

244 Fifth Ave., 2nd Fl., Ste. 2801 • New York, NY 10001 • Tel: (212) 726 1408 • Fax: (413) 215 0880**Egghead.com, Inc. (NASDAQ: EGGS)****Update: The Race To Profitability – HOLD**

January 31, 2001

KEY CONSIDERATIONS

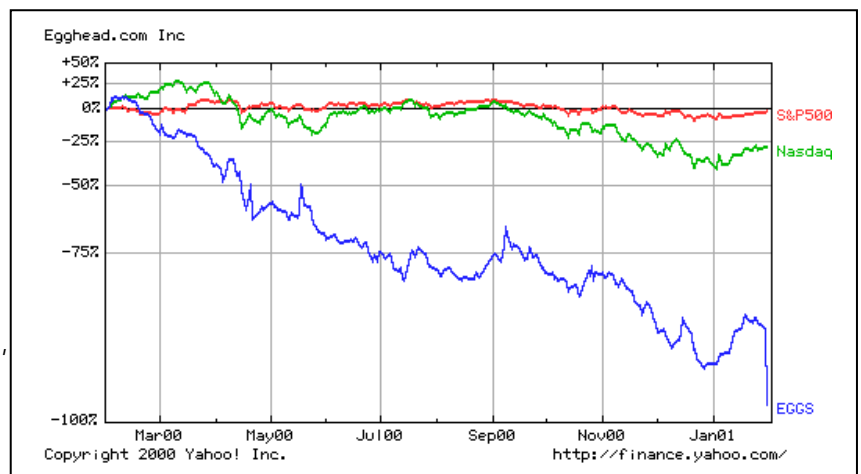
- Egghead.com's third quarter results show double-digit gross margins and solid progress towards profitability
- Egghead.com expects to report lower than expected losses in the fourth-quarter despite weak sales because of softening personal-computer demand. Earnings (Q4) conference call is scheduled to start Thursday, Feb 22, 2001, 5:00 pm EST
- Egghead.com Inc. could be reaching profitability faster than expected by cutting costs and boosting margins. In the past months eliminating \$10 million to \$ 20 million in "unprofitable" sales – essentially no longer selling products for less, than it paid for them
- Egghead.com continued to demonstrate strong customer growth in a number of important metrics. The total number of people registered to bid or buy rose 5% to 3,623,000 at the end of the third quarter. Repeat buyers accounted for 77% of purchases, a slight increase over 74% for the previous quarter
- We expect Egghead.com Inc. losses will drop in 2000, from 1999's per share figure of \$-4.29 to \$-1.74. We project losses to further decline in 2001, with losses in the area of \$-0.73 likely
- In our opinion it is likely that Egghead.com will reach profitability in the first quarter of fiscal 2002

Key Ratios & Statistics

Recent Price	\$ 1.03
52WK Low	\$ 0.50
52WK High	\$13.44
Average Daily Volume	0.48Mil
Market Capitalization	\$43.77Mil
Shares Outstanding	42.45Mil
Float	32.70Mil
P/E (TTM)	N/A
Price/Book (TTM)	1.54
Price/Sales (MRQ)	0.08
EPS	
1998	\$-1.03
1999	\$-2.84
2000	\$-1.74
2001(E)	\$-0.69
Quick Ratio (MRQ)	1.23
Current Ratio (MRQ)	1.43
LT Debt/Equity (MRQ)	0.00
Total Debt/Equity (MRQ)	0.00
Gross Margin (TTM) %	6.57
Operating Margin (TTM) %	-28.87
Profit Margin (TTM) %	-27.53

MRQ=Most Recent Quarter
TTM=Trailing Twelve Months**COMPANY PROFILE**

Egghead.com is a leading Internet retailer specializing in technology products for the office and home. With an emphasis on Small – to Medium- sized Business (SMB) customers. Egghead.com offers a wide range of products from computer hardware, software, peripherals and accessories, to consumer electronics and office products, to sporting goods and vacation packages. Its auction site offers bargains on excess and closeout goods and services. Egghead.com combines broad selection, low prices and excellent service to provide an outstanding online shopping experience for businesses and consumers. Egghead.com is located on the internet at <http://www.egghead.com>

ONE-YEAR PRICE AND VOLUME GRAPH

This report was prepared by Jaspreet Walia, and David R. Rivas, Ph.D.

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FINANCIAL SUMMARY

For the nine months ended 9/30/00, total revenue fell less than 1% to \$387.2 million. Net loss fell 18% to \$52.6 million. Results reflect the reduction of unprofitable sales, offset by higher margins and lower marketing costs. We believe the financial results for the quarter ended September 30, 2000 continue to demonstrate the company's progress towards profitability. Through a variety of actions such as the reduction of unprofitable sales, the conversion of more of its surplus and closeout business to a fixed price model, and more of its surplus and non-price-sensitive new goods. Egghead.com increased its gross margin rate by 320 basis points over the quarter ended June 30, 2000; reduced net loss per share by 45% and increased margin contribution per order by 39%. In our opinion the future for this particular e-tailer looks positive and profitable in the long run.

STRATEGIES FOR GROWTH

The main strategies for growth are focused on expanding the business with synergistic product categories to complement the present product mix and continue building brand recognition. Egghead.com has pursued the objective to expand its product line mainly through reseller agreement, new services and strategic alliances.

• STRATEGIC ALLIANCES

Build to order PC's from eNetpc, Inc.

Egghead.com, Inc., is now offering eNetpc's build-to-order desktops, laptops and servers on its website. eNetpc has custom designed their new application software, eSelect(TM) 2.0, specifically for Egghead.com. Under terms of the license agreement, eNetpc will host the application, which will enable Egghead's customers to custom configure a desktop, laptop or server to their own specifications. In our opinion the eNetpc configurator will differentiate Egghead.com from their competition by providing maximum choice to their customers.

Savings on Business and Residential DSL Services

Eghead.com Inc. is now offering business and residential customers two ways to save on DSL services. Through InternetConnect a provider of broadband networking solutions to businesses, Egghead.com provides business customers a secure, private broadband network between the offices, remote locations and telecommuters across the country. Through Telocity, a leading nationwide provider of broadband services to the residential market, Egghead.com customers will be able to surf, share and communicate over the Internet at speeds up to 50 times faster than the traditional dial-up Internet service providers.

• RELOCATION AND EXPANSION OF OPERATIONS

Relocation Efforts Help Reduce Expenses

Egghead.com relocated approximately 20% of its Menlo Park-based jobs to its Vancouver, WA offices as part of its plan to reach profitability by the end of this year. The company relocated engineering, technical operations, accounts payable, loss prevention and inventory accounting functions to its offices in Vancouver. This move will allow the company to eliminate functional redundancies, locate related positions together, and take advantage of Vancouver's significantly lower cost-of-living and high employee retention rates.

• SMALL-TO MEDIUM BUSINESS(SMB) CUSTOMERS

Greater emphasis on SMB customers

Egghead.com continued to demonstrate its commitment to its core business customers with a redesign of its website to address the needs of its core SMB customers. In addition, the company made substantial progress in executing on its plan to increase its Business Account Management team. Egghead.com currently has almost 200 Business Account Managers, up from 40 at the end of Q2 and will continue hiring through the first quarter of 2001 as the company builds this team to its projected goal of 300 members.

• REWARDING LOYAL CUSTOMERS THIS HOLIDAY SEASON

Since gaining global brand recognition, consumer loyalty has become even more critical. Egghead.com continuously tries to improve its competitive position and make the shopping experience as easy and rewarding for the consumer as possible. This holiday season Egghead.com started a promotional plan in mid November that provided the "mobile professional" with United Reward Miles toward free flights for shopping

online. This program was designed to cater to the mobile business traveler who is always on the go in today's global economy by awarding United Reward Miles when they shop on the Egghead.com site.

KEY RISK FACTORS

In our opinion the main risk factor remains the increasing competition in the Online Retail sector. New competitors or alliances among competitors and vendors continuously emerge threatening rapidly Egghead's market share.

- **Online Security:** On the one hand there is no doubt that U.S consumers are committed to e-commerce; on the other hand they are very deal sensitive. Consumers select sites that offer them the best whole experience, including price, freebies, savings and most importantly security. Security was an area where Egghead.com had some serious problems this holiday season. The stock was hit badly in mid-december dropping 20% due to a security breach. A hacker breached its computer systems and possibly its customer database. Egghead.com has hired a computer security firm to help investigate and is taking steps to ensure a security breach like this does not take place in the future.

- **System failures:** E-tailers' success depends on the efficient and uninterrupted operation of its computer and communications hardware systems; the reliability and availability of the web site are necessary key to success factors in this sector. Failures in the day-to-day operations of the site and in the capacity to deal with growth could lead to unfavorable consequences on the business, results of operations and financial condition. This was another area where Egghead.com learnt the lesson the hard way. A study by WatchDog247.com a national web site monitoring company showed that many of the top e-commerce Web sites could not process orders for more than 30 minutes a day the week before Christmas. Egghead.com was among the sites down the most frequently while its top competitors like Amazon.com were among the best performing sites in the study. In addition the study also estimates that Egghead.com lost more than \$1 million of revenue during the last week of the peak holiday due to system failures.

- **Internet Sector:** Internet companies are vulnerable to the rapid evolution of electronic commerce and related technology. The Internet and the electronic commerce industry are characterized by rapid technological change, change in customer requirements, new service or product introductions embodying new technologies, and the emergence of new industry standards and practices. In order not to become obsolete the company must continue to develop or license new technologies and respond promptly and cost-effectively to technological advances and emerging industry standards and practices.

FINANCIALS

Revenue: Online revenue decreased \$38.0 million, or 27.2%, for the three months ended September 30, 2000 compared with the three months ended September 30, 1999 and \$4.6 million, or 1.2%, for the nine months ended September 30, 2000 compared to the nine months ended September 30, 1999. Revenue declined during these periods due primarily to Egghead.com's decision to minimize unprofitable sales. Commission and other revenue increased \$839,000, or 31% for the three months ended September 30, 2000 compared to the same three month period in 1999, primarily due to increased advertising revenue.

Margins: Gross margin for online revenue was 6.8% and 2.3%, respectively, for the quarters ended September 30, 2000 and September 30, 1999. Gross margin for online sales throughout the last two quarters of 1999 remained fairly stable, fluctuating between 1.9% and 2.3%. During the first, second and third quarters of 2000 the company raised prices on new and excess and refurbished goods sold in fixed price formats, limited the quantity of auction merchandise available for bid at any one time, and added a flat fee shipping charge on new goods orders. These changes resulted in increases in total gross margins to 5.8%, 6.8% and 10.0% in the quarters ended March 31, 2000, June 30, 2000 and September 30, 2000 respectively.

Sales and Marketing: Egghead.com 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.

However sales and advertising margin fell in 2000 to 14.4% for the nine months ended September 30, 2000 compared to 17.2% for the same period in 1999.

Engineering and Other: 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 are expected to slightly fall through fiscal year 2000 and 2001

Income Tax: The company is expected to have net losses for each of the quarters in 2000 and 2001, therefore will not record a provision for income taxes for these periods.

Net Loss: We expect Egghead.com's losses will drop in 2000, from 1999's per share figure of \$-4.29 to \$-1.74. We project losses to further decline in 2001, with losses in the area of \$-0.73 likely. We believe Egghead.com will maintain a net loss during 2000 and 2001; positive earnings are expected in the first quarter of 2002.

VALUATION

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, its main competitors and the Amex Internet Index (IIX) points out that in 2000 e-commerce stocks were characterized by an evident price correction. Egghead.com and many other e-tailers under-performed the IIX. As quickly as they become an investing fad, e-tailers have gone out of fashion. even e-tailing powerhouses like Amazon and eBay are down by a third or more since the beginning of the year 2000 and things don't look like they are improving in 2001 either. Truly getting the short end of the stick are now-defunct companies like Boo.com and toysmart.com, as well as several badly cash strapped e-tailers who continue their struggle to stay up and running. Some of which boast established brand names but will need to raise more cash before they reach profitability. Egghead currently trades at 1.03; its value has dropped 90% since the beginning of 2000. Furthermore in our opinion it is likely that there will be even more turmoil in the e-commerce area due to weaker sales growth and the increasing investors' risk aversion to technology and e-commerce stocks. Investors are becoming more selective when investing in technology stocks and the main focus seems to have shifted from hyper growth to long-term growth.



Value Comparison 01/31/2001

	<i>\$ Price</i>	<i>Market Cap. In millions</i>	<i>Trailing 12 month sales</i>	<i>P/S</i>	<i>Gross Margin %(TTM)</i>
Egghead Inc.	1.03	43.77	13.25	0.08	6.57
Cyberian Outpost	1.73	54.91	11.07	0.16	13.64
Amazon	14.38	5,133.89	7.87	1.83	23.74
eBay	46.23	12,386.00	1.54	30.05	77.61
Buy.com	0.56	75.69	6.14	0.09	4.01

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. At present Egghead P/S ratio value is not in line with the values of its main competitors mainly due to the low level of the price during the last two months. eBay's P/S ratio is considerably higher than the competitors'; this is the result of a greater confidence the market has demonstrated toward the company one of the reasons being that eBay had a positive Net Income in 1999 and it is expected to be even more profitable in 2000 and 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. The cash available to Egghead.com at the end of the third quarter was \$44 million. In our opinion with a decreased burn out rate and higher margins, Egghead.com has adequate cash to finance the ongoing business plan.

Investment Opinion

Egghead.com is one of the best-known and most recognizable brand names in the Internet; thus we believe that the company will most likely maintain its leading position in the online business. In addition to that we expect Egghead.com to have a 15% to 25% earnings growth over the next three years. However, the market seems not to trust e-commerce companies with large losses and not enough cash to cover them while continuing growing. Also, given the actual low level of Egghead.com's stock Egghead might be an attractive acquisition target for a larger company with a better cash position. However, we believe that Egghead.com's business has significant long term potential and that, as discussed above, it currently has a reasonable long-term valuation. We thus give its stock a HOLD recommendation with a year-end target price of \$4.

	<u>1999</u>	<u>2000E</u>	<u>2001E</u>
Revenue:			
Merchandise	503,171	462,899	555,479
Commission and other revenue	<u>11,633</u>	<u>15,325</u>	<u>18,390</u>
Total Revenue	<u>514,804</u>	<u>478,224</u>	<u>573,869</u>
Cost of Revenue	<u>487,177</u>	<u>439,966</u>	<u>502,422</u>
Gross Profit	<u>27,627</u>	<u>38,258</u>	<u>71,447</u>
Operating Expenses:			
Sales and marketing	101,753	79,863	76,291
General and administrative	22,017	25,585	26,250
Engineering	15,521	13,868	11,750
Amortization of goodwill	1,534		
Merger Costs	52,215	2,488	
Restructuring and impairment costs	<u>(2,735)</u>		
Total operating expenses	<u>190,305</u>	<u>121,805</u>	<u>114,291</u>
Loss from operation	<u>(162,678)</u>	<u>(83,547)</u>	<u>(42,844)</u>
Equity in net loss of joint venture	<u>(1,001)</u>		
Interest and other income, net	<u>8,750</u>	<u>7,216</u>	<u>8,360</u>
Loss before tax	<u>(154,929)</u>	<u>(76,331)</u>	<u>(34,484)</u>
Provision for income taxes			
Net loss	<u>(154,929)</u>	<u>(76,331)</u>	<u>(34,484)</u>
Net loss per share:			
Basic	<u>(4.29)</u>	<u>(1.80)</u>	<u>(0.73)</u>
Net loss per share excluding merger costs:			
Basic	<u>(2.84)</u>	<u>(1.74)</u>	<u>(0.73)</u>
Weighted average common shares:			
Basic	<u>36,146</u>	<u>42,451</u>	<u>47,000</u>
Margin Analysis (%age of revenue)			
Gross Margin	5.37%	8.00%	12.45%
Sales and marketing	19.77%	16.70%	13.29%
General and administrative	4.28%	5.35%	4.57%
Engineering	3.01%	2.90%	2.05%
Operating Margin	-31.60%	-17.47%	-7.47%
Operating Margin excluding merger costs	-21.46%	-16.95%	-7.47%
Net Margin	-31.80%	-15.96%	-6.01%
Net Margin excluding merger costs	-19.95%	-15.44%	-6.01%
Growth excluding merger costs			
Total Revenue	--	-7.10%	20.00%
Gross Profit	--	38.48%	86.75%
Operating Expense		-11.79%	-6.17%
Net loss	--	-25.69%	-54.82%
Fully diluted EPS		38.79%	57.82%