ENERGY TECHNOLOGIES & SERVICES RESEARCH

ROBERTSON STEPHENS

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ENRON CORPORATION

Sun Microsystems to Team with Enron in Development of Enron's Broadband Services Business

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Enron Corporation **ENE**
Energy Technologies & Services

Change in	Yes/No	Was	Is
...Rating:	No		BUY
...EPS 1998A:	No		$1.01
...EPS 1999A:	No		$1.18
...EPS 2000E:	No		$1.35
...EPS 2001E:	No		$1.55

52-Week Range:	30-67
Shrs Out (MM):	779.1
Market Cap ($MM):	$52,394
Average Daily Volume (000):	3,184.6
12/98 Book Value/Share:	$9.05
1998 ROE:	11.1%
1998 IBIT Margin	5.1%
Tot. dbt / cap as of 12/98:	24.8%
12/98 Net Cash/Share	$0.14
Dividend/Yield:	0.7%
3 Year Sec Growth Rate:	15%

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$67.25 **1/21/00**
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FY Dec	1999A	2000E	2001E
EPS: 1Q	$0.34	$0.30	
2Q	$0.27	$0.32	
3Q	$0.27	$0.34	
4Q	$0.31	$0.38	
Year	$1.18	$1.35	$1.55
P/E	$56.99	$50.00	$43.42
Cal Year	$1.18	$1.35	$1.55
Cal P/E	$56.99	$50.00	$43.42
Revs($M)	**1999A**	**2000E**	**2001E**
1Q	$7,632	$8,861	
2Q	$9,673	$11,852	
3Q	$11,835	$12,811	
4Q	$\boxed{\$10,973}$	$13,462	
Year	$40,113	$46,985	$52,873
EqtyMkt/Rev	1.3	1.1	1.0

Key Points:

- Today at Enron's annual analysts' meeting the company announced an agreement with Sun Microsystems in which Sun will collaborate with Enron on the buildout and commercial development of Enron's broadband services business. We view this agreement as an endorsement of Enron's strategy in broadband services. Enron indicated that it believes its broadband services business has a potential present value of $29 billion, equivalent to $37 per share.
- We believe the price performance of Enron's stock over the past six months, taken prior to any "buzz" surrounding the potential value of the broadband business, would suggest a baseline value for Enron's core energy businesses of $40-45 per share. Thus, if we take Enron's analysis of the potential of the broadband business at face value, we arrive at a price target of $75-80 per share for the company.
- The company struck an upbeat note on its core businesses as well. Its new EnronOnline, an online trading site, is generating significant incremental volume since introduction in November. The Retail Energy Services unit predicts a doubling in contract backlog this year, to $16 billion, with projected IBIT of $75 million (the company's prior estimate was $50 million). We believe the forces at work in the global energy market—deregulation and privatization—will continue to create opportunities for Enron.
- All systems appear go. We reiterate our "Buy" rating on this stock.

Enron Broadband Services

Enron's broadband services business targets the high bandwidth market. Its strategy is two-pronged:

- **The company will develop a bandwidth intermediation business, much as it has built its gas and power trading businesses.** First (as with gas and power), there will be an investment in hard assets and a physical ability to deliver. The company has constructed a 12,000-mile fiber optic network, with plans to go to 18,000 miles by 2001. It is now in the process of building a network of 3,000 servers, to provide customer entry points to its fiber optic network, and some 40 pooling points, to channel users on to its (or others') broadband conduits. Second, on top of this physical presence, the company intends to create a trading market in bandwidth, and, in doing so, to encourage (or force) other bandwidth owners to provide open access to their networks.
- **Second, the company is developing content-related services.** In essence, the service side of the business will leverage the intermediation business to optimize its clients' use of bandwidth. Again, the clients are companies that want to have the ability to deliver high bandwidth content to their customers, yet for whom management of the delivery "piece"—for example, the scheduling, quality, and reliability of delivery—is non-core.

If this brief summary fails to do justice to Enron's broadband business, it points to what we view as a potential problem for Enron in capturing the full market value of this new business. We suspect that most attendees at today's conference, like ourselves, are being asked to venture fairly far afield from their home turf (natural gas, power, energy) to understand and value the broadband business. It's not that we don't get it, or are unexcited by the prospects laid out for us; rather, it's that we have no highly tuned critical filter to apply, to assess the strengths, weaknesses, and likelihood of success of Enron's strategy. In our experience, it is difficult to find audiences for "fish <u>and</u> fowl" investment stories. (Behind this simple communications problem lurk other, more fundamental issues: are energy and telecom compatible businesses from a management, personnel, systems and culture point of view? At what point does the effort to hold the two businesses together begin to tax and divert the energies of both organizations?)

To bridge the communications gap, Enron wisely sprinkled expert endorsements throughout its presentation of the broadband business. The most important of these was the appearance of Scott McNealy, CEO of Sun Microsystems, to announce with Jeff Skilling, Enron's CEO, an agreement whereby Sun will support Enron's buildout of its network. Enron will purchase 18,000 servers from Sun as part of the agreement, so clearly Sun has some self interest at stake. But, fundamentally, Scott McNealy appears to view Enron's open architecture for broadband as the preferable, and inevitable, structure for this emerging market.

At bottom, we think Enron will do the right thing for its shareholders with the broadband business. While Enron management made it clear that they would prefer to hold the energy and telecom businesses together in the near term, given the parallels and synergies between the two, if the market fails to give full value to this new enterprise, management stated it would look at alternatives such as a subsidiary IPO.

The Company and Investment Thesis

Enron is an integrated global energy company. Its operations span the production of natural gas and oil; the transmission and distribution of natural gas; the generation, transmission, and distribution of electricity; wholesale trading of energy in all forms; and retail sales of energy and of services associated with retail energy use. Approximately 80% of Enron's revenues derive from its domestic businesses; its international operations are principally in Europe, South America, and Asia. In 1999, the company reported revenues of $40.1 billion and net income of approximately $950 million (net of nonrecurring items).

We view Enron as the premier, large-cap play on the deregulation and restructuring of the electric utility industry in the U.S. and Europe. In our view, the opportunities created by this restructuring are substantial (see our April 12, 1999 report ***Rejoice Re: Juice Redux*** and our October 20, 1999 report, ***Talkin' 'Bout My Generation***). In addition, Enron has established itself as a leading force in other international power markets, where privatization is allowing new entry.

Investment Risks

Among the risks faced by Enron are risks associated with the company's construction of new power plants and other energy projects: the cost to construct, time to complete, and operating characteristics of the projects once complete all represent potential sources of risk. Enron's strategy has been to build merchant peaking plants, thus exposing the company to the risks (and high potential rewards) of power sold to meet short-term and relatively unpredictable requirements. As the largest marketer of power, Enron faces trading risks. Enron hedges these risks to a significant extent. Lastly, Enron faces exposure to political risk in its international operations.

Robertson Stephens maintains a market in the shares of Sun Microsystems, Inc.

FOR ADDITIONAL INFORMATION, PLEASE CONTACT YOUR ROBERTSON STEPHENS REPRESENTATIVE AT:

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Unless otherwise noted, prices are as of Thursday, January 20, 2000.

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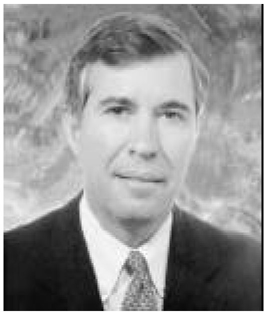

Hugh F. Holman

Hugh Holman joined Robertson Stephens in 1998 as a senior equity analyst covering the environmental sector and the deregulation of the electric utility industry. Prior to joining the firm, he ran his own consulting firm, Environmental Capital Associates, Inc. Hugh has seven years of experience on Wall Street as an equity analyst, principally with Alex. Brown. Prior to joining Alex. Brown in 1989, Hugh was a management consultant with Putnam, Hayes & Bartlett. He also worked for the U.S. Environmental Protection Agency, where he was the lead policy analyst for the Agency's hazardous and solid waste programs. In 1994, *The Wall Street Journal* recognized him as an All-Star pollution control analyst. He received his BA degree from Dartmouth College and his MBA from Stanford University.

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