Enron CEO Skilling Takes Company in New Directions

Houston, May 1 (Bloomberg) -- A year ago, Enron Corp. CEO Jeffrey Skilling put up a banner in the lobby of his company's Houston office tower that welcomed visitors to ``The World's Leading Energy Company.'' Skilling, 47, has now decided that the company's tag should be more ambitious: ``The World's Leading Company,'' the banner says today.

It's no shock that even the CEO isn't sure how to describe Enron, for it's a company swept by constant change. In the 1990s, Skilling transformed a regulated gas-pipeline company into the largest competitor in the business of trading energy, mainly natural gas and electric power.

Now Skilling is pushing the company into Internet trading of all sorts of things: paper products, plastics, metals, fiber-optic bandwidth, commercial credit, pollution emission controls, and even weather derivatives.

All of this morphing unnerves investors, and some of the company's ventures may not be growing as fast as Enron says, according to analysts and industry insiders.

They say the company is overstating the value of the new businesses it's entering. Some investors are increasingly concerned about a lack of clarity regarding where the company is going -- and what exactly it does now.

``Owning Enron is a bit of a leap of faith,'' said John Hancock Advisers Inc. mutual fund manager Greg Phelps, who invests $1.1 billion in utility stocks and doesn't own any Enron. ``I want to buy a stock where I have absolute certainty about the business and direction it's headed.''

Exuding Nervous Energy

Skilling, a man who exudes nervous energy and speaks in rapid-fire bursts, says his track record should ease investors' concerns. In the first quarter of 2001, Enron's profit from operations rose 20 percent to $406 million as revenue almost quadrupled to $50.1 billion.

Enron shares have soared more than 11-fold since the start of the decade, four times the gain of the Standard & Poor's 500 Index. Enron's shares have dropped 25 percent this year, closing at $62.72 on April 30.

Enron isn't merely a trading company, Skilling says. It's a logistics concern that ties together supply and demand for any given commodity and then figures out the most cost-efficient way to deliver that commodity to its destination.

Skilling, who joined Enron in 1990 after leading McKinsey & Co.'s energy and chemical consulting practices, is unapologetic about moving the company in so many different directions. ``In five years, we'll be a different company,'' he said. ``We're not finished reinventing ourselves.''

$65 Billion in Assets

Enron owns $65 billion in assets, including 32,000 miles of pipeline that span 21 states and transport 15 percent of all of the natural gas consumed in the U.S. The company owns an 18,000-mile fiber-optic network in the U.S. and controls 51 power plants and other energy projects in 15 countries on four continents.

Pinpointing what Enron does isn't easy. Some businesses are simple to grasp: In 2000, Enron won $16.1 billion in energy management contracts from such giant corporations as Owens-Illinois Inc. and International Business Machines Corp.

The bulk of Enron's money -- 93 percent of revenue and more than four-fifths of profit in 2000 -- came from wholesale energy operations and services: what it calls ``the financialization of energy.''

Cloaked in Secrecy

This is largely the gas and electricity trading business it pioneered. Enron cloaks the details of that business in secrecy, citing competitive reasons, which makes its bread-and-butter activities as difficult to understand as the abstract Joan Miro lithograph that looms behind Skilling's desk.

``Enron keeps a lot of facts close to the vest,'' said Andre Meade, an analyst at Commerzbank Capital Markets. ``That makes constructing earnings models a real challenge.''

Even many of Enron's employees are shielded from the intricacies of Enron's business. Signs in stairwells and on office walls forbid employees from freely moving around the building into trading rooms and other off-limits areas.

For now, Wall Street is betting that behind closed doors, Skilling and company will figure out how to extend Enron's trading prowess into fast-growing industries.

Of the 22 analysts who track Enron, 19 of them rate the stock a buy.

Enron traded at 40 times 2000 earnings on April 30. That's exactly double the price-earnings ratio of 20 for rival Duke Energy Corp., the biggest U.S. utility owner and energy trader, and 42 percent higher than the S&P 500's April 30 multiple.

`GE of the New Economy'

``Enron is uniquely positioned to be the GE of the new economy,'' said Merrill Lynch's Donato Eassey. ``This isn't a management team to bet against.''

With analyst expectations so positive, some longtime Enron holders are selling stock.

``Especially with its high valuation, the stock's risky, and I don't see much upside,'' said Timothy Ghriskey, senior portfolio manager at Dreyfus Corp., which controls funds that sold about 1.55 million Enron shares at the end of 2000. ``If they fail to deliver for one reason or another, things could get ugly.''

Enron says its 2001 sales will swell to at least $160 billion. Analysts and investors say there are several trouble spots that could slow its growth.

Trading Broadband Bandwidth

At a late-January meeting in Houston, Skilling told 170 analysts and investors -- and dozens of others hooked in via the Web -- that Enron's biggest immediate opportunity is its plan to trade broadband bandwidth: space on the fiber-optic networks that zip voices, data, and images around the planet.

Skilling says that based on discounted cash flow, Enron's broadband business is worth $36 billion, or $40 a share. That's a hefty valuation considering the business lost $60 million on $408 million in revenue in 2000.

Enron has already hit a major roadblock in part of its broadband plan: delivering videos over its own high-speed fiber-optic network. In March, Enron and Blockbuster Inc. broke off a planned 20-year venture to deliver movies and other content directly into customers' homes.

Enron says Blockbuster didn't provide the quantity and quality of movies needed to deliver the service.

Enron and Blockbuster Disagree

Blockbuster has a different take. ``Blockbuster wanted out of the deal basically because we had a lack of confidence in Enron,'' said Karen Raskopf, Blockbuster's vice president of corporate communications.

Specifically, Blockbuster maintains that Enron couldn't handle technical issues such as protecting the copyright of the films that were to be distributed. ``Maybe Enron could have worked those details out,'' Raskopf said, ``but we decided there were plenty of other carriers out there that were more sophisticated technically.''

Several analysts and industry executives say that Enron's broadband business isn't worth anywhere near the valuation that Skilling talks about.

``I don't want to be disrespectful, because Enron's made remarkable progress from its days as a regulated pipeline,'' said Leo Hindery Jr., former CEO of Global Crossing Ltd., which like Enron has a nationwide fiber-optic network. ``But they're way out of their league in the telecommunications business. The [valuation] numbers they throw around are laughable; they'll be a bit player at best.''

California Energy Crisis

The California energy crisis is likely to derail ongoing efforts to deregulate electricity markets in about 25 states and could slow the opening of markets in several Asian and European countries as well, analysts and consultants say, eliminating future profit streams.

Not so, says Skilling. Deregulation is here to stay despite the problems in California, he said, adding: ``Deregulation doesn't cause problems. Stupid deregulation does.''

Besides, he said, Enron merely trades and doesn't produce power in California. The company's biggest business is in the wholesale market, serving utilities and big industrial suppliers, not retail customers.

'Japan and Europe Are Opening Up'

Plus, wholesale markets in Japan and Europe are rapidly opening up. ``California won't nick us,'' he said.

Critics charge that Enron, which doesn't reveal its California financial results, has been reaping huge profits during the crisis.

``California has been a feeding frenzy, with every trading company in the world feasting on it, and Enron is the biggest and shrewdest of them all,'' said Michael Shames, executive director of the Utility Consumers' Action Network.

Doubters wonder whether Enron can succeed in new businesses like fiber. ``I don't think this industry is going to evolve as swiftly as Enron believes it will,'' said Rod Woodward, a telecom services industry analyst at consultancy Frost & Sullivan Inc.

Skilling brushes off such skepticism. ``People who throw stones at us don't keep me up at night,'' he said. ``I worry about whether the air conditioner will blow and knock out our computer servers.''

Proving Naysayers Wrong

Skilling contends he's proved the naysayers wrong once before. In 1991, at the Colorado ski resort of Beaver Creek, in his first presentation to energy analysts and investors, Skilling outlined his plan to transform Enron from an asset-based pipeline company into a trading company.

``I basically laid out our trading model for them,'' said Skilling. ``The crowd yawned. They didn't get it. I was brilliant. So we went out and proved we were right.''

Skilling's intensity permeates Enron's headquarters. In the lobby, about 20 employees wait in line for a Starbucks coffee jolt -- at 4:30 p.m. In the company's elevators, TVs blare with messages to ``maximize revenue.''

There aren't many private offices in Enron's headquarters building; most floors are open to encourage communication between workers. Of the few walls that are around, many are write and wash to encourage extemporaneous diagramming.

Skilling's office is filled with toys: a mini basketball hoop, Koosh Ball rackets for his two sons. (He's divorced and also has a daughter.)

182-Mile Bicycle Ride

He's working himself into shape so this spring he can lead about 500 employees on a 182-mile bicycle ride from Austin to Houston for charity. He says he hates his 50th-floor office, with its 20-foot ceilings, mahogany paneling, and sweeping views of the nation's fourth-largest city.

``It's too quiet and too removed from any action,'' he said.

So he's moving to the seventh-floor trading room of a 40-story tower being built across the street from Enron's current headquarters.

Even on vacations, Skilling doesn't kick back. Every year, the Pittsburgh native and Harvard Business School graduate takes important customers on a trip. This isn't the sedate corporate golf outing to Augusta National or Pebble Beach. Skilling leads such jaunts as a seven-day trek through the Australian outback and a thousand-mile dirt bike expedition in Mexico.

``If I can't bust up a couple bikes, I don't really want to go,'' he said.

Gung-Ho Atmosphere

That sort of gung ho atmosphere is a far cry from Enron's early days in 1985, when it was formed by the $2.4 billion merger of InterNorth and Houston National Gas and became the largest natural-gas pipeline company in the U.S.

The industry was in the midst of great upheaval, as the Federal Energy Regulatory Commission began deregulating the gas pipeline business. Until then, the business could have been the poster boy for overregulation.

By federal law, companies that owned pipelines could sell gas only to a handful of gas and electric utilities along their routes. If there were a big freeze in Chicago or a heat wave in Atlanta, for instance, pipelines couldn't reroute their supply to meet demand.

In 1985, Chairman Kenneth Lay retained Skilling, who was then a consultant at McKinsey, to help spot opportunities as the business deregulated.

Government Loosens Rules

Over the next few years, as the government slowly loosened rules, Skilling put together a plan to buy natural gas reserves and package them for sale at various prices to any number of customer specifications: fixed prices, floating prices with minimum and maximum caps, guaranteed increases in supply if temperatures soared or plummeted.

Both Enron officials and outside analysts say that companies would save as much as 50 percent of their cost of buying gas and Enron would profit from the trades and from packaging other lucrative services such as futures and swaps contracts that companies use to hedge their energy costs.

``There was a lot of initial resistance,'' said Skilling, who joined Enron permanently in August 1990. ``Enron engineers had no concept about what we were trying to do. They wanted to see the gas. It was like trading pork bellies and asking to see the pigs.''

Big Trading Floors

With Lay's backing, Skilling pressed ahead. He ripped out walls and built big trading floors to foster interaction. At first, the business grew slowly, through phone-based trading desks.

``In the early days, we'd sit on our hands a lot,'' said Kevin Hannon, who was in Enron's power business and is now president and chief operating officer of Enron's broadband unit. ``It took a while to find buyers and sellers and convince them what we could do.''

In the late 1990s, Enron extended its gas-trading business to electricity. The U.S. government encouraged competition in 1992 via the Energy Policy Act. About half of the states began enacting laws or rules to let electricity generators compete for retail customers on price, which opened the door for Enron to replicate its buy-and-sell gas-trading model for electricity.

In April 1999, as Internet mania began sweeping through even old-line corporations, John Sherriff, head of Enron's European operations, and Greg Whalley, who was head trader at the time, decided to take another look at using the Internet to boost trading volumes.

Torpedoes Previous Efforts

Skilling had torpedoed previous online efforts, fearing the complexity of trading energy online and concerned that opening up the system would expose Enron to too much risk.

So well-known was his aversion to risk that the team of employees that created EnronOnline didn't even tell Skilling about it until two weeks before it was ready to launch.

It isn't a typical business-to-business exchange that brings buyers and sellers together to negotiate trades. At EnronOnline, which cost $20 million to put together, Enron does all of the buying and selling. A trader with gas to market sells it to Enron, which then finds a buyer for the fuel.

Enron either finds a way to deliver the gas or ships it through its own pipes. That system enables Enron to skim a profit at every stage of the transaction -- buying, selling, and transporting the commodity -- in addition to packing on lucrative services, such as swaps, options, and forwards.

Competitors say that energy buyers won't be satisfied with a site that allows them to buy from only one supplier.

EnronOnline

``A market is buyers, sellers, and speculators,'' said Harvey Padewer, president of Duke Energy Group, which oversees Duke Energy's nonutility business. ``EnronOnline is, `Come buy from me,' and that isn't a market.''

Skilling counters that Enron's results speak for themselves. In 2000, its first full year of operation, EnronOnline completed 548,000 transactions with a total value of $336 billion, and its European business posted a threefold increase in power trading and a fourfold gain in gas trading.

Enron's trading and risk management business did especially well last year, with revenue up 150 percent and profit up 10 percent, because of wide price swings in California and other markets this past winter. Those swings prompt energy buyers and sellers to try to lock in prices, which Enron does with futures, forwards, and other financial instruments.

``Volatility is what a trader like Enron thrives on,'' said Merrill Lynch's Eassey.

Volatility Brings Competitors

The volatility also brought in scores of competitors. Last July, six of Enron's biggest rivals, including Duke and El Paso Energy Corp., bought stakes in the Intercontinental Exchange as part of a plan to take business from EnronOnline.

Entergy Corp., a New Orleans power company, and Koch Industries Inc., a closely held refiner and gas pipeline owner, formed an energy-trading venture in April.

Other companies, including Bloomberg L.P., parent company of Bloomberg News, and BayCorp Holdings Ltd., owner of a New Hampshire utility, have developed electronic marketplaces for energy.

Room For Everyone

Skilling says there's room for everyone. The total wholesale gas and power market in North America, Europe, and Japan will grow to $1.7 trillion over the next several years from $660 billion today, according to Enron estimates.

``Only about 40 percent of that market has deregulated,'' said Skilling. ``So we still have more than half of the market to go. I think a lot of that will be transacted online.''

While the competition is catching up in the business that Enron pioneered, the company is forging ahead into new opportunities -- such as weather.

``People laugh when they hear about us, and I hate that,'' said Gary Taylor, 30, marketing director of Enron's weather risk management business. ``We've processed 2,000 transactions since 1997 and have been profitable in each of the last three years.''

Weather brokers at other companies say that Enron's claims sound reasonable. This past autumn, for example, an executive at Bombardier Inc., a Montreal aerospace company that also makes snowmobiles, did an Internet search for weather trading and found Enron. Bombardier was offering customers who bought new snowmobiles by October 1 a $1,000 refund if total snowfall in their area was less than half of the average of the prior three years.

Bombardier Example

Enron collected money from Bombardier for each snowmobile sold and paid premiums in March so Bombardier could refund customers in low-snowfall areas.

Enron has doubled, to 26, the size of its weather-trading staff and has tripled, to 9, the number of meteorologists, plucking talent from places like the Weather Channel, to grow the business.

Taylor says his analysis of earnings reports reveals that the bottom lines of 45 percent of all publicly traded companies are somehow affected by weather.

``I see no reason why anyone should wear weather risk when they hedge away things like currency fluctuations,'' Taylor said. ``By bringing weather trading online, we have a big opportunity to bring in hundreds of companies and process thousands of weather trades.''

Other major players in this business include Southern Co., Aquila Inc., and Koch Energy Trading.

Fiber-Optic Broadband Opportunity

Skilling says weather is a sideshow compared with Enron's biggest business opportunity: fiber-optic broadband, the hair-thin glass tubing that transmits data at the speed of light.

Until now, telecommunications carriers -- AT&T and Level 3 Communications Inc., among them -- had sold bandwidth in fixed-rate monthly contracts, locking buyers into paying for capacity they didn't always need. Enron can offer customers only as much bandwidth as they need -- and on short notice.

In October, for example, Enron signed a three-year pact to manage the fiber-optic needs of i2 Technologies Inc., a Dallas-based Internet software company.

Under the deal, terms of which weren't disclosed, Enron will provide i2 with the capacity to link its headquarters with offices in Parsippany, New Jersey; Tokyo; Brussels; and Mumbai and Bangalore, India, on an as-needed basis. Enron will use its own network as well as other, unspecified network providers.

Where Profits Will Come From

Skilling expects to profit in the broadband business in other ways as well. He hopes Enron's trading system will sell more service through its own network, which covers 18,000 miles -- a small portion of the 200,000 miles of fiber in the U.S.

He also expects to make money on the spread between buy and sell prices for the bandwidth, as well as on related activities like risk management.

If successful, Enron says, the business could prove to be a gold mine. The global broadband market will expand to as much as $388 billion in 2005 from $155 billion in 2001, Skilling says, and he estimates it could generate $1 billion in annual operating profits in five years.

Aggressive Estimates

Those estimates are too aggressive, several analysts, consultants, and industry executives say, especially since at least 16 different fiber-optic networks span North America alone, and excess capacity has driven prices down about 75 percent in a year.

``I give them credit for trying to change the market, but they're spreading a lot of misinformation,'' said Chris Lemmer, executive director of broadband trading and risk management at rival Williams Communications Group Inc. in Tulsa, Oklahoma.

Lemmer says Skilling is looking at the entire broadband universe -- wholesale, retail, and residential services --when he projects industry growth. It's unlikely, Lemmer charges, that Enron can get a healthy slice of each of these disparate businesses.

Competitors like Lemmer say that Enron isn't being realistic and that its lack of expertise in the business is showing. ``This isn't the gas business, where you can stick pipe in the ground and leave it there for 20 years,'' said Lemmer. ``In this business, infrastructure continually changes, and Enron seems to be ignoring that because it interferes with the propaganda they're trying to spread.''

$36 Billion Value For Business

So far, the results don't seem to justify Skilling's $36 billion value for the business.

Though Enron says the number of broadband trading transactions in the first quarter of 2001 has risen to 400-500 from just 3 in the same period a year ago, the business isn't yet profitable.

In the fourth quarter, the broadband business reported a $32 million loss on revenue of $63 million. ``They really have to post the numbers and show that the broadband business is going somewhere,'' said Commerzbank analyst Meade.

Company History

A glimpse at company history reveals that Enron doesn't always deliver what it promises. A case in point is the company's October 1998 purchase of Wessex Water Plc of the U.K. for $2.8 billion in cash and assumed debt.

Enron officials spoke of the water business in much the same way they now talk about broadband: It's a fragmented international market worth $300 billion a year, and Enron could extend its expertise to this business and win a huge share of that market.

Lay tapped Enron vice chairman Rebecca Mark, one of the most prominent women in U.S. business, as chairman and CEO of Azurix Corp., an Enron subsidiary that was supposed to win projects to repair, build, or buy government-owned water systems.

Mark cut a distinctive figure in the male-dominated industry, wearing spike heels and miniskirts as she traveled the globe negotiating complex energy projects.

Azurix's performance never matched expectations. The company was spun off in an initial public offering at $19 a share in June 1999. The stock rose to a high of $24.25 in August 2000 and then plunged all the way down to $3.38 by October.

Executive Quits

That prevented Azurix from using its stock for acquisitions as the company had originally planned. Mark quit in August and resigned from Enron's board. An Azurix official says Mark plans to be a private investor in other water businesses.

In December, Enron bought back Azurix for $327.5 million, or $8.38 a share.

Skilling says he's learned lessons from Enron's struggles, helping him create what he describes as the prototype 21st-century corporation.

``It's part of the learning curve,'' he said. ``I think our legacy will be that we proved you can build a business on intellectual capital, not physical assets.''

A self-described business history buff, Skilling argues that the era of corporate success based on gathering assets is over. He says modern companies that try to emulate J. P. Morgan's assembling of U.S. Steel or Harold Geneen's buying spree to form ITT are making a mistake.

Exxon Mobil Merger

He cites in particular the 1999 creation of Exxon Mobil Corp. and Daimler-Benz AG's cross-border acquisition of Chrysler Corp. ``Mergers like Exxon/Mobil were good ideas to cut costs, but they'll run out of opportunities, and we won't,'' he said.

That's because, he argues, Enron isn't tied to its assets in the same way as a big integrated company. ``If you're stuck with a whole bunch of concrete that you can't move, you're in trouble,'' he said.

Only about 20 percent of Enron's $65 billion in assets is tied up in plants and equipment, and Skilling says he's willing to sell anything anytime. Skilling says he'd rather spend money retaining good people, who are easily shifted around to new businesses.

``We're brain-power intensive,'' Skilling said.

When Enron created its broadband business, for example, it moved 60 people -- mainly from Enron's energy-trading units -- into the new division in the space of a week.

Skilling Not Shy

Skilling doesn't shy away from voicing his opinions publicly. In December, he stunned the crowd at Arthur Andersen LLP's annual Energy Symposium in Houston by predicting the demise of Exxon Mobil, an enterprise with $17.7 billion in profit in 2000, and BP Amoco Plc, the third-largest publicly traded oil company.

He said that integrated oil companies -- ones that drill for oil and natural gas, transport and refine it, and sell the resulting fuels to consumers -- can't possibly be the low-cost provider and producer in all of their businesses.

``The odds of that are zero,'' he said. ``We have a marketplace now that can provide virtual integration, getting all those components quicker and cheaper. These big companies will topple over from their own weight.''

Soon after that speech, Skilling was promoted to CEO, as Lay stepped aside. Lay, who remains chairman, said the best time for succession to occur was when the company is doing well.

Fine Judgments

There's always the danger that Skilling will misjudge which industries are ripe for Enron's Internet trading platform and that some of Enron's biggest initiatives, like its much-ballyhooed plans to shake up the broadband business, won't meet their lofty expectations.

There are heightened competition and the possibility for unfavorable changes in the regulatory environment to worry about as well. Skilling says his new job and the challenges that come with it won't change too much the way he operates. ``I'll probably have to be a little less blunt,'' he said.

For all of Enron's grand plans, that might be this former pipeline company's biggest pipe dream.

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