

EARTHLINK NETWORK, INC. (NASDAQ: ELNK)

Update: Current status and merger with Mindspring completed - BUY

May 30, 2000

Key Considerations

- ◆ \$4 billion merger with Mindspring completed.
- ◆ Sprint purchases 26 million shares to increase ownership to 26.7%.
- ◆ 54% increase in member base to 3.46 million from 3/31/99 to 3/31/00.
- ◆ Revenue growth by area from 3/31/99 to 3/31/00

Narrowband	62%
Web hosting	77%
Broadband	157%
Content / Adv.	275%
- ◆ Cost of revenue as a % of revenue decreases from 39% to 35%.
- ◆ Earthlinks cash position increases to 1.1 billion.
- ◆ Earthlink is default ISP on Apple Macintosh line of computers for two years.

Recent Price	\$14.63
52 WK High	\$71.25
52 WK Low	\$10.56
P/E	N/A
P/Sales	2.28
Mkt. Cap. (mil)	1,728.3

Shrs. O/S (mil)	118.17
Float (mil)	60.30
Avg. Daily Volume (mil)	1.70

EPS

1997	(\$.439)
1998	(\$.665)
1999	(\$ 1.653)
2000	(\$ 1.633)
2001	(\$.638)

Financials

Current Ratio (MRQ)	2.59
Debt/Equity (MRQ)	.21
LT Debt (MRQ) (mil)	8.2
Gross Margin (TTM)	63.82%



This report was prepared by Michael D. London and David R. Rivas, Ph.D.

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Summary Update

Earthlink and Mindspring completed their \$4 billion merger in February of 2000 creating the second largest ISP only to AOL. Earthlink and Mindspring stockholders received 1.615 shares and 1 share respectively of the new entity, and increased the total number of customers to 3.46 million, and first quarter revenues to \$219.7 million. This is an 11% increase over 1999's year-end membership of 2.25 million and a 54% increase from the same time last year of 3.12 million customers. The company estimates this year's total membership to reach 4.5 million and revenues to reach \$1 billion by end of 2000. The company has four key areas of business and revenue; narrowband, web hosting, broadband, and advertising. Revenue growth over a one-year period ending March 31, 2000 in each of these divisions was 62%, 77%, 157%, and 275% respectively. Currently, there are over 50,000 broadband customers, more than double from the beginning of the year, and 450% more than last year. This is clearly one of the fastest growing sectors of income.

February's merger diluted Sprint's (NYSE:FON) ownership in Earthlink to 14.6%. Sprint has since committed to purchase approximately 26 million additional shares for approximately \$431 million, bringing their overall ownership to 26.7%. This investment increases Earthlink's cash position to \$1.1 billion.

Industry Comparison

The ISP industry can be broken into three areas, free narrowband, pay narrowband, and broadband, the latter we will discuss separately. Pay narrowband has been the norm dominated by AOL, Earthlink, AT&T, and others. Free narrowband has been gaining momentum from companies such as Netzero and most recently Juno.

The free services clearly offer less than perfect connections and in many cases, advertising banners that are overwhelming. This may explain why Netzero has 4 million registered users, but maintains less than half the number as active users. Considering it's a free service, they have yet to surpass many pay ISPs in membership, leading us to believe customers are willing to pay for quality connections and speed. Recent efforts for Netzero to improve its service have resulted in a technology called "auto dial" that provides a good connection on the first call in 95% of all cases. This was a necessary step, but only brings the service a step closer to par with pay services. They have also added marketing partnerships but fall short of the plethora of partnerships established by pay companies. Free ISPs continue to remain a threat to Earthlink because of registered member growth, however until the ISPs can maintain a more solid base of active users, Earthlink should continue to generate more members and revenue.

We believe Earthlink falls between AOL and free ISPs. Earthlink offers quality connections to the Internet with a standard price and many added value features. However, they falter behind AOL mainly because they continue to have fewer subscribers. We believe Earthlink will fall further behind now that AOL has the monetary support of 26 million subscribers. AOL's strongest abilities to succeed are rooted in its consistent innovation and growing member base.

AOL's merger with Time Warner allows for new media connections to television, such as AOL T.V., and music, including the Time Warner joint venture with EMI music. Other technologies in progress include a 6.0 browser said to include a language translation technology that should move AOL closer to becoming a global ISP.

We believe it is imperative that Earthlink continues to concentrate on advertising in order to improve its member base. In the meantime, gaining new partnerships and offering new services, as well continuation of excellent customer service should keep the member churn rate to a minimum.

Two partnerships Earthlink has established are with Apple Computers, and Research In Motion. Earthlink has inked an agreement with Apple to be the default ISP for two years on their Macintosh line of computers. Earthlink has also formed a partnership with Research In Motion to initiate a wireless Internet service for Earthlink customers. The service will allow members to read, forward, originate, and reply to email messages using Research In Motion's Blackberry handheld device. This is part of the "Earthlink Everywhere" product group. This service is also under development with other ISPs.

DSL Update

Earthlink's DSL service shows a growing source of revenues, having increased to \$9 million, or 157%, in one year as of March 31, 2000. The revenue growth is due to an increase in the broadband member base from 9,400 to over 50,000. Earthlink has DSL presence in over 30 markets and cable presence in 9 markets. DSL penetration is expected to expand to 40 markets by the end of the second quarter. We believe this service will continue to grow at an even faster rate throughout the remainder of the year. Prior opportunity had been stunted by the phone companies inability to satisfy original demand. Until recently, customers ordering Earthlink's DSL service required local phone company installation. The success rate of the phone company actually showing up to the customer's home was in some cases less than 50%. Earthlink has since offered customer installation kits and instructions, but the phone companies have also improved their installation performance. In addition, Earthlink has eliminated the installation and equipment fee which was typically \$350. Their DSL service is competitively priced with most other services at \$50 per month.

1st Quarter Results

Earthlinks February 2000 \$4 billion merger with Mindspring at a cost of \$34 million makes it the second largest ISP. The member base increased from 3.1 million to 3.4 million during the span of the 1st quarter. The company can break down its revenue streams into four areas including narrowband access, web hosting, broadband access, and advertising through various partnerships and programs.

Narrowband access continues to be the company's main source of revenue despite stronger growth in other areas. Narrowband revenue increased from \$114.8 million during the three months ending March 31, 1999 to \$185.5 million during the three months ending March 31, 2000, a 62% increase. This revenue growth was primarily due to an increase in the member base over the same period from 2.2 million to 3.3 million.

Web hosting revenue improved from \$9.2 million ending March 31, 1999 to \$16.3 million ending March 31, 2000, a 77% increase. The number of web sites hosted over the same period improved from 68,000 to 121,000, a 78% increase.

Broadband access revenue increased from \$3.5 million during the three months ending March 31, 1999 to \$9 million ending March 31, 2000, a 157% increase. The revenue growth was primarily driven by the expanding broadband member base over the same period from 9,400 to 45,000 and is presently over 50,000. This represents over 30 broadband markets serviced.

Content, commerce and advertising revenues grew from \$2.4 million at the three months ending March 31, 1999 to \$9 million the three months ending March 31, 2000, a 275% increase. The focal point of this increase is the company's multiple premier partnerships connecting both advertisers and customers.

Revenue Growth by Business Area

Revenue Stream	% change from 3/99 to 3/00	Total Revenues for 1 st Qtr.
Narrowband	62%	\$185.5 million
Web hosting	77%	\$16.2 million
Broadband	157%	\$9.0 million
Advertising	275%	\$9.0 million
		<i>\$219.7 million</i>

Although the company's cost of revenue increased in part because of a growing member base, the cost of revenue as a percentage of revenue decreased from 39% to 35% from March 31, 1999 to March 31, 2000. This is a result of greater efficiencies and the leverage obtained with a larger member base. Other notable charges for the quarter include \$34 million for the merger between Earthlink and Mindspring, which is expected to be paid in 10 months.

Investment Advice

Earthlink's stock has fallen in step with other ISP stocks to near their 52 week lows. Although we expect Earthlink's member base and revenue streams to continue to grow, we do not see them reaching a profit for another few years. We expect the stock to increase in value from its current level but not to out pace the Internet Index by year-end. We maintain a buy rating. The company might get acquired, just like AOL did and the merger with MCI makes it difficult to come up with conclusions.

Earthlink Financial Model *

	1997 Restated 12/31/99	1998 Restated 12/31/99	1999 Actual	2000 E	2001 E	2002 E	2003 E
Narrowband Access	119,030	260,229	582,883	1,323,144	3,030,001	5,423,701	7,755,893
Web Hosting	12,557	22,007	47,435	107,677	253,042	609,831	1,494,087
Broadband Access	1,220	3,321	23,540	223,630	1,162,876	3,953,778	11,426,420
Content/ Advertising	637	5,057	16,575	33,150	58,013	63,814	62,537
Total Revenues	133,444	290,614	670,433	1,687,602	4,503,931	10,051,125	20,738,936
Cost of Revenues	57,183	115,529	248,487	573,785	1,441,258	3,216,360	6,429,070
Ops./ Customer Support	44,801	80,244	182,134	421,900	1,125,983	2,512,781	5,184,734
Sales and Marketing	36,281	65,037	219,349	658,165	1,486,297	3,316,871	7,258,628
General and Administrative	23,168	34,575	67,876	151,884	495,432	1,105,624	2,073,894
Acquisition Related	4,208	49,684	148,267	90,000	50,000	50,000	50,000
Total costs and expenses	165,641	345,069	866,113	1,895,734	4,598,971	10,201,636	20,996,326
Interest Expense	0	0	0	0	0	0	0
Other, Net	(1,800)	3,671	21,986				
Income Before Taxes	(33,997)	(50,784)	(173,694)	(208,132)	(95,039)	(150,511)	(257,389)
Income Taxes	0	2,394	0				
Income After Taxes	(33,997)	(53,178)	(173,694)	(208,132)	(95,039)	(150,511)	(257,389)
Preferred Dividends	0	(7,601)	(14,106)	(14,500)	(14,500)	(14,500)	(14,500)
Primary/Basic Avg Sh.	77,387	91,466	113,637	136,364	171,819	219,929	285,907
Common Dividends/Shr.	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Diluted EPS	(0.439)	(0.665)	(1.653)	(1.633)	(0.638)	(0.750)	(0.951)

*1997 & 1998 are restated to account for both Earthlink and Mindspring combined financials.

Stock	Price	Market Capitalization (mil)	Price to Sales Ratio	Gross Margin	52-Week High	52-Week Low
ELNK	18	2,127	2.8	63.82%	71.25	10.56
AOL	57	130,951	23.45	47.64%	95.81	38.47
NetZero	8.69	910	11.05	-30.89%	40	5
PRGY	11.94	772	3.43	42.87%	35.44	8.25