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EARTHLINK NETWORK, INC. (NASDAQ: ELNK)

Initiating Coverage: **BUY**

January 20, 2000

KEY CONSIDERATIONS

- ◆ Pooling of interest with Mindspring.
- ◆ First to rollout nationwide DSL, with 12,300 broadband customers increasing 37% quarter over quarter.
- ◆ 231,000 new subscribers for the third quarter 1999. bil A 17% increase over the second quarter 1999, and a 92% increase over the third quarter 1998.
- ◆ Availability of EarthLink 5.0, the next-generation Internet access software.
- ◆ Company enjoys one of the lowest churn rates of 3.6%.
- ◆ Over 500 affinity marketing partners, including CompUSA Novus, Sony Entertainment, Packard Bell, etc.
- ◆ A brand known with the best technical support, most reliable connections and innovative navigation and Internet personalization tools.
- ◆ Rated "A+" in seven of nine categories by Inverse Network Technology Inc.

Recent Price	\$45.85
52WK Low	\$35.00
52WK High	\$99.38
P/E	NA
P/Sales	4.34
Mkt. Cap.	\$1.336
Shrs. O/S	32.6 mil
Float	16.6 mil
Avg. Daily Volume	1.14 mil
EPS	
1997	(\$1.50)
1998	(\$2.29)
1999	(\$3.80)
2000	(\$0.73)
2001	\$0.36
Financials	
Current Ratio	4.61
Debt/Equity	0.05
LT Debt	9.2 mil
Gross Margin	58%



THE COMPANY

Earthlink is a leading Internet service provider (ISP). On September 23, 1999 Earthlink and Mindspring co-announced a merger creating the second largest ISP after AOL.

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1. OVERVIEW

PRODUCTS AND SERVICES

Earthlink currently provides dial-up Internet access to more than 1,566,000 members via 2,300 points of presence (POPs) in North America and 42+ internationally. EarthLink, like most other ISP's, is available for \$19.95 per month for unlimited access, however AOL and MSN have initiated a 10% increase to \$21.95. One of EarthLink's greatest strengths lies in its ratio of users to "points of presence." EarthLink typically has more POP's per user than any other ISP translating into less congestion and a more reliable connection.

TotalAccess Software Package: Provides a core set of features, including Email, Web Browser, 6 MB Web Space for a personal Web Site, and Personal Start Page for a monthly fee of \$19.95 and a one-time set up fee (which is frequently waived). Historically, this service counts approximately 93% of the revenue.

EarthLink 5.0: A new software, supporting Windows 98 is designed to provide EarthLink members with an intuitive, all-in-one Internet environment.

Guardian Angel Program: Assists users through any "bumps" along the information highway. This service is the only proactive support program in the industry as it targets low usage members and contacts them to assist the user on a navigated tour of the Internet.

Click-n-Build: Web-site building may be EarthLink's greatest strength in comparison to its competitors. Members can click and build their personalized Web-site without an HTML connection, which is much easier than the traditional web-site building process.

High Speed Access: EarthLink also provides higher-end services like ISDN, national frame relay, Digital Subscriber Line (DSL) and cable access. They are developing the next generation of Internet access services targeted at consumers and small businesses, such as ADSL, Fiber To The Curb and Satellite/Wireless Access.

Through its partnerships with Sprint, UUNET, Pacific Bell, and most recently, GTE, Earthlink was the first company to announce nationwide availability of DSL service. While specific DSL testing with the various exchange carriers is ongoing in different cities, full commercial rollout began in the fourth quarter 1999. For \$49.95 per month, the service can obtain 384 Kbps downloads, and 128 Kbps uploads. As of January 2000, Earthlink suspended processing DSL orders in five of seven cities due to vendor demand constraints. We believe this to be a temporary and minor setback, but a positive sign of future demand for this product. Despite the current delay, the company's choice to heavily invest in DSL was wise as cable rollout is facing some difficulties, as evident with AT&T's four-year plus delay in certain regions. DSL is also a logical choice since phone line penetration is 95% compared to coaxial cable penetration of 80%. Another advantage to providing early access to a new product is the ability to capture the initial market build up for broadband use. These early users will be less likely to leave a service once signed to a high speed ISP with good customer service.

eLink & bLink Newsletters: Free newsletters for EarthLink subscribers that deliver cutting edge Internet news, hot web sites, Net events, etc. Also gives Internet tutorials, quick tips and software reviews.

Web Hosting: Allows members to host their own Web site at EarthLink Sprint. Offers prepackaged solutions that are simple to load and use. Allows businesses to focus on their core competencies and not running Web servers.

Knowledge Network: A program that aims to provide unlimited Internet access as an educational tool for students of all ages. EarthLink will also acquaint teachers with tutorials on how to use the Internet to improve professional skills to lead students into the 21st century.

Electronic Commerce Solution: The software components allow businesses to build and operate an online "storefront" and process online credit card transactions. In conjunction with its hosting services, businesses can conveniently establish their electronic commerce presence.

INDUSTRY

The 7,000 companies that make up the ISP industry can be divided into three tiers: national, regional and local. After its pending first quarter 2000 merger with Mindspring, Earthlink should be the second largest Internet service provider (ISP) based on subscribers after AOL.

The industry's adoption of AOL's original unlimited pricing model (\$20 per month unlimited access) has forced mid-size ISPs to acquire smaller ISPs in order to achieve economies of scale, and become profitable.

The primary driving force of Internet industry is the tremendous growth in the Internet access market. Industry analyst IDC estimates that the 142 million Internet users in 1998 will increase to 502 million by 2003. IDC estimates that by the year 2000, the Internet access market value could reach \$200 billion of the telecommunications industry. E-commerce and advertising revenue should benefit from the continual growth of new Internet users.

The Internet industry is divided into three layers:

- Physical - telephone companies that own the wires and fiberoptic cable lines.
- Network - backbone and router companies that deliver Internet Protocol packets.
- Application – communications software providers.

Earthlink places itself in the applications layer and partners with software, hardware and content companies to provide added services to its subscribers. The use of third parties to provide Internet connectivity enables Earthlink to increase port capacity without the significant capital requirements, as well as the flexibility to adapt to changing technology such as cable.

Due to the combination of innovative and cost-conscious marketing programs, Earthlink has demonstrated great potential for growth, its sales continue to increase significantly from its

inception. Currently, Earthlink provides approximately 5% of the total market share of ISP industry.

2. STRATEGY FOR GROWTH

EARTHLINK / MINDSPRING MERGER

On September 23, 1999 Earthlink and Mindspring co-announced a merger creating the second largest ISP after AOL. Referred to as a "pooling of interests" by the companies, the combined entity will reorganize 1.615 shares per Earthlink share and an even share per share for Mindspring shareholders creating a 50/50 split. The new public company will maintain the Earthlink name and stock symbol, but will utilize the Mindspring headquarters in Atlanta.

Charles Brewer, Founder, CEO and President of Mindspring will take control as Chairman, while Charles Betty of Earthlink will maintain his position as CEO. Sky Daton, Earthlink's founder and Chairman will be a Director and made the following comment on the life cycle of the resulting company: "With more than 70 percent of US households still not connected to the Internet, we both realize we are still facing a market in its infancy. This merger combines two companies who share a vision, and it gives us the tools to bring great Internet service to the masses."

The new entity will have a nationwide effect as Earthlink's stronghold is the west coast and Mindspring the east coast. The new entity estimates they will have 8 million subscribers by the end of 2001. Earthlink claims 30% of its subscriber base is derived from unsatisfied AOL members, and believes the new entity will command a greater audience.

SPRINT TRANSACTION

In June 1998 the company entered into a strategic partnership with Sprint Corporation. As a result, EarthLink acquired approximately 130,000 Sprint Internet PassPort customers and became Sprint's exclusive Internet service provider for its customer channels. This partnership was accompanied by Sprint's commitment to deliver a minimum of 150,000 new members per year for five years.

Earthlink also purchased the right to use Sprint's brand and marketing channels, \$24 million in cash, up to \$100 million credit line, and a four-year network agreement at a favorable price. In exchange, Sprint received 4.1 million shares of non-voting preferred EarthLink stock. Sprint also purchased 1.25 million shares of EarthLink's common stock at \$45 per share in a tender offer and obtained two seats on EarthLink's board of directors.

We believe that this strategic alliance is an excellent move for EarthLink. Now it not only has the access to enter millions of homes through Sprint's telephone operations, but also the impact on earning ability by acquiring new members at a cost significantly lower than those acquired through direct marketing and sales efforts.

CUSTOMER SUPPORT

One of EarthLink's major strengths is its dedication to superior customer support. This is evident by their 3.6% churn rate, which is one of the best in the industry. More than half of the company's employees work in Member Support, where members receive excellent

education regarding the Internet. Further, the company is an industry leader in educating its members through various mediums, including a bi-monthly educational Internet newsletter. Finally, EarthLink possesses one of the most reliable services in the ISP market, as the company has more POP's per customer than other leading competitors.

AFFINITY MARKETING PROGRAMS

Approximately 30% of the Company's subscribers are signed through affinity marketing programs. In these programs, EarthLink bundles its Total Access service with other companies' products and services. Some successful affinity marketing partnerships are with Sony Entertainment, Columbia Tri-Star, and Comp USA to name a few. Other partnerships have been forged with Discover Card, the National Football League, the Weather Channel, and Ebay. The company also became the preferred ISP for CNET Snap!. Another important strategic alliance has been formed with Apple Computer and its launch of the iMAC personal computer. The company is the only ISP listed on the iMAC startup. This alliance has the potential of adding about 4,000 subscribers per month.

In December 1999, EarthLink secured major broadband partnerships with GO.com's ABCNEWS.com and ESPN.com, FOXNews.com, FOXSports.com and ZDNet for its high speed users. The agreements will leverage EarthLink's existing narrowband content partnerships, or Premiere Partnerships, to deliver customized content optimized for broadband services like EarthLink Sprint DSL and Sprint ION. The new broadband content will be easily accessible through the EarthLink Sprint Personal Start Page and special broadband content sections of Sprint's High Speed DSL and Sprint ION services.

The program, a significant incremental revenue driver for EarthLink, is designed to deliver marketing reach and frequency to Premiere Partners, familiarize EarthLink Sprint members with Premiere Partner products and services, and enhance each EarthLink member's Internet experience. EarthLink reported record incremental revenues of \$3 million for the third quarter of 1999, a 131% increase over the same period in 1998. EarthLink is the only pure Internet service provider generating an increasing amount of significant non-access revenue through its online marketing channels.

AGGRESSIVE MARKETING PLAN

Earthlink has leveraged their policy of not releasing member information to third parties as a marketing point over AOL. Recently, EarthLink offered AOL customers who wish to "Opt Out of AOL" a free month of service and will also donate \$50 to the Electronic Privacy Information Center (EPIC), one of the industry's leading online privacy advocacy organizations. Earthlink has also developed tools that help in the transition from AOL to EarthLink, such as change-of-address notifications and an AOL Graduates' guide.

3. RISK FACTORS

COMPETITION:

The Internet service industry is extremely competitive. Earthlink competes directly or indirectly with established on-line services, such as AOL; local and national ISPs, such as Prodigy and Internet America Inc.; and national telecommunications companies, such as AT&T and GTE. We believe the industry will remain competitive as large diversified

telecommunications and media companies acquire ISPs, and as ISPs consolidate into larger, more competitive companies

Although it's closest competitors are NetZero, AT&T and MSN, Earthlink has set its sights on AOL. AOL is in the forefront of the ISP market with over 20 million subscribers comparing to less than several million for a handful of its closest competitors. AOL's large subscriber base can be partly attributed to its strong advertising and marketing programs. Earthlink's combined distribution channels and marketing partnerships are one of the best in the industry, but a strong national advertising campaign is needed in order to compete successfully with AOL on a national level. The following are the major competitors of EarthLink based on some key factors:

Competitive Factors	Earthlink	AOL	A&T	NetZero
Brand	medium	high	high	low
User friendly	medium to high	high	high	low
Technology	high	high	high	low

Earthlink believes the key to its success in the competitive ISP market is to rapidly expand its member base. The merger with Mindspring marks a culmination of aggressive growth strategies pursued independently by both EarthLink and MindSpring over the past five years. Inverse Network Technology Inc. recently gave EarthLink high marks in Internet Benchmark tests of ISPs. EarthLink received "A+" ratings in seven of nine categories and "As" in the other two categories. In addition, a recent JD Power and Associates study ranked MindSpring and EarthLink numbers one and two, respectively, in overall customer satisfaction among the largest National Internet Service Providers. By combining their businesses, strong marketing channels, award-winning customer service and acquisition expertise, the merged company should surpass all other national ISPs by establishing itself as the clear alternative to America Online.

Currently, companies are squabbling over the rights to cable line connections in order to provide high-speed cable access. @Home and AT&T have signed exclusive rights to more than 70% of the cable lines in the United States which has led to anti-competitive legal disputes. The Court ruled that the exclusivity agreements are valid and do not constitute a monopoly. For this reason, EarthLink has decided to stay out of the backbone business, and focus on its core competencies of customer service, reliability and software.

We believe that EarthLink is displaying correct judgment by focusing on its core competencies, while forming alliances with leading cable companies and exchange carriers to offer high-speed access. This allows EarthLink to compete with @Home with the industry's first -- and, to date, only -- national contracts for DSL services. Utilizing the existing phone wiring in a home or office, DSL features Internet speeds that are up to 100 times faster than analog modems. Plus, the Internet connection is always open, so there's no waiting to dial, and DSL allows users to talk on the phone and surf the Net or fax simultaneously.

FREE INTERNET ACCESS

Free Internet Access has been gaining momentum in recent months. Customers pay nothing to use the service but must supply personal information for advertiser's use, and bear with a constant advertising banner across the top of their screen. The banner must be moved about to navigate various controls on your browser. In addition, the free service has had mixed reviews from rating as well as any other service to frustratingly poor reliability. As membership increases, the quality of the service could decrease further if bottlenecks occur.

The most notable free service is NetZero which has grown quickly to over 2 million members. However, only about 1 million members used the service in the month of September 1999, and this is no indication of how many times the service was used. NetZero poses a short-term threat to Earthlink as a new branding campaign will continue to grow its subscriber base at an explosive rate. The true test of the free ISP's is their monthly usage rate. We believe that as NetZero's membership increases, the ratio of active monthly users to total members will slowly decrease. They appear to make a good back-up service.

We believe the future of the Internet is faster speeds, reliability and full interactive media, where consumers can obtain cable, internet, and phone service all at the same time and on the same line. Free-ISP's do not fit into this formula well. Currently, the industry is introducing the roll out phase of higher speeds via DSL and cable. This will become a commodity over the next 3 to 6 years, as the Internet will become the center of people's lives as the telephone and television. While free service is a good secondary access, we believe the media exposure is temporary and can not sustain itself without a more solid offering.

4. FINANCIAL ANALYSIS

Recurring revenue of \$84.6 million for the quarter ending 9/30/99 increased 80% over the quarter ending 9/30/98 (see Income Statement). This was primarily due to an increase in the company's member base to 1.56 million up from 815,000 over the same periods respectively. Incremental revenue for the third quarter was \$3 million, a 131% increase over the same period in 1998. The total 1999 incremental revenue was \$7.3 million. The company's incremental revenue is derived from promotional packages that advertisers provide to Earthlink subscribers through multiple points. The company reports an incremental revenue backlog of \$21.3 million. As the subscriber base increases, the costs associated with maintaining the network decrease on a per customer basis, thus increasing the gross margin. The gross margin improved from 57% to 62% from the second to the third quarter. Another positive sign during the year was management's ability to keep the churn rate to 3.6% versus the industry average of about 6%.

EarthLink recently reported 1999 third and fourth quarter membership estimates to increase from 470,000 to 600,000, improving total year end membership to nearly 2 million. We have increased our revenue estimate to approximately \$339 million for 1999. This estimate is a 93% increase in total revenue, which is ambitious, but possible with the company's rapid membership growth.

INCOME STATEMENT*

	1997	1998	1999	2000	2001	2002	2003
			E	E	E	E	E
Revenues - Recurring	72,943	164,723	321,376	488,440	678,932	889,400	1,120,645
Revenues - Other	6,231	11,218	18,347	28,438	42,088	59,344	78,928
Total Revenues	79,174	175,941	339,723	516,878	721,020	948,744	1,199,573
Cost of Recurring Revenues	37,974	76,643	133,419	176,301	242,890	309,926	379,917
Cost of Other Revenues	3,401	685	994	1,423	2,104	2,967	3,946
Gross Profits	37,799	98,613	205,310	339,154	476,026	635,851	815,710
Operating Expenses:							
Sales and Marketing	21,020	42,732	126,334	175,739	252,357	332,060	419,851
General and Administrative	14,333	21,042	36,782	36,181	43,261	56,925	71,974
Ops & Member Support	30,900	54,443	101,414	144,726	194,675	256,161	323,885
Transaction Costs	0	42,635	72,761	25,000	0	0	0
Total Operating expenses	66,253	160,852	337,291	381,646	490,293	645,146	815,710
Operating Income	-28,454	-62,239	-131,981	-42,492	-14,267	-9,295	0
Interest Income - Net	-1,462	2,457	16,109	20,136	25,170	31,462	39,327
Net Income	-29,916	-59,782	-115,872	-22,356	10,903	22,167	39,327
Fully Diluted EPS	-1.50	-2.29	-3.80	-0.73	0.36	0.73	1.29
Shares Outstanding	20,002	26,157	30,500	30,500	30,500	30,500	30,500
Margin Analysis							
Gross Margin	48%	56%	60%	66%	66%	67%	68%
Sales & Marketing	27%	24%	37%	34%	35%	35%	35%
General & Administrative	18%	12%	11%	7%	6%	6%	6%
Research & Development	39%	31%	30%	28%	27%	27%	27%
Operating Margin	-36%	-35%	-39%	-8%	-2%	-1%	0%
Net Margin	-38%	-34%	-34%	-4%	2%	2%	3%
Growth							
Total Revenue	N/A	122%	93%	52%	39%	32%	26%
Gross Profit	N/A	161%	108%	65%	40%	34%	28%
Operating Expense	N/A	143%	110%	13%	28%	32%	26%
Operating Income	N/A	119%	112%	-68%	-66%	-35%	-100%
Net Income	N/A	100%	94%	-81%	-149%	103%	77%
Fully Diluted EPS	N/A	53%	66%	-81%	-149%	103%	77%

*Does not include merger with Mindspring

Revenues – EarthLink divides its revenue into three categories: recurring revenue, incremental revenue and other revenue. Recurring revenues are derived from monthly dial-up subscriptions, and other ongoing services such as business Web site hosting, national ISDN, LAN ISDN, DSL and frame relay connection. Right now, more than 93% of EarthLink’s revenue is derived from this component. To remain successful, EarthLink must continue to diversify its business revenues (see income statement)

Cost of Revenues – EarthLink pays UUNET, Sprint, and PSINet a fixed monthly fee per member plus a variable amount based on customer usage. The decrease in the cost of

revenue as percentage of revenue was primarily due to the Company's ability to negotiate more favorable contracts with third party access providers and to effectively manage communication cost per member.

Gross Profit – The Company continues to increase its gross profit margin through economies of scale and its growing membership base. As the membership base increases, the company can spread its costs over a larger pool of members thus increasing efficiency.

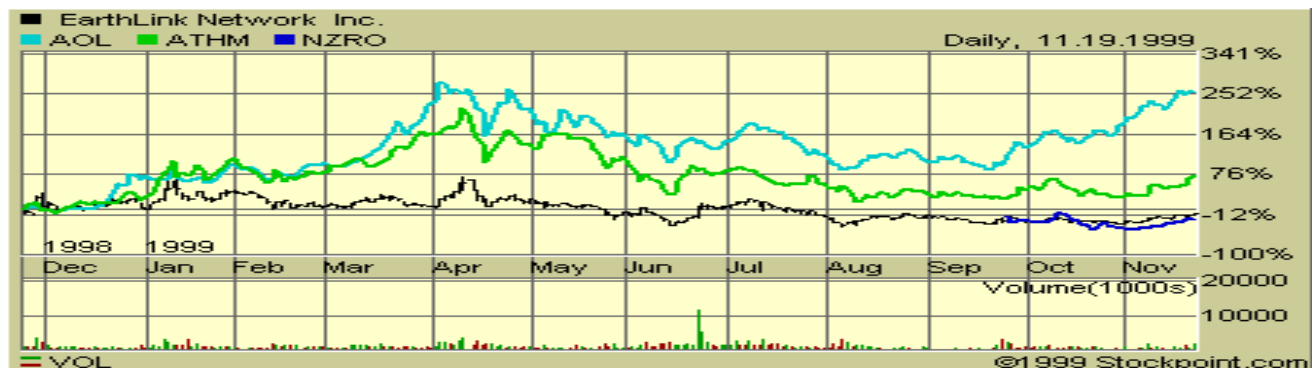
Sales and Marketing – Consist mainly of advertising, sales commission, salaries and the cost of promotional material. This category increased 260% from \$10.6 million to \$38.2 million during the three month period ending September 30, 1998 and 1999, respectively. The increase was primarily due to management's increased emphasis on organic growth through marketing strategies including expanding sales and other direct costs associated with the acquisition of members.

General & Administrative – Include costs associated with human resources, accounting, rent, professional fees, bad debt and compensation. This expense will decrease significantly after the first quarter 2000 when the Mindspring merger is complete.

Operations & Member Support – As a percentage of revenue this number is higher than most competitors. The company plans to devote significant resources to expand technical support and network operations capabilities. With its 96.4% monthly member-retention rate, EarthLink is the envy of the industry. We believe it is vital for EarthLink to maintain emphasis on this area in order to become the #1 pure Internet service provider.

Cash – Cash provided by financing an activity was approximately \$ 6.4 million and \$239.2 million during the three and nine month periods ending September 30, 1999, respectively. As of September 30, the Company has cash and cash equivalent of approximately \$338.3 million. The Company believes that available cash will be sufficient to meet the Company's operating expenses and capital requirements for the next 12 months.

5. VALUATION BY COMPARATIVE ANALYSIS



FINANCIAL RATIOS

EarthLink's quick and current ratios are well above the industry due to large amounts of cash generated through financing and stock offerings. The debt to equity ratio shows the company has very little debt. This is important as the company can invest all its cash in research and development rather than debt interest payments.

FINANCIAL RATIOS

Financial Strength	Company	Industry	S&P 500
Quick Ratio (MRQ)	4.45	3.11	1.01
Current Ratio (MRQ)	4.61	3.39	1.49
LT Debt to Equity (MRQ)	0.03	0.14	0.64
Total Debt to Equity (MRQ)	0.05	0.17	0.96
Interest Coverage (TTM)	-84.61	10.47	10.29

Growth Rates

EarthLink has demonstrated great potential for growth as its sales base continues to increase due to the addition of new subscribers. We believe incremental revenues from areas such as advertising and e-commerce will continue to increase, as the Internet becomes more prevalent in both the business and consumer markets.

Short Interest

Earthlink has shown increased amounts of shorted stock since earlier this year. In particular, the shorted shares increased from 462 million in May to as much as 1.92 million in August. December's shorted shares improved to 1.10 million. We believe there are a number of factors underlying the bearish sentiment in the sector. The threat of interest rate hikes sent down ISP stocks, most of which have high betas. Additionally, close to \$14.5 billion has been raised in the ISP sector during the first 3 quarters of 1999 causing a shake out of investors daunted by uncertainty of which ISP's will be successful in the future. This was also compounded by the arrival of free ISP's.

Investment Opinion

Stock	Price	Market Capitalization (mil)	Price to Sales Ratio	Gross Margin	52-Week High	52-Week Low
ELNK	47 1/2	1,507	4.9	58%	99	47
AOL	64 3/4	141,394	30	45%	95	33
MSPG	29 9/16	1,836	6.3	66%	66	23
PRGY	19 1/2	1,241	2.84	34%	50	14

We believe that Earthlink is fairly valued at a price to sales ratio close to 5. AOL deserves a high price to sales ratio close to 30 because it is more of a media company rather than a regular ISP. Compared to other companies in its sector, we can ascertain that EarthLink has healthy key ratios, such as quick, current, price to sales and price to book. However, its growing short interest ratio, could imply uncertainty among investors. This was common throughout the ISP sector partly due to the introduction of free ISPs, and threats of rising interest rates over the middle two quarters of the year. EarthLink's ability to counter free service with a nationwide rollout of DSL could position them to capture a large percentage of high-speed subscribers. The merger with Mindspring has put the company in an excellent position to succeed with increased subscribers and lower SGA. As their subscriber base increases, the company will be able to expand alternative revenue sources from e-commerce and advertising.

We initiate coverage of EarthLink with a Buy rating and assign a short-term price target of \$54. We believe the stock price has been suppressed for a few quarters, and pending favorable 1999 yearend financials and the Mindspring merger, an appreciable gain is expected in the near future. We also recommend EarthLink as a long-term Strong Buy with a 12 month price target of \$75. We believe this year will be a year of increased efficiencies, accelerated marketing efforts, and key partnerships making the Internet more available to consumers. We expect subscribership to grow faster than as seen in previous years.