and electricity, can be marketed by CMS' Sales Department.

CMS can operate power plants from fuel from their own wells. The company cannot only explore for and produce oil and gas, but can gather, process and store the fuel using its own systems. Furthermore, the fuel can be transported using CMS pipelines. The complete menu of services that CMS can provide gives the company both flexibility and cost efficiency.

The company was going to enter new markets – both domestic and international. In 1998 and 1999, CMS noted the potential in India and the African continent. India is the world's sixth largest energy consumer. In 1998, the energy supply was 30% below the country's needs. Only 10% of the population of the African continent had access to electricity in 1999. Additionally, CMS noted the potential of West Africa's oil and gas reserves.

At one point, CMS had operating assets in 17 countries on five continents. The intent of CMS Energy was to try for international growth by investing in multiple projects in each chosen country. CMS conducted its development business from offices in four regions of the world:

- Dearborn, MI for the Americas –Northern Hemisphere.
- Buenos Aires, Argentina for the Americas – Southern Hemisphere
- London for Africa, Europe and the Middle East
- Singapore for Southeast Asia and Australia

In 1997, the company was the fifth largest developer and operator of independent power companies.

Developers of this "vision" were paid large sums of money to "close the deals" and put CMS "on the map." All of this was contrary to the company's core competence, which is operating power plants in a regulated environment.



The managers were able to increase the company's revenues from \$5.141 billion in 1998 to \$9.597 billion in 2001. This sounds impressive until I tell you the rest. Over the last four years (1998 through 2001) the company issued \$4.278 billion of debt, \$627 million of preferred stock and \$901 million of common stock. The company used the proceeds to buy assets. The assets, in theory, were going to generate additional profits, which in turn would reward the stockholders. As often happens, things did not work out according to plan. The company's earnings peaked in 1998 and have dramatically decreased since.

**Consumers Energy Company
Selected Financial Information**

	1997	1998	1999	2000	2001
Operating revenue (in millions)	\$4,781	\$5,141	\$5,926	\$8,739	\$9,597
Consolidated net income (in millions)	\$244	\$285	\$277	\$36	(\$545)

The Growth Stops:

Starting in 1999, some of CMS' aggressive growth strategies started to produce poor results. The growth story of CMS was now over. In 1992, an investor could have bought CMS at \$14.90 a share. The stock peaked at \$48.50 in mid-1999. In 1999, CMS Energy stock dropped 36% while the peer group stock declined 25%. Since that time, the stock has been trending down and hit a 14-year low of \$11.75 in June 2002.

Hindsight being 20-20, it was evident that the company had done too much, too fast. Since 1999, CMS has been taking one-time charges to write off or write-down various investments.

The type of people interested in CMS has shifted from growth investors to value investors. Value investors are more interested in hearing about how the future will be rather than rehashing what has happened in the recent past. It is important, however, to talk about the past so an investor can understand what happened.

CMS Today:

CMS has a number of assets that remain strong. These assets are described below:

Asset 1 – Consumers Energy:

Consumers Energy, formed in Michigan in 1968, is the successor to a corporation organized in Maine in 1910 that conducted business in Michigan from 1915 to 1968. In 1997, Consumers, formerly named Consumers Power Company, changed its name to Consumers Energy Company to better reflect its integrated electricity and gas businesses.

At year-end 2001, Consumer's customer base and operating revenues were as follows:

	Customers Served (Millions)	Operating Revenue (Millions)
Electric Utility Business	1.70	\$2,633
Gas Utility Business	1.63	1,338

Consumers' Electric Utility Operations:

Based on the number of customers, Consumers' electric utility operations, if independent, would be the thirteenth largest electric utility company in the U.S. Consumers' electric utility operations include the generation, purchase, transmission, distribution and sale of electricity. At year-end 2001, it served customers in 61 of the 68 counties in Michigan's lower peninsula. Principal cities served include Battle Creek, Flint, Grand Rapids, Jackson, Kalamazoo, Midland, Muskegon and Saginaw.

Consumers' electric utility customer base includes a mix of residential, commercial and diversified industrial customers, the largest segment of which is the automotive industry. Consumer's electric utility operations are not dependent upon a single customer, or even a few customers. The loss of any one or even a few of such customers is not reasonably likely to have a material adverse effect on its financial condition.

In October, CMS signed an agreement to sell its electric transmission system for approximately \$300 million to an independent transmission company, Trans-Electric. This sale price includes a \$33 million gain for CMS.

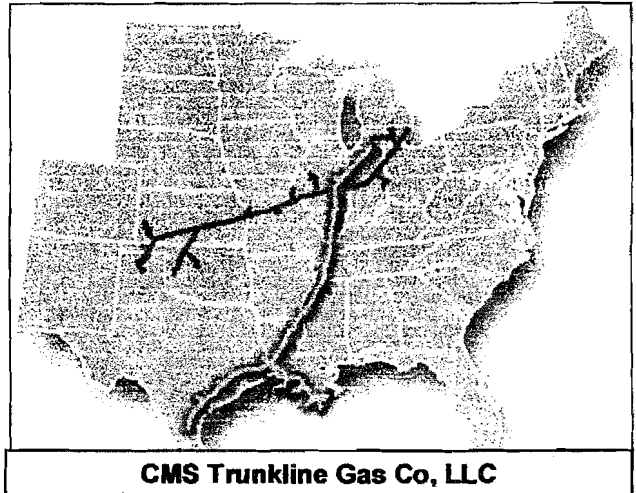
Consumers' Gas Utility Operations:

Based on the number of customers, Consumers' gas utility operations, if independent, would be the fifth largest gas utility company in the U.S. Consumers' gas utility operations purchase, transport, store, distribute and sell natural gas. As of December 31, 2001, it was authorized to provide service in 54 of the 68 counties in Michigan's lower peninsula. Principal cities served include Bay City, Flint, Jackson, Kalamazoo, Lansing, Pontiac, Saginaw, and Suburban Detroit.



Asset 2 – Natural Gas Transmission:

CMS Gas Transmission, formed in 1988, owns, develops and manages domestic and international natural gas facilities. In 2001, CMS Gas Transmission's operating revenue was \$1,054 million. CMS Gas Transmission has a total of 15,850 miles of pipeline in the U.S. This includes CMS Trunkline Gas Company LLC, which operates a 2,786-mile pipeline with access to the Gulf Coast and 141 miles of projects under construction.



CMS Trunkline Gas Co, LLC

CMS natural gas business is the segment with the most potential. Please consider the following facts and figures about natural gas:

- Natural gas accounts for 24% of total U.S. energy consumption.
- Natural gas use in the U.S. has increased by 35% over the last decade and is projected to grow by as much as 50% between 2000 and 2020.
- Natural gas is expected to account for about 90% of the country's new electric generation between 1999 and 2020.
- Seventy percent of single-family homes completed in 2000 feature natural gas heat.

Below is a table that shows selected financial information for this division:

CMS Natural Gas Transmission Selected Financial Information (In \$Millions)							
	1995	1996	1997	1998	1999	2000	2001
Revenue	—	\$53	\$96	\$160	\$895	\$1,053	\$1,290
Operating Income	\$12	\$26	\$33	\$20	\$64 ¹	\$227	\$207
Margin	—	49.1%	34.4%	12.5%	—	21.6%	16.1%
Operating Income Assets	\$272	\$397	\$508	\$971	\$3,526	\$3,826	\$3,727
Margin	—	6.5%	6.5%	2.1%	1.8%	5.9%	5.6%

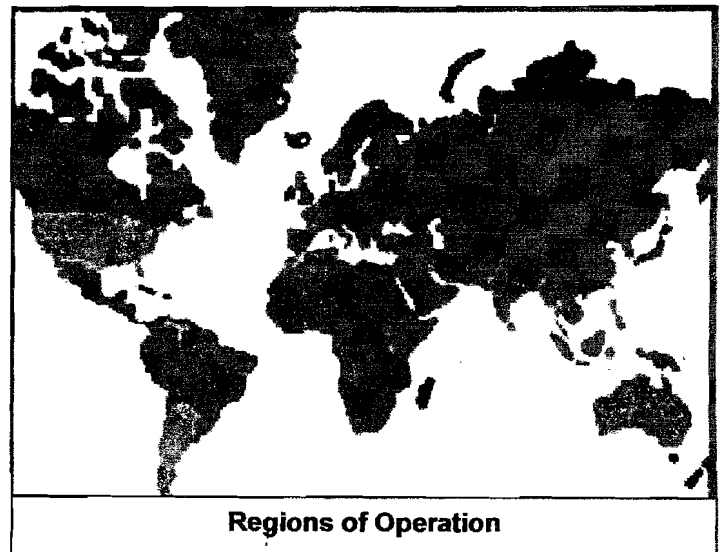
Note 1: Net of write-off of Nitrotec.

With the demand for natural gas increasing, it is reasonable to believe that pipeline assets will continue to increase in value over a period of time. In March 1999, CMS acquired Panhandle Eastern Pipe Line. Formed in 1929, Panhandle was purchased for \$1.96 billion and the assumption of \$300 million in debt. The company believed that Panhandle's purchase established CMS as the premier energy company serving the Midwest. Panhandle operates a 6,325-mile pipeline system, and transports about 7% of the country's natural gas including more than a quarter of all the gas consumed in the Midwest.

It is primarily engaged in the interstate transmission and storage of natural gas. Panhandle operates a large natural gas pipeline network, which provides customers in the Midwest and Southwest with a comprehensive array of transportation services. Panhandle's major customers include 25 utilities located primarily in the Midwest. This market area encompasses large portions of Illinois, Indiana, Michigan, Missouri, Ohio and Tennessee.

Asset 3 – Independent Power Production:

CMS Generation, formed in 1986, invests in, acquires, develops, constructs and operates non-utility power generation plants in the U.S. and abroad. CMS management aggressively expanded the company's independent power production worldwide. The company expanded both domestically and internationally.



In North America, the company operates 12 independent power plants (IPP). CMS' largest operation is the Midland Cogeneration Venture in Michigan. CMS owns 49% of this facility. The plant has been recognized as one of the largest and most reliable IPPs in the U.S. The plant is capable of supplying enough electricity for a city of more than one million people.

The international generating plant that remains in CMS' portfolio is *Jorf Lasfar* in Morocco, Africa. Jorf Lasfar is the largest IPP in Africa. It generates more than half of Morocco's electricity supply. Also remaining is the first major privatized power and water project in United Arab Emirates. This plant opened in July 2000 and was expanded in 2001.

Asset 4 – Energy Marketing, Services and Trading (MST):

CMS MST provides gas, oil and electric marketing, risk management and energy management services to industrial, commercial, utility and municipal energy users throughout the U.S. and abroad. CMS has the ability to analyze a corporation's energy use, help improve energy efficiency, and ensure that adequate backup power is available to maintain production lines.

CMS MST has grown dramatically since its inception in 1996. CMS Energy intends to use CMS MST to focus on wholesale customers such as municipalities, cooperative electric companies and industrial and commercial customers. On December 31, 2001, CMS MST had more than 10,300 customers, transported gas on more than 40 gas pipelines and was active in most of the 50 states and Canada. In 2001, CMS MST's operating revenue was \$4.0 billion.

This division is probably the most controversial portion of CMS. Historically, utilities generated, transmitted and distributed electricity themselves. The price of electricity was regulated. As electricity was deregulated across the country, a new business called "energy trading" emerged. Understanding some of the history helps the investor to understand energy trading better.

Electricity as a commodity has some unique properties:

- It cannot be stored. It must be generated and delivered in real time.
- The demand for electricity changes dramatically throughout the day. The extreme example is when the temperature is over 90 degrees. In the afternoon, when the majority of people are awake and also working, the demand is at the highest point. Usually in the late evening, even on a hot day, the demand decreases dramatically.
- It is difficult to move electricity over great distances.

Electricity is considered the most volatile commodity because of the spikes in demand. In the Chicagoland area, as you know, there are hot summers when it seems like the air conditioner is running full out all the time and then there are cool summers where the air conditioner isn't needed as much.

On the average, electricity, nationwide, costs about \$10 to \$20 per megawatt hour. When the entire U.S. goes through a heat wave, the cost could soar to over \$5,000 per megawatt hour. At these extreme times, the demand for electricity is exceeding the supply. Sometimes you will hear a spokesperson for a local utility on television or radio asking the public to please use less electricity if possible or a brown out or blackout may occur.

Energy trading is a legitimate business. Industrial customers such as automotive assembly plants and local utilities, which sometimes do not generate electricity, want to know that a future electrical supply will be available when they need it. Municipal utility and electric cooperatives often do not produce their own electricity. These customers often contract with an energy-trading firm to assure that their future needs will be met. This is similar to a manufacturer such as Kellogg contracting well in the future for a supply of corn to assure that it will be available regardless of any unforeseen events.

CMS can lower a business' energy costs through services such as fuel conversions, equipment maintenance and energy optimization, and also concentrates on saving money through the redesign or retrofit of lighting systems and controls.

What is difficult to accept is that managers took a legitimate business and tried to turn it into something else. CMS has disclosed that approximately 78% of its activity was phony. As disclosed earlier in this report, this practice appears to be legal. Ultimately, through the passage of time and money, the issues will pass.

Debt Level:

As of March 31, 2002, CMS has a lot of debt on its balance sheet. The management is focusing on reducing this debt.

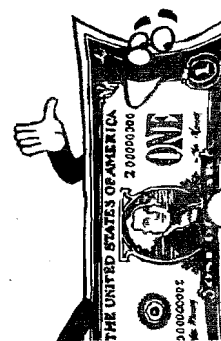
Capitalization as of 03-31-02 (In \$Millions)		
	12-31-01	03-31-02
Equity:		
Common stockholders equity	\$1,890	\$2,289
Preferred stock of subsidiary	44	44
Company-obligated convertible trust preferred securities	694	694
Company-obligated mandatorily redeemable preferred securities	<u>520</u>	<u>490</u>
	\$3,148	\$3,517
Equity as a percentage of capitalization	31%	35%
Debt		
Long term debt	6,923	6,543
Non-current portion of capital leases	<u>60</u>	<u>60</u>
Total	\$6,983	\$6,603
Debt as a percentage of capitalization	69%	65%

CMS interest expense for the year 2001 was \$691 million and for the first quarter of 2002 was \$160 million.

Interest Expense (in \$Millions)			
Quarter 1		Year	
2001	2002	2000	2001
\$166	\$160	\$676	\$691

In May 2002, CMS announced plans to put its oil and gas exploration and production units up for sale and exit the oil and gas exploration and production business. The proceeds will be used to reduce debt. In June 2002, the company projected \$566 million will be raised from this sale.

CMS has projected that it will earn \$2.00 to \$2.05 per share for calendar year 2002. This means that it will earn approximately \$270 to \$276 million after interest expense. In the first quarter, CMS earned \$0.72 per share. The projections for the second quarter are approximately \$0.30 - \$0.40 per share.

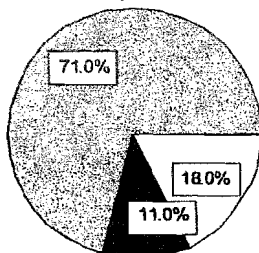


If CMS can, in fact, earn \$2.00 per share, this would be respectable. The key quarters for CMS are the first (heating season) and the third (cooling season). A hot summer would really help the company. If the company can earn \$2.00 per share, it would also restore Wall Street's confidence in it to a certain degree.

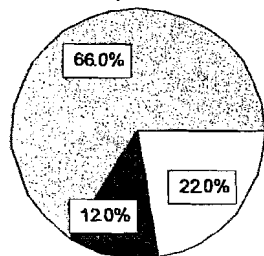
CMS is projecting that its balance sheet will be at the following levels by December 31, 2002:

Improving Capital Structure

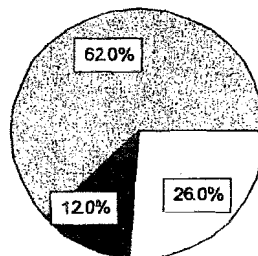
12/31/01 \$11.1 billion



3/31/02 \$10.6 billion



Est. 12/31/02



Legend: Debt (stippled), Preferred Stock (solid black), Common Equity (white)

*Excludes securitization debt of \$449 million.

Additional Problem - The Dividend:

CMS is paying a large dividend – approximately \$10.8% based on a price of \$13.54. I believe the dividend should be cut and the cash used to pay down debt.

The Prior Crisis:

Finally, it is also interesting to note that CMS has stumbled badly and recovered in the past. The company took several big charges to earnings in the 1990-1992 time period:

	Charge per Share				Charge in Millions
1990	\$9.80	X	80.75	=	\$791.35
			shares		
1991	\$5.36	X	79.82	=	\$427.84
			shares		
1992	\$4.71	X	79.97	=	\$376.66
			shares		
					<u>\$1,595.85</u>

The company managed to blow \$1.6 billion of stockholders money during this time period. CMS

was going to build a nuclear power plant in Midland, Michigan. The nuclear plant never got off the ground. The company was able to salvage some of the plant by converting it to a gas-fired facility. Ultimately, the company worked through its problems.

Section II - The History:

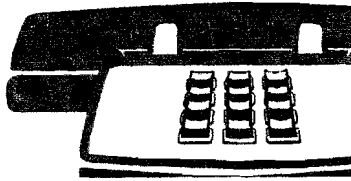
CMS made two major mistakes. First the company underestimated the risk of international business. Second, the company expanded too quickly, both domestically and internationally.

1. Risks of International Business:

CMS management believed that an opportunity had presented itself to expand internationally. Many countries outside of North America had both an unmet and fast-growing need for energy. CMS felt that it could take its knowledge and energy value chain skills and leverage them internationally. The perfect investment for the company is one that provides opportunities for a number of CMS businesses, not just stand-alone projects. In theory,

this seemed reasonable. CMS entered several international markets.

In the U.S., utility customers take for granted the supply of electricity, gas, water and telephone service.



Utility companies provide services and customers pay for the services provided. If a customer does not pay the bill, the utility shuts off service. This system has worked for decades for several reasons:

Customers felt that, by and large, they were getting value for the money spent. That is, service is delivered reliably to the customers' homes or businesses.

- Utilities earned a fair return on their investment.
- The system was, and still is, stable.

The political and economic system in the U.S. is stable. Stability is also a function of the constant demand and need. Most customers want service and also have the ability to pay for a steady supply of gas, water, electricity and telephone service.

I have often been perplexed with the living conditions in other parts of the world. When you watch television on a regular basis, you are shown living conditions in undeveloped parts of the world. It is hard to comprehend that many parts of the world do not have running water, gas, electricity or telephone service.

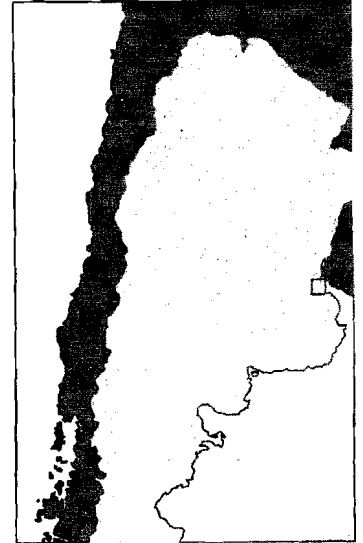
Why should this be? I have studied CMS and I found out the answer. An interesting question to debate is who should provide utility service. Two possible answers are the government and private industry.

The evolution of utility companies in an emerging market is considered to be a shift from government control to private industry. In theory, this means that the system should be self-sufficient and investors in private industry should be able to earn a fair return on their investment. Earning this fair return allows investors to maintain and perhaps expand the system. This is the basis of capitalism. If business were this easy, then people in other

parts of the world would have basic utility service immediately. Ultimately, over a long period of time, perhaps decades, this will happen. This is not what is currently happening. A description of some of the difficulties CMS faced in various international operations follows:

Argentina:

On April 30, 2002, CMS wrote down 80% of its Argentine investment. (An asset is written down because the current value is not as high as the purchase price.) A point that should be discussed is "Are CMS assets in Argentina really impaired?" The answer depends on what time period you consider:



- CMS management borrowed American dollars to invest in Argentina. Argentine customers paid for the provided services in pesos. A 2002 peso is worth less than a 2001 peso, so CMS is earning less money today in Argentina that it did in 2001.
- CMS decided to exit Argentina and currently is trying to see all their assets in that country.

The company made two mistakes. The first mistake, which I have identified in hindsight, is that CMS should not have invested in Argentina in the first place. The second mistake is what the company is doing now – the company is trying to sell its assets there at the worst possible time.

CMS is not alone in its misery. Other U.S.-based utilities also over-expanded in Argentina and are now trying to sell assets. Currently, more companies are trying to sell their assets than there are buyers willing to purchase these assets.

CMS has some wonderful assets in Argentina including the TGN Pipeline system, which serves about 40% of the Argentine gas transportation market. The assets are essential to life and are used daily. What has changed is the present value. It is possible that the future value of the assets has

not changed. What I cannot quantify is how far in the future you have to go to prove this theory. It is possible that investors may have to wait five or ten years or even longer for the Argentine economy to improve.

Australia:



Another international investment, the Loy Yang power plant, was located near two provinces in Australia: Victoria and New South Wales. Each province had its own power supply. CMS bought Loy Yang from Victoria in 1997 for approximately \$500 million. Shortly thereafter, circa 1998, New South Wales determined that it had extra power. New South Wales started marketing power to Victoria customers at a lower cost, one that CMS could not compete with. CMS then exited the power plant business in Australia.

As explained earlier, the evolution of utilities is supposed to be the shifting of business from government to private industry. At this particular moment, this is not happening in Argentina or Australia. Ultimately, perhaps, it will.

2. Rapid Expansion:

As explained earlier, utilities are a very slow growing business. CMS was going to buck the trend with a growth by acquisition strategy. As often happens, the company made two major mistakes. First, they overpaid for what they bought, and second, the company was not able to integrate the acquisitions into the core business.

Now CMS is focusing on improving its balance sheet. The company has taken several one-time charges to explain both the overpayment and the failure to integrate the acquisitions.

In a three-year time period, 1998 through 2001, CMS management blew \$1.041 billion of stockholders' money:

Lost Contracts and Reduced Asset Values	
Year	Amount in \$Millions
1999	\$84
2000	628
2001	329

Summary:

There are a lot of moving parts with CMS, which makes it difficult to track. There are often huge changes in the company structure each year. In the end, a broker is reporting on what the company *did* instead of fully comprehending and analyzing the *results* of the original action. Now it appears that the company focus is on the four or five core businesses. Acquisitions have stopped and CMS is working to improve its balance sheet.

It appears that CMS has enough financial flexibility to survive its current crisis. CMS certainly is not boring today. I project that the company will stabilize in the next 30 to 120 days. The key points to watch for are:

- Certifying the company financial statements by Ernest & Young LLP.
- Renewing the revolving bank loan.
- Meeting or exceeding the company's earnings estimate for the second quarter.
- Selling the company's Oil and Gas Exploration and Production unit.
- Naming a permanent replacement for William T. McCormack, Jr., the former Chairman and C.E.O.

I believe that CMS will achieve most of its goals. Time heals all wounds, and it appears that CMS has learned its lessons. In a relatively short period of time, I predict that the company will again return to being a slow, boring utility company. Buying CMS bonds at the present level is a good choice and should produce a satisfactory return.