

244 Fifth Ave., 2nd Fl., Ste. 2801 • New York, NY 10001 • Tel: (212) 726 1408 • Fax: (413) 215 0880**EGGHEAD.COM, INC. (Egghead.com + ONSALE.com) (NASDAQ: EGGS)**
Initiating Coverage: HOLD

Jan. 25,2000

KEY CONSIDERATIONS

Recent merger of ONSALE.com with Egghead.com should help the combined company to maintain its leading position as an online retail and auction site. In addition, its partnership with telstreet.com is part of its overall strategy of diversification and competitiveness.

The company is being rated as the most visited computer and software web site by Neilson// Netratings, and also being named among the top ten e-commerce sites by Media Matrix, proving that it has been successful in effectively promoting its brand name.

The company currently faces and will face intense competition and this increases its risks and time to break-even.

Increasing operating expenses, marketing efforts, staffing, software development efforts and growing infrastructure makes the company's foreseeable future to experience quarterly net losses. Tough the revenue has increased considerably, the decreasing profit margins make it difficult for the company to show positive earnings in fiscal year 2000 and 2001.

Recent Price	\$15.00
52WK Low	\$11.31
52WK High	\$26.50
P/E	N/A
P/Book	4.76
P/Sales	1.32
Market Capitalization	\$556.22 Mil
Shares Outstanding	37.08 Mil
Float	27.4 Mil
Daily Volume (3-month Average)	N/A
EPS	
1998	\$(1.03)
1999E	\$(1.68)
2000E	\$(1.90)
Current Ratio	2.53
Total Debt to Equity	0.00
LT Debt	0.00
Total Cash	\$150 Mil

COMPANY PROFILE

Egghead.com is a leading Internet retailer of computer hardware, software, peripherals, and accessories, including excess, reconditioned, and closeout brand-name computer products. Egghead.com also sells consumer electronics, sporting goods and vacation packages. Through its auction site, Onsale.com, the Company offers bargains on excess and closeout goods and services. Egghead.com, Inc. was formed following the November 22, 1999 merger between Egghead.com, Inc. (old) and Onsale.com, Inc. As a result of the merger Egghead became a wholly owned subsidiary of Onsale.

All outstanding shares of Egghead were converted into shares of Onsale's common stock, and the name of the Company was changed to Egghead.com. In the pooling of interests merger, Egghead.com (old) shareholders received .565 shares of Onsale common stock in exchange for each share of Egghead common stock.

This report was prepared by Satnam Singh, Francesca Durante and David R. Rivas, Ph.D.

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ONE-YEAR PRICE AND VOLUME GRAPH

THE COMPANY and its SERVICES

Egghead.com, inc. is an internet retailer, which sells retail and wholesale goods to businesses, resellers and consumers. The company provides value-conscious customers with the opportunity to find great deals on a wide selection of merchandise through its online "stores" on the web site.

The electronic retailing format offers customers the following benefits:

1. Compelling merchandise, and, 2. Verifiably fair pricing.

The company offers more than 1,400 different merchandise items in each daily auction and more than 35,000 merchandise items through superstore. It sells quantities from one to several hundred of each item, generally ranging in price or minimum bid from \$1 to \$3,000.

The company offers merchandise primarily in the following categories:

- o Personal Computers
- o Printers, Monitors and Scanners
- o Computer Peripherals
- o Network Equipment
- o Consumer Electronics
- o Sports and Fitness Equipment
- o Vacation Packages

The merchandise is being sold under two formats:

1. AUCTIONS and SURPLUS

2. SUPERSTORE

Auctions and Surplus: Auctions and Surplus is an interactive online auction designed to serve as an efficient and entertaining marketing channel for products that typically are unavailable through conventional distribution channels. Through the auction, the company sells excess merchandise and services, including refurbished and close out products, to businesses, resellers and consumers. Merchandise and services sold on the auctions and surplus site include personal computers, consumer electronics, sports and fitness equipment, and vacation packages.

Superstore: Through Superstore, the company offers businesses, resellers and consumers a broad selection of new computers and computer-related products like software and electronics products for sale at prices generally equal to the amount invoiced by the vendors, plus payment processing, shipping and handling fees.

The Process

The auction and sales processes are fully automated:

- Presentation of goods for sale - The descriptions and images of the merchandise being offered for auction and for a fixed price sale, are posted on the web site.
- Completion of the bid or order - customers are sent communications via email regarding their bids or orders, and, credit card authorizations are executed electronically once an order is finalized.
- Transporting products - The automated processes transmit orders either to one of our warehouses for fulfillment, or directly to suppliers for shipment.
- Customer service - The online customer service center lets customers see the status of their orders, 24-hours a day, seven days a week.

The online retailing and auctioning not only provides the benefits of compelling merchandise and verifiably fair pricing to the customers but also entertainment and excitement and a feeling of community, as the bidders participating in auctioning can post brief comments, which helps in building a sense of community among the customers. On the other hand the vendors are benefited by efficient distribution solution, resolution of channel conflict, and superior inventory liquidation.

ONLINE RETAIL INDUSTRY

Online commerce and the companies competing for market share are both growing rapidly. By the year 2001, online retail transactions are expected to reach \$59 billion. Though the online retail sales during the holiday season is supposed to be around \$11 billion, tripling the amount from a year before, but still online retailing is full of challenges and surprises. The competition is getting tougher and tougher, because of increasing participants (due to low entry barriers), and, decreasing profit margins. Although virtually any retailer or auctioneer can establish an online presence, not all companies are able to successfully use the new medium. The main factors affecting the online retailing are:

- **Brand name loyalty:** Companies must provide a recognizable brand name that consumers trust and to which they return. This is the reason that only 2% of actual purchases during holidays in 1999 were actually ordered online. Most of the customers searched online for information on specific products but they used traditional retail store to buy them.
- **Marketing and advertising:** Online retailers are investing heavily in advertising and marketing to compete for consumers effectively.
- **Timely delivery and other services:** This has become one of the most important factors affecting the success of the companies. Due to diversified product lines and dependence on the third party (vendors) to reduce the cost of inventory, many online retailers are not able to deliver the product right on time. This has caused the diversion of customers from online buying to the traditional channel.

Companies are lacking the profitability in their adolescent stage of development. Many of the leading retailers, however, are rapidly growing sales. Thus, we believe that the distinguishing characteristics of successful online retailers include rapidly growing sales, brand-name recognition, customer loyalty, and an adaptable management style.

The online retail market is showing alliance building as leading retailers with strong followings emerge.

Many current auction sites and retailers are cooperating with portal sites and other companies in order to garner advertising agreements and revenue-generating joint agreements. In this way, we expect that the market leaders will further increase their reach and strength versus lagging businesses.

In 1999, around 38.8million people bought products and services online according to eMarket statistics, which shows 17.8% increase. According to a study by shop.org (the trade association of online retailers) and Boston Consulting Group (BCG), on online sales, there was 270% growth in the number of orders placed by consumers and a 300% increase in revenues enjoyed by retailers for the holiday shopping season in this year as compared to last year. Thus, there is a basic trust in online transactions.

ONLINE AUCTIONING

Interactive online auctions are an increasingly popular medium for online retail sales. Over 40 web sites offer auctioning for the computer and hardware goods. Others provide a variety of consumer goods and services. The advantage for an online auctioneer over traditional auctions is that they can amass bidders more rapidly, have lower rents, and process sales more quickly. The advantage that auctions have over the direct sales methods is that the customer has complete price validation through an auction. Meaning, the customer sets the price he is willing to pay for a product. These advantages are also the reason the number of online auctions is increasing rapidly. The barriers to entry are low. Thus, popular items and pricing will likely be available at multiple web sites. Auctions online would have to distinguish themselves in terms of interactivity, service, and reliability.

The main factor, which differentiates the auctioning sites, is the fees for participation. Some of the sites charge little fees for participating in the auctioning process, whereas the others attract the customers by letting them participate for free.

COMPETITION

Though after the merger of Onsale and Egghead, the combined company has become one of the main players in the online commerce, but the electronic commerce market, particularly over the Internet, is new, rapidly evolving and extremely competitive, and its getting intense. Egghead and Onsale combined

potentially compete with a variety of other companies depending on the type of merchandise and sales format offered to customers.

These competitors include:

- **Online computer retailers** such as Buy.com, Cyberian Outpost and Value America
- **Internet auction houses** such as uBid, First Auction (the auction site for Internet Shopping Network, a wholly owned subsidiary of Home Shopping Network, Inc.)
- **Companies with substantial customer bases in the computer and peripherals catalog business**, including Micro Warehouse, Inc., Insight Enterprises, Inc., Creative Computers, Inc., and CDW Computer Centers, Inc.
- Numerous indirect competitors that specialize in electronic commerce or derive a portion of revenue from electronic commerce, including Internet Shopping Network, New England Circuit Exchange, America Online, Inc., Cendant Corporation, and Yahoo! Inc.
- A variety of other companies that offer merchandise similar to ours but through physical auctions and with which we compete for sources of supply.

Primary Competitors			
Category	Main Companies	Services/ Features	Change in stockprice as compared to Egghead.com, Inc.
Online computer retailers	Buy.com(BUYC), Cyberian Outpost(COOL) and Value America(VUSA)	Retailers, with some of these companies providing diverse product linings, and some special features, like free overnight delivery by Cyberian Outpost. Some of these also have auctioning services.	Follow trend more or less similar to the Egghead's stock price changes.
Internet auction houses	UBid.com(UBID), First Auction	Concentrates only on auctioning, provide diverse product lining, and special features like email alerts and bid tracking.	Follow trend more or less similar to the Egghead's stock price changes.
Companies with substantial customer bases in the computer and peripherals catalog business	Micro Warehouse, Inc.(MWHS), Insight Enterprise, Inc.(NSIT), Creative Computer, Inc. (MALL), and, CDW Computer Centers, Inc. (CDWC)	Retailer and direct marketer companies, concentrating mainly on the business, government, and educational organizations. These companies focus on effective marketing, breadth of product offerings, high volume, and competitive pricing.	Stronger in performance than the egghead and the other online retail and auctioning companies, hence stable or growing stock prices in this sector.

The principal competitive factors affecting the market are, ability to secure merchandise for sale at favorable terms, attract new customers to the web site at favorable customer acquisition costs, operate the web site in an uninterrupted manner, and develop and enhance the proprietary sales management software. Although Egghead.com, Inc. is currently competing favorably with respect to such factors, but due to intense competition it is uncertain if it will be able to maintain our competitive position against current and potential competitors.

Current and potential competitors have established or may establish cooperative relationships among themselves or directly with vendors to obtain exclusive or semi-exclusive sources of merchandise. Accordingly, it is possible that new competitors or alliances among competitors and vendors may emerge and rapidly acquire market share. In addition, manufacturers might elect to sell or liquidate their products directly to customers. Increased competition is likely to result in reduced operating margins, loss of market share and a diminished brand franchise, any one of which could seriously harm Egghead.com, In.'s business. Many of the current and potential competitors have significantly greater financial, technical, marketing and other resources than Egghead.com does. As a result, they may be able to secure

merchandise from vendors on more favorable terms than it may, and they may be able to respond more quickly than it to changes in customer preferences or to devote greater resources than us to development, promotion and sale of their merchandise.

STRATEGIES FOR GROWTH

Merger

Egghead.com and Onsale.com: The merger of Onsale.com with Egghead.com, resulting into a new company Egghead.com, Inc. results in a leader of online retailing of the technology products. Through this merger, the combined company is able to avail additional financing to fund the operations, hence avoiding the sale of additional equity, which would have resulted in the dilution to the stockholders. Moreover the combined company has the benefit of strengthened management. Merger will help the combined company not only the operating and administration expenses, but will also help in terms of increase in the total customer base and hence increase in the revenues generated. With the merger, the combined company Egghead.com, Inc. maintains a leading position in the online retailing of computer and electronics products. Moreover the Onsale.com being the pioneer in online auctioning, we feel that the combined company definitely has an edge over the newer auctioning companies.

The company mainly focuses on the following strategies for growth:

- **Cross-Selling:** Egghead.com is expanding and diversifying the array of products and services it offers online. A major strategy is to cross-sell to customers so that, for instance, a person buying a VCR may return to the site before a holiday to purchase a vacation package. Moreover by providing both retailing and auctioning services at the same site, it provides customers greater opportunities. This approach is an advantage over competitors who focus on a specialized market, depend on selling a narrow range of products, or, focuses on a single mode of selling, i.e. either by retailing, or by auctioning.
- **Brand Name:** Brand name recognition is one of the most important things in the e-commerce business. And Egghead.com has been successful in promoting its brand name very effectively. The company being rated as the most visited site during the holiday period in the end of 1999, is a clear indication of this factor. Moreover the company intends to continue to build relationships with leading online content providers and commerce companies to drive traffic to its Web site, and secure merchandise supply
- **Various Additional features:**
Egghead.com established **credit accounts for businesses and educational institutions** on its web site at www.egghead.com, based upon the requests by business and educational customers. These organizations can now obtain a line of credit and purchase products via purchase orders directly through Egghead.com's web site. Egghead.com introduced the **gift certificates** making it easy to give someone a gift. The gift certificates, which are in dollar amounts designated by the giver, can be purchased by anyone; he doesn't need to be a registered customer with Egghead.com. The recipient of an Egghead.com gift certificate can redeem it at the site.

Strategic Alliances

- **Telestreet.com:** Egghead.com, Inc., and, Telstreet.com, a leading online wireless superstore allied together for marketing partnership. The Wireless Store, located in the Electronics Superstore at www.egghead.com, features information and data from Telstreet.com's site that aims to reach customers looking for a convenient way to shop, compare and purchase wireless products and services online. Consumers can compare and purchase wireless phones and services from leading carriers including AT&T Wireless, Sprint PCS and Nextel and phone manufacturers including Nokia, Motorola and Ericsson. And Telstreet.com provides shoppers at Egghead.com with an easy and convenient way to purchase wireless phones and services online.
- **NetSanity:** Egghead.com teamed up with NetSanity, which will deliver Egghead content directly to customers. Thus it joined a group of over twenty-five leading commerce and content companies who would support and use NetSanity's technology. Egghead.com plans to make the NetSanity assistant

available as a free download from its Onsale.com web site and use it to update customers on auction bid status, online promotions and news.

KEY RISK FACTORS

- **Competitive market:** The e-commerce market particularly over the Internet is new, rapidly evolving and extremely competitive, and the competition is expected to intensify in the future. Egghead.com competes with a variety of other companies who either offer the same types of merchandise and/or provide the same or a similar type of sales format to customers. Many of these competitors have significantly greater financial, technical, marketing and other resources. Moreover since the entry barriers in this market are low it is possible that new competitors or alliances among competitors and vendors may emerge and rapidly acquire the market share. In addition, manufacturers might elect to liquidate their products directly. Increased competition may result in reduced operating margins, loss of market share and a diminished brand franchise.
- **Short operating history:** Company's short operating history in new and rapidly evolving market of electronic commerce, may cause problems in successfully implement all or any of the business strategies or successfully address the risks and uncertainties that it encounters. Moreover the pre-merger company ONSALE incurred net losses in each of 1998 and 1997, and is also expecting to experience substantial quarterly net losses through the first half of 2000.
- **Risks associated with our new business offerings and international expansion:**
Risks of new offerings. General risks associated with diversifying the business offerings include dilution of the Egghead brand, lack of customer interest and vendor dissatisfaction.
Risks of international expansion. Expansions into international markets has the risks of not gaining broad market acceptance, difficulty in managing international operations as a result of competition, technical problems, local laws and regulations, distance, and language and cultural differences.
- **Risks associated with purchasing and carrying the inventory, and risk of dependence on third parties for fulfillment of purchased inventory:** Company purchases a large majority of merchandise from vendors. This has the risk of declines in the market value of the purchase goods, risk of managing customer returns and credits associated with merchandise to be returned to vendors, and, the risk of unpredictable sale prices due to the nature of our auction process. Moreover the company depends on Gage Marketing Group, its contract warehouse; to fulfill approximately 85% of purchased inventory sales, United Parcel Service as the delivery service. Due to this dependence on the third parties without any long-term relationship the business could be harmed. Company also relies on merchandise vendors for supply, shipping and quality of products.
- **Volatile nature of stockprice:** Because of the increasing operating and specially marketing and advertising expenses the company is facing lower sales margin, and hence loss for last 2 years. Moreover because of technological innovations, new sales formats, changes in financial estimates, and, conditions and trends in the Internet and electronic commerce industries, the stock price is volatile, and is likely to be, highly volatile and could be subject to wide fluctuations in future.

EXPLANATION OF FINANCIALS

Revenue. We expect that Internet commerce-based growth will continue over the next 3-5 years. It is in fact expected that an increasing percentage of the domestic population will have access to the Internet over the next several years, we believe up to 95% of the total U.S. population may have Internet access by year 2004. This will traduce in dramatic increases in the overall volumes of online commerce during that time frame. As a consequence Egghead revenues are expected to grow of 45% to 50% in 2000; the revenue growth rate is seen slowing to 35% to 40% in 2001 mainly due to the low of large numbers.

Gross profit. Gross profit in expected to increase mainly because of the relevant increase in revenues, however the gross margin is expected to fall slightly both in 1999 and 2000.

Sales and Marketing. Onsale undertook an aggressive sales and customer-acquisition campaign during the second and third quarter of 1999, as a result sales and marketing expenses doubled in 1999. Due to the fierce competition the firm will likely increase its sales and marketing expenses in the next several quarters in order to maintain customer loyalty, build traffic and retain market share. However, this year significant advertising effort is not expected to incur next year, thus sales and advertising margin is expected to fall from 17% to 14%.

General and Administrative. Additional personnel are being added to meet the company's rapid growth. The costs of handling payroll and other personnel concerns are increasing in absolute terms, however margins will slightly fall through fiscal year 1999 and 2000.

Engineering. The programs used to run the auction site will not only be enhanced over time, but also adjusted in order to revise the auction format so as to maintain consumer interest and interactivity. Thus, engineering costs will grow slightly over the next few quarters. As a percentage of revenue, engineering expenses will be lower due to the achievement of economy of scale, remaining around 1 percent in the near future.

Operating Expenses. Total operating expenses will rise moderately in absolute terms in the next several quarters mainly due to increased sales and marketing expenses. However the operating expenses growth rate is expected to fall.

Operating Income. Increased spending on promotional, administrative, and programming activities will likely result in a negative operating income.

Tax Rate. Tax will not be incurred for the near future due to continuing losses.

Net Income. Both Egghead and Onsale have incurred substantial losses in the past year. Egghead losses were due to the closing of the former retail store network and in the operation of electronic commerce business. Onsale losses were due to the cost of setting atCost and the increased sales and marketing expenses. Egghead will maintain a net loss during 2000; positive earnings will likely arise only in 2002.

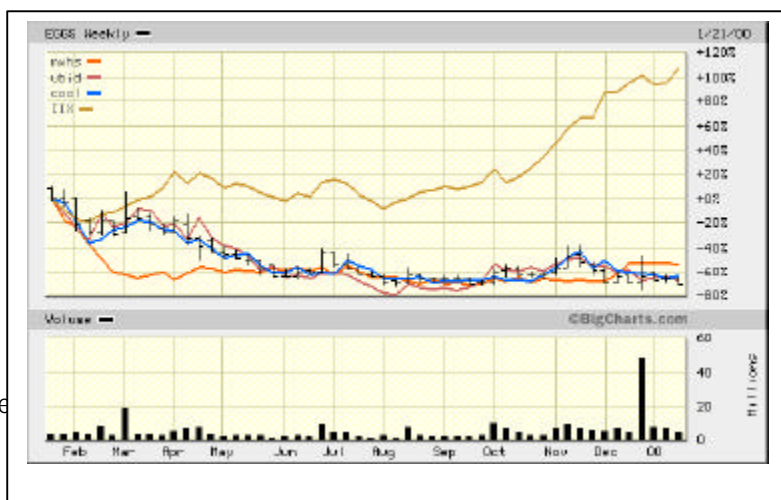
Number of shares outstanding. Egghead relies greatly on issuing shares in order to raise capital. Due to the planned shelf registration the number of share outstanding will rise by \$100 million.

A RELATIVE APPROACH TO VALUATION

Many pure online retail companies are unprofitable in their early stages and their future performance is highly unpredictable due to the fast changing nature of this industry. Thus we believe a reliance on price to earnings ratios and discounted cash flow models is not practical for evaluation purposes. However, other ratios such as price to sales can be measured and compared to other companies. In addition, other

factors such as revenues, margins, customer base, and sector leadership are significant in helping to determine the relative value of an online company. We believe a focus on the latter aspects of a company's performance provides a reasonable valuation of a company.

Internet Sector. The Internet sector as a whole has been volatile with even greater price movements among individual companies. A historical price comparison between Egghead, it's main competitors and the Amex Internet Index (IIX) shows that last year all the considered stocks not only have under-performed, the market they have also performed opposite to the IIX. After 1998 investors' enthusiasm for Internet stocks in general, 1999 evidenced a preference towards the more profitable Internet sectors while lower margin sectors, such as computer retail, showed a marked price correction.



Revenues and Growth. The company is expecting 10% to 12% sequential revenue growth in Q1 of next year, contributing to overall year-over-year revenue growth of 45% to 50% in 2000. In 2001, the revenue growth rate is seen slowing to 35% to 40%. The more conservative Egghead.com estimation forecasted \$1 billion revenue in 2001. Profitability is expected to follow in 2002, as gross margins ramp up from 3% - 5% in Q4 of this year to 6% - 8% in 2000 and 8% - 10% in 2001.

Value Comparison 01/20/00					
	\$ Price	Market Cap. In millions	Trailing 12 month sales	P/S	Gross Margin % (TTM)
Egghead Inc.	15	556.22	11.38	1.32	9.84
Cyberian Outpost	8.75	206.04	6.28	1.39	10.48
Ubid	29.25	337.05	18.00	1.63	9.14
Micro Warehouse	18.50	653.00	65.87	0.28	15.75

Price to Sales. We believe that price to sales ratio is a key valuation ratio and one that is relevant to a comparison among online retail companies. Egghead P/S ratio value is in line with the values of its main competitors; this indicates that the current price is at a reasonable level and the company stock is fairly evaluated. This year P/S's equilibrium is probably a consequence of the price correction that has happened during the whole 1999.

Gross Margin. Gross margin for Egghead has been around 10 percent is projected to decline slightly over the next several quarters. As stated previously gross margins is expected to rise from 3% - 5% in Q4 of this year to 6% - 8% in 2000 and 8% - 10% in 2001.

Cash. Having substantial cash is essential to sustain continued losses and keep investing in new business areas that offer the opportunity for large future returns off a relatively minimal investment base. With \$150 million in cash the new Egghead.com will need more resources to keep its expansion plans and, consequently, its growth going. The planned shelf registration of \$100 million in equity securities will provide additional financing.

Investment Opinion

We believe that Egghead's brand name value, along with its customer focus strategy and innovative business model, will help the Company maintain its position in the Internet E-Commerce sector. We feel that the current valuation of the stock is reasonable. We also expect the stock to appreciate in line with the company's revenue growth and thus almost in line with the Internet sector as opposed to what has happened during the last twelve months, the change in trend will likely take place in the next two-three months. We thus give Egghead an **ACCUMULATE** rating as we expect the stock to appreciate in line with the company's revenue growth in the long term.

Short term rating: hold, target price \$ 11

	<u>1999E</u>	<u>2000E</u>
Revenue:		
Merchandise	488,130	708,018
Commission and other revenue	6,927	14,765
	<u>495,057</u>	<u>722,783</u>
Cost of Revenue	<u>446,043</u>	<u>664,960</u>
Gross Profit	<u>49,014</u>	<u>57,823</u>
Operating Expenses:		
Sales and marketing	86,722	101,190
General and administrative	27,084	28,911
Engineering	714	7,228
Amortization of goodwill	1,800	1,800
Depreciation	2,852	1,500
Total operating expenses	<u>119,172</u>	<u>140,629</u>
Income (loss) from operation	<u>(70,158)</u>	<u>(82,806)</u>
Equity in net loss for joint venture	(640)	(200)
Interest and other income, net	8,576	9,000
Income (loss) before tax	<u>(62,222)</u>	<u>(74,006)</u>
Provision for income taxes		
Net Income (loss)	<u>(62,222)</u>	<u>(74,006)</u>
Net Income (loss) per share:		
Basic	<u>(1.68)</u>	<u>(1.90)</u>
Weighted average common shares:		
Basic	<u>37,100</u>	<u>39,000</u>

Margin Analysis (%age of revenue)

Gross Margin	9.90%	8.00%
Sales and marketing	17.52%	14.00%
General and administrative	5.47%	4.00%
Engineering	0.14%	1.00%
Operating Margin	-14.17%	-11.46%
Net Margin	-0.14%	-0.03%

Growth

Total Revenue	--	46.00%
Gross Profit	--	17.97%
Operating Expense	--	18.00%
Net Income	--	-18.94%
Fully diluted EPS	--	-13.14%