

244 Fifth Ave., 2nd Fl., Ste. 2801 • New York, NY 10001 • Tel: (212) 726 1408 • Fax: (413) 215 0880

EToys Inc. (NASDAQ: ETYS)

Initiating Coverage: BUY

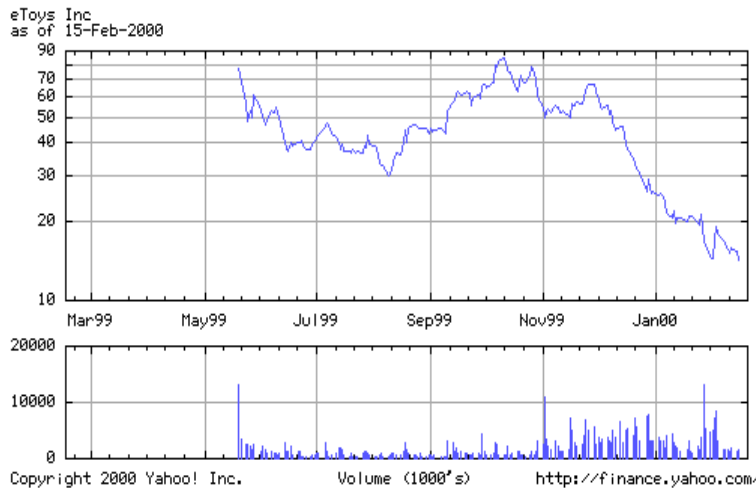
February 17, 2000

KEY CONSIDERATIONS

- Strong focused management team who has flawlessly executed to date.
- Highly competitive market consisting of many players with deep pockets.
- One of the leading brands on the web.
- Room for strong growth both domestically and abroad.
- Recent weakness presents a buying opportunity.

Recent Price	\$13.63
52WK Low	\$13.63
52WK High	\$86.00
P/E	N/A
P/Book	5.75
P/Sales	11.60
Market Capitalization	\$1640 million
Shares Outstanding	119.7million
Float	41.9 million
Daily Volume (3-month Average)	N/A
EPS	
1998A	-0.3
1999F	-1.40
2000F	-1.27
2001F	-1.30
Current Ratio	2.76
Total Debt to Equity	003
LT Debt	0.02
Total Cash	\$219.9 Million

ONE-YEAR PRICE AND VOLUME GRAPH



COMPANY PROFILE

A product of the Idealab internet company incubator, eToys was founded in 1996 in Santa Monica California and employs a staff of over 500 people. The company is one of the most prominent Web-based retailers and is exclusively focused on Toys and children's products. The company aims to combine their expertise in children's products, a commitment to excellent customer service with the benefits of Internet retailing in order to provide a unique and fun shopping experience to consumers.

This report was prepared by Kevin Shacknofsky and David R. Rivas, Ph.D.

The content of this report represents an interpretation and analysis of information generally available to the public or released by responsible individuals in the subject companies but is not guaranteed as to accuracy or completeness. InternetFundManager.com, LLC has not independently verified any of the information contained herein. Opinions expressed herein are subject to change without notice. This report is published solely for information purposes and is not to be construed as an offer to sell or the solicitation of an offer to buy any security. Recommendations made in this report are intended for investors who are aware of, suited to and financially able to bear the risks involved. InternetFundManager.com, LLC and its officers, from time to time, may have long or short positions in the securities mentioned or options to buy or sell the securities mentioned in this report. Past performance does not guarantee future performance. Forward looking statements that relate to future events or future business and financial performance can be only predictions and the actual events or results may differ from those discussed due to, among other things, those risks described in the company's reports on form 10-Q and 10-K. Copyright © 2000. All rights reserved.

Description of the Company

Background

A product of the Idealab internet company incubator, eToys was founded in 1996 in Santa Monica California and employs a staff of over 500 people. The company is one of the most prominent Web-based retailers and is exclusively focused on Toys and children's products. The company aims to combine their expertise in children's products, a commitment to excellent customer service with the benefits of Internet retailing in order to provide a unique and fun shopping experience to consumers.

They launched their first online store, in October 1997 and on April 21, 1999, entered into a warehouse and distribution agreement with Fingerhut Business Services, Inc. Fingerhut will provide warehouse and distribution services from its approximately 1,000,000 square foot warehouse and distribution facility located in Utah.

In July 1999 eToys acquired Babycenter.com a leading provider of baby products over the internet. In October 1999 eToys launched their first overseas operation eToys UK . This was followed up by eToys Canada in November 1999.

Products

eToys also sells children's video games, software, videos, books and stock over 100,000 stock keeping units (SKUs). The company sells a combination of traditional, well-known brands and specialty toy brands that are economically and physically impractical to stock in a traditional store.

eToys offers a comprehensive selection of Toy products from Mattel, Hasbro, LEGO, BRIO, PLAYMOBIL, and Learning Curve. In addition to toys, The company sells video games for the Sony PlayStation, Nintendo 64 and Game Boy platforms. The software products are sourced from a variety of well-known classic and currently popular brands including Broderbund, Disney Interactive, Microsoft's Magic School Bus and Jumpstart. The children's video department offer a variety of well-known titles from popular television series, including Barney, Blue's Clues, Dr. Seuss, Magic School Bus, Muppets, Peanuts, Rugrats, Teletubbies and Winnie the Pooh. Through the children's music department, they offer an extensive assortment of children's music in both cassette and CD format. eToys also feature a variety of popular children's music categories, including books on tape, Disney, educational, holiday, lullabies and bedtime, rock for kids, soundtracks, storytelling and Sesame Street.

Content

The company has incorporated a variety of different types of content to draw customers to the site and to encourage them to return. eToys' user-friendly Web site combines detailed product information, helpful shopping services, and innovative merchandising strategies, along with the convenience and flexibility of shopping 24 hours a day, seven days a week. They provide advanced search technology to make it easy for customers to locate products by any combination of age, category, keyword, or price. In addition, Etoys provides regularly updated product recommendations through toybox essentials, which provides information on favorites by age, picks of the month, and twenty under \$20 sections provided by the online store. They also highlight award-winning products from prominent parenting and family publications. The free monthly e-mail newsletter, "The eToys News", delivers updates about new products and services and special offers to customers.

The eToys website includes a theme-oriented destination termed "Idea Center" which currently offers nine themes designed to stoke children's imagination around various educational topics. The themes currently include: 1) when I grow up (i.e., I want to be a policeman, an doctor, a banker, etc.); 2) the wonders of science (chemistry, physics); 3) nature and discoveries (dinosaurs, birds); 4) how to host an event (a children's party, an)excursion; 5) girl power (topics to encourage girls to learn more about technology); and

four other themes. In each section eToys provides interviews with experts focused on children's interests, information, and statistics, and suggestions for parents to encourage further learning and feedback from other children regarding their own experiences. Idea Center intends to promote increased interaction between children and parents.

Services

eToys also provides a number of services to promote customer retention and loyalty. The Gift Center supplies gift recommendations by age, child-appropriate gift wrapping, personalized message cards to accompany the gifts, and electronic gift certificates. They also provide a birthday reminder service, through which they notify shoppers of a child's birthday three weeks in advance via e-mail and offer age-appropriate recommendations. Through their wish list service, parents and children can e-mail family and friends a list of the gifts they just can't do without. The company provides customers with an address book, in which to record the addresses of people to whom they send gifts to so they do not need to re-enter the same addresses multiple times. They also provide In-Stock Notification and if a product is out of stock, their customers can request and to be e-mailed when the product is back in stock. This service helps customers avoid extended store-to-store searches for hard-to-find products.

The company focus's on providing a high level of customer service. They provide free pre- and post-sales support via both e-mail and toll-free telephone service during extended business hours. Once an order is made, customers can view order-tracking information on the Web site or contact the customer service department to obtain the status of their orders and, when necessary, resolve order and product questions. Furthermore, the customer service area of the Web site contains extensive information for first-time and repeat visitors. These include helpful hints in searching for, shopping for, ordering and returning our products

Customer service representatives are available from 6:00 a.m. to 11:00 p.m. seven days a week to provide assistance via e-mail or telephone. They answer all customer inquiries within 24 hours. The customer service representatives handle questions about orders, assist customers in finding desired products and register customers' credit card information over the telephone.

It is our belief that eToys along with Amazon.com are the pioneers of high level service over the internet and are blazing a trail on how to be a successful online retailer.

Website

The eToys website is regarded by online retailing experts as a market leader. Unlike traditional retailers they organise their products by age group thus making it much easier for parents to locate appropriate toys for their children. Anyone who is a student of e-commerce will rate the eToys Web site as the easiest for the consumer to navigate and the one with the best presentation for toys," says David Miller, president of Toy Manufacturers of America.

Marketing

Through advertising and promotions, they target adult purchasers of children's products, with a focus on mothers. This strategy is based on the premise that mothers are the principal decision-makers for purchases of children's products and they strongly influence the purchasing decisions of family and friends. Marketing strategies for maximizing customer awareness and enhancing the eToys brand include partnering with Internet Service Providers, online portals, parenting-related Web sites, and children-oriented companies as well as more traditional advertising efforts. They currently have relationships with AOL, Children's Television Workshop, and Moms Online, and advertise on the sites of major online portals including Excite, Infoseek, Microsoft Network, Yahoo!, and Lycos. More traditional offline advertising is used to promote brand and specific merchandising opportunities through print advertising in *Family Fun*, *FamilyPC*, *Parenting*, *Parents*, and *Child* publications, and radio and television advertising in major markets. Additionally, by focusing on

existing customers through direct marketing techniques, building features unique to each individual customer, and enhancing customer service, eToys intend to maximize the number of repeat purchases.

eToys in their 1999 advertising campaign pursued a very focused branding strategy. The eToys campaign depicted toys as a symbol of parent's understanding of their children's interests. One TV advertisement showed a mother taking her son to a tide pool, where he sees his first school of fish. Later the mother types "fish" into search engine on the eToys site. The final scene shows the boy back at the pond with a snorkel and mask. The tag line says "where will you find the perfect gift for your child? eToys. It is our belief that eToys have the ability to build a lasting brand that will ensure they generate and retain a significant customer base.

Management

Toby Lenk - President, Chief Executive Officer

Before founding eToys, Toby Lenk was a Corporate Vice President with the Walt Disney Company in the Strategic Planning Group. He developed strategic direction for Disney's Attraction Division, including Walt Disney World, Disneyland, Tokyo Disneyland, and Disneyland Paris. In addition, he was responsible for the strategic evaluation and feasibility assessments on more than \$8 billion worth of new theme park projects. Toby developed marketing and pricing strategy for existing theme parks and was instrumental in redirecting Walt Disney World's marketing strategy to include customer-segment managers, customer database-marketing programs, air-inclusive packaging, and a new advertising approach. Prior to Disney, Toby was a strategy consultant at the LEK Partnership. He is a summa cum laude graduate of Bowdoin College and received a Master's in Business Administration with distinction from the Harvard Business School.

Janine Bousquette - Senior Vice President of Marketing

Janine Bousquette joined the company in May 1999. She is responsible for building the eToys brand name. Previously, Janine was with PepsiCo as Vice President of Marketing where she was responsible for the flagship brand Pepsi. She also served as Vice President of Marketing for the Flavor Brands (Mountain Dew, Mug Rootbeer, Slice, and Josta). Janine also has extensive experience in brand building from her 12 years with Proctor & Gamble where she was successful marketing soaps, household cleaners, cosmetics and fragrances. Janine received a Bachelor's of Arts phi beta kappa from the University of Michigan.

Frank Han - Senior Vice President of Product Development

Frank Han has been Senior Vice President of Product Development since January 1999. He is responsible for the eToys Web site, all the way from design and feature development to engineering execution. Frank was Chief Operating Officer at eToys from February 1997 to January 1999. Prior to that, he served as Vice President of Interactive Markets and Director of Strategic Planning at Union Bank of California. Frank graduated from Yale University and received a Master's in Business Administration from the Stanford Graduate School of Business.

John Hnanicek - Senior Vice President and Chief Information Officer

John joined eToys in December 1998. He is responsible for all information technology, including the systems used for site management, search, customer interaction, and distribution services. Prior to joining eToys, John held positions as Senior Vice President of Information Systems for Hollywood Entertainment, Inc., a nationwide retail video chain, and Chief Information Officer for Homeplace, Inc., a home furnishings chain. He also served as Senior Vice President of Information Systems and Logistics at OfficeMax, Inc., a retail office supply outlet. John has a Bachelor's of Science in computer science and accounting from Cleveland State University.

Steve Schoch - Senior Vice President and Chief Financial Officer

In January 1999, Steve joined eToys and took charge of all financial functions, including finance and administration, planning and reporting, legal, and investor relations. Steve comes to eToys from the Times

Mirror Company, a Los Angeles-based news and information organization, where he served both as Vice President and Treasurer. He also served as Chief Executive Officer and President of Times Mirror Resource Management Company, a cost control and process re-engineering unit. Prior to that, Steve held financial management positions with Walt Disney Company, EuroDisney, S.C.A., and Citibank. Steve earned his Bachelor's degree in Engineering from Tufts University and a master's in business administration from the Amos Tuck School of Business Administration at Dartmouth College.

Louis Zambello - Senior Vice President of Operations

Lou manages the company's fulfillment centers, inbound/outbound logistics, inventory, and customer service. He came to eToys in December 1998 after a successful stint at L.L. Bean, Inc. Louis held various executive positions over his distinguished 14-year career at L.L. Bean, most recently Senior Vice President of Operations. He received a Bachelor's of Arts magna cum laude from Cornell University and a Master's in Business Administration from Harvard Business School

Assessment

A crucial determinant of a high growth company such as eToys success is the depth and quality of the management team. The company is pursuing a simple business model where the main challenge is the management of the growth and significant scaling up of the company as its customer base grows ie execution risk. It is evident that the company has assembled a quality management team, with blue chip backgrounds, that would capably run a company far greater than the size of eToys. Furthermore, the company is headed by a founder with a demonstrated passion for selling toys and the internet which in our opinion is significant determinant of success.

Industry Analysis

Toy Industry

According to the Toy Manufacturers of America the American Toy Industry has annual sales of over \$23 billion (excluding video games) that have been growing at a rate of about 5% per annum. Total video game sales are over \$6 Billion per annum and have approximately doubled since 1996. ". The international toy market has total sales of \$68 billion. The industry is characterized by volatile changes in consumer tastes and sales are usually dominated by the "current craze

There are four types of products

The Current Craze – The latest toy that every kid has to have.

The Evergreen Product – perennial favourites including: Barbie, Leggo and Matchbox Cars.

The Entertainment Tie Ins – these include products associated with movies such as Star Wars and TV shows such as Tele Tubbies.

Interactive products – Video games which is the fastest growing segment in the industry.

The industry is dominated by the worlds two largest toy manufactures Hasbro and Mattel who comprise close to 40% of the US market.

Sales are highly seasonal with 52% of sales occurring in the December quarter.

Despite the decline in the birth rate the Toy Sector will benefit from a number of trends including the fact that the last of the baby boomer generation are having children creating a baby boomlet. This demographic are known for being big spenders and the average spend per child should increase. Furthermore, due to the increase of the average persons lifespan grandparents are living longer and thus their toy spending years

are being extended. The increasing divorce rate is resulting in children being part of more than one family therefore are part of a larger gift giving circle.

eTailing Industry

From its beginnings five years ago when the browser was first introduced the internet has grown to become practically ubiquitous. Usage of the internet has grown faster than any other medium. 1999 was the year when buying over the internet came of age. Consumers fears of credit card security and privacy concerns have been allayed and they embraced buying over the internet with abandon. The Boston Consulting Group estimated that total sales in the US over the internet approximated \$31 Billion. Forrester Research figures online sales to businesses and consumers in the U.S. will more than double this year, and could nearly double again in 2001. This is still a small percentage of the total retail industry of \$2.7 trillion and thus online retailing should experience significant growth for a number of years.

Ernst and Young estimated that online sales during the Christmas season estimated \$13 Billion. During the 1999 holiday period online retailers learned that their ability to scale up their operations over the Christmas period to avoid site outages, product shortages and ensure on time delivery are crucial to their ultimate success. Ernst and Young estimated that consumers spent an average of \$US1,080 on their Christmas purchases and that 67 per cent of goods were bought in stores, 7 per cent by catalogue and 26 per cent online. A New York Times/CBS News poll found that some 17 percent of Americans shopped on the Web during the holiday season, up from 7 percent the year before.

Summation

To date consumers have only been comfortable buying tangible products on the web where they know what they are receiving. Toys have rapidly joined books and CDs as a successful internet product. Furthermore, parents are keen to avoid the crowds and hassle of Christmas shopping and the internet provides a far more efficient and informative shopping destination. Consequently, it is our belief that toys will be a sector with one of the fastest growing rates of consumers transferring to purchasing online.

Competition

Before online retailing became a significant force the toy retailing industry was divided up (as per the Toy Manufacturers Association) as follows:

Rank	Retailer	Estimated Dollar Share of U.S. Toy Industry in 1998
1	Wal-Mart	17.4%
2	Toys R Us	16.8%
3	Kmart	8.0%
4	Target	6.9%
5	KB Toys/Toy Works	4.9%
6	J.C. Penny	1.6%
7	Ames	1.3%
8	Meijer	1.2%
9	Hills	1.1%
10	Sears	1.1%

However we believe that eToys has significant advantage over traditional retailers as the online marketplace provides customers with twenty-four-hour, seven-day-a-week access to an extensive product selection unlimited by shelf space or store layout constraints.

The company's main competition are those companies who have launched an online channel to sell toys and these include:

Wal-Mart

Founded by Sam Walton, Wal-Mart is the world's largest retailer, with about 3,600 Wal-Marts, Sam's Club membership-only warehouse stores, and Wal-Mart Supercenters combination discount and grocery stores. Most of its stores are in the US, where it is converting older Wal-Mart outlets into Supercenters. Wal-Mart is expanding internationally; it is now the number one retailer in Canada and Mexico, and it also has operations in South America, Asia, and Europe. Their subsidiary, the McLane Company, is the biggest convenience store distributor in the US.

After delaying the launch of its revamped Website in late 1999, Wal-Mart unveiled a new improved online offering on January 1. The site, expands the number of products the company offers online sixfold to 600,000 in 24 categories-including appliances, toys, apparel, and electronics. Wal-Mart also announced that it would team up with Accel, a 16-year-old Silicon Valley venture firm with more than \$1.4 billion in assets under management. Led by managing partner Jim Breyer, Accel has invested early in such technology home runs as Foundry Networks and Macromedia. They also plan to spin-off and list the internet operations separately.

Toys "R" Us

Toys "R" Us, is the largest toy specialty retailer and offers toys, games, sporting goods, and software at more than 1,500 stores and through its Web site and catalog. Toys "R" Us sells children's clothes in more than 200 Kids "R" Us stores; infant/toddler apparel, furniture, and feeding supplies in over 100 Babies "R" Us stores; and educational toys in about 40 Imaginarium stores. The retailer has operations in 25 countries, mainly in Japan, Canada, and Europe. Toys "R" Us initially teamed up with Benchmark Capital, a prominent Silicon Valley venture firm which is best known for backing Internet auctioneer eBay. Toys "R" Us abruptly pulled out of the deal last year after the parent company clashed with the dot.com's management over critical issues, such as pricing, return policy, supplier relationships and general integration with the brick-and-mortar stores.

Toys "R" Us experienced a decline of 2% for same store sales in 1999. This has been attributed to the company experiencing shortages of hot products and competition from discounters and the internet.

KBkids.com

KBkids.com was formed in July 1999 when Consolidated Stores (a closeout retailer that also operates over 1,300 K-B Toys stores) combined its online toy operations with those of BrainPlay.com. BrainPlay.com founder Srikant Srinivasan is the company's CEO.

Amazon

Founded by Jeff Bezos Amazon was the first internationally famous online retailer. Initially the company focused on selling books but now Amazon.com's main site offers millions of books, CDs, videos, toys, electronics, and gifts. It also conducts auctions for items ranging from dolls to computers. Amazon also owns stakes in companies offering pet supplies, prescription drugs, and groceries. Amazon.com pioneered the model of Internet companies putting market share ahead of profits and has consistently made significant losses.

Performance over the 1999 Holiday Season

As per Nextcard a leading Internet Visa, the top ten e-commerce retailers, based on actual NextCard purchase volume, for the six-week holiday shopping period from pre-Thanksgiving through Christmas are:

Transaction Volume Rank	Merchant	Average Holiday Purchase Price
1.	AMAZON	\$36.00
2.	BUY.COM	\$64.63
3.	BARNESANDNOBLE.COM	\$22.16
4.	CD NOW	\$25.91
5.	ETOYS	\$60.31
6.	REEL.COM	\$19.53
7.	EGGHEAD.COM	\$144.51
8.	KBKIDS.COM	\$52.32
9.	MORE.COM	\$7.42
10.	DRUGSTORE.COM	\$18.65

This contrasted with the survey results of Media Metrix which showed that Amazon.com, the biggest Internet retailer, led shopping sites with 5.69 million individual visitors this season, a rise of 81 percent from a year earlier. It was followed by auctioneer eBay, whose 4.07 million visitors marked an increase of 76 percent; and eToys, whose number jumped 45 percent to 1.66 million. Barnesandnoble.com had 1.52 million visitors, a 20 percent gain; and toysrus.com's number rose more than fourfold to 1.49 million. Rounding out the top 10 sites were computer, music and book seller Buy.com, with 1.43 million visitors; music retailer CDnow, 1.42 million; greeting-card site Egreetings.com, 1.11 million; and travel sites Expedia and Travelocity.com, which is owned by Sabre Holdings, with 1.02 million and 934,000, respectively.

"The 1999 online holiday shopping season was a huge test to see if traditional offline merchants can effectively compete with pure internet rivals -- in merchandising and delivering goods," said Jamie Hale, manager of NextCard's merchant initiatives.

"What we've seen, however, is that although some major offline brands can draw significant traffic to their sites, they are still unable to convert those visitors into online buyers. For example, ToysRUs.com ranked 5th in total holiday visitor volume according to Media Metrix, but did not make NextCard's Top Ten; in fact, it did not make the top 30.

" eToys, on the other hand, experienced some of the highest visitor to buyer conversion in the industry, ranking 3rd in traffic volume according to Media Metrix and 5th in transaction volume according to NextCard's data."

EToys established the standard for customer service in the 1999 Xmas season. During the peak months of November and December the company shipped 96% of its orders on time; in all, 99% of orders placed prior to the holiday shipping deadline of Dec. 18 arrived in time for Christmas.

Assessment

Wal-Mart, Toys "R" US and KBKidds are all significant bricks and mortar players. Their key strength is in sourcing product and distributing it on mass. However, they do not have any experience in servicing and delivering products to individuals and operating a web based business. This was evidenced by the fact that Wal-Mart refused to guarantee delivery before Christmas for products ordered after December 9, and website outages and stock shortages experienced by Toys "R" Us during the holiday shopping period. Wal-

Mart's focus is further diluted by the fact that they aim to sell other products such as electronics and apparel through their website.

There online sales are also cannibalising their traditional outlet sales and thus their focus and commitment is compromised. This has definitely been the case at Toys R Us where the internet operations management clashed with the traditional managers over a number of issues. Old traditional retailers also lack the flexibility and nimbleness of young and hungry new players like eToys. This was evidenced by the failure of Wal-Mart to revamp their website by Christmas as per their announcement earlier in the year.

Amazon has a significant customer base of 10 million people and it has used this to dominate every market it has entered. They surged into the lead in Internet music sales in four months and, in videos, in just 45 days. Amazon has set the standard for servicing customers over the internet and therefore remain eToys most significant competitor. However, Amazon are trying to be all things to all people and not only supply a broad range of products but a number of different services as well. We believe eToys focus, not only on the Toy sector, but the kids under twelve demographic as well, provide them with a significant competitive advantage.

Competitive Advantages

eToys has established many barriers to entry that we believe will enable them to retain its leading position in the on-line toys retail market and enable them to generate economic profits in the long term.

First mover advantage – As the first toy retailer in cyberspace, it has an accumulated experience advantage. In addition, eToys has benefited extensively from free public relations due the significant press coverage it received.

Domain name – The eToys name provides consumers easy access to their site. The company also has purchased the rights to the Toys.com name.

Brand – The company has spent millions of dollars marketing the company and has established an instantly recognizable brand name.

Distribution Network – eToys exclusive partnership with Fingerhut, a distribution specialist, has worked out so far but now eToys plans to improve its distribution by doing it itself. This could be a competitive advantage.

Exclusive supply contracts – For a number of specialty toys the company has been able to secure exclusive online distribution rights.

Customer retention services – eToys superior site layout, content and level of customer service will ensure that they attract and retain a significant customer base.

Focus – Unlike their competitors, eToys are focusing on the under 12 demographic and are intent on establishing a relationship with parents who are the buyers for this target market.

Strategy for Growth

EToys' goal is to become the leading e-commerce site for the children under 12 demographic. Its strategies to reach this goal consist of the following:

Grow the customer base- eToys will continually adopt aggressive marketing campaigns to grow their customer base. eToys strong brand will assist them to win a large share of the new consumers who will move on line in the next few years.

Increase average customer spend- the current average eToys customer spend is \$67. The average annual spend on toys in the US per the Toy Manufacturers of America is \$341 therefore there is considerable room for eToys to make more sales to existing customers.

International Expansion- eToys has in the past year expanded into Canada and the UK. The rest of Europe as well as Asia and Latin America are large potential markets.

Diversify into other products targeted at the children under 12 demographic eg clothes and school accessories.

Leverage the Baby Center acquisition- eToys will direct their considerable e-commerce experience and expertise towards the \$15 billion baby products market.

Alliances and Partnerships

Powerful marketing alliances - In a strategic cross promotion with GapKids and babyGap, eToys. Has aligned itself with one of the world's best known family-oriented brands and focused on attracting new customers while rewarding existing best customers with reciprocal \$10 gift certificates for purchases of \$75 or more. The company also launched "Rosie's Readers" program, a creative collaboration between TV talk-show host Rosie O'Donnell and eToys' online Book Store. Additionally, eToys participated as a retail partner in the nationwide McDonald's(R) LEGO(R) Happy Meal(R) Promotion.

AOL- eToys spent \$18 million on an anchor spot on AOL for the next three years. This should enable them to extend their customer reach due to AOL's ubiquitous reach.

Fingerhut – Since the company's inception distribution and fulfillment has been taken care of the Fingerhut group. This relationship will cease at the end of March this year. There is a conflict of interest when a company outsources its distributor since the distributor tries to minimize costs at the expense of quality and reliability. The company now plans to use company-run distribution facilities as its primary means of order fulfillment and decrease its reliance on outsourcing vendors. The company is currently outfitting an East Coast distribution center in Danville, Va., which is expected to begin shipping products in the spring, and is also expanding its existing West Coast distribution operations in Southern California.

IBM Global Services, Oracle and Dulcian Inc are eToys technology partners and they recently helped the company re-engineer the website and the customer database. Strong technical partners are essential due to the importance of website reliability.

Key Risk Factors

Product shortages- the toy industry is characterized by crazes that result in a rush on specific products and often result in toy retailers experiencing product shortages. This can result in lost sales.

Inventory obsolescence – toys are highly fashionable and if a toy retailer over stocks an item that becomes unfashionable the inventory may become obsolete.

Late fulfillment – the huge rush during the Christmas season can put pressure on the company's ability to deliver. The consequences of late delivery of Christmas presents can create irreparable customer ill will.

Increased competition – eToys competitors such as Toys R' US, Wal-mart and Amazon have the financial capability to start a price war that could place huge pressure on the company's margins.

Financial Model

Income Statement

	Actual	Forecasted	Forecasted	Forecasted
(\$000's)	Year End	Year End	Year End	Year End
	Mar-99	Mar-00	Mar-01	Mar-02
Net Sales	29,958	156,264	344,091	659,744
Cogs	24,246	123,960	278,709	534,385
Gross Profit	5,712	32,304	63,091	123,628
Marketing & sales	20,718	115,000	138,001	165,601
Product Development	3,608	34,147	8,765	3,361
General Admin	4,662	12,523	10,320	42,299
Amort of Good will and Def Comp	5,823	42,696	52,108	52,108
Operating Income/(Loss)	- 29,099	- 172,062	- 146,102	- 139,741
Net Interest	542	4,528	- 5,958	- 16,414
Pretax Income/(Loss)	- 28,557	- 167,534	- 152,060	- 156,155
Tax Expense	1	-	-	-
Net Income/(Loss)	- 28,558	- 167,534	- 152,060	- 156,155
Weighted Average Shares	93,700	119,719	133,000	140,000
Reported EPS	- 0.30	- 1.40	- 1.27	- 1.30
Margin Analysis				
Gross Margin	19%	21%	19%	19%
Marketing & sales	69%	74%	40%	25%
Product Development	12%	22%	3%	1%
General Admin	16%	8%	3%	6%
Amort of Good will and Def Comp	19%	27%	15%	8%
Operating Margin	-97%	-110%	-42%	-21%
Net Margin	-95%	-107%	-44%	-24%
Growth				
Revenue	n/a	522%	220%	192%
Gross Margin	n.a	566%	195%	196%
Marketing & sales	n./a	555%	120%	120%
Product Development	n/a	946%	26%	38%
General Admin	n/a	269%	82%	410%
No registered users	365	1,920	3,843	6,408

FINANCIALS

Revenue We expect that eToys should continually experience strong top line revenue growth as the average consumer moves more and more of their purchases on line. Revenues will continue to be driven by aggressive marketing and international expression.

Gross Profit. Gross Margins should remain stable as competition to date has focused on service and marketing.

Sales and Marketing Margin. The continuing strengthening of the company's brand we expect will reduce the customer acquisition cost in the long term. Higher growth will be achieved without significant increases in the levels of marketing expense.

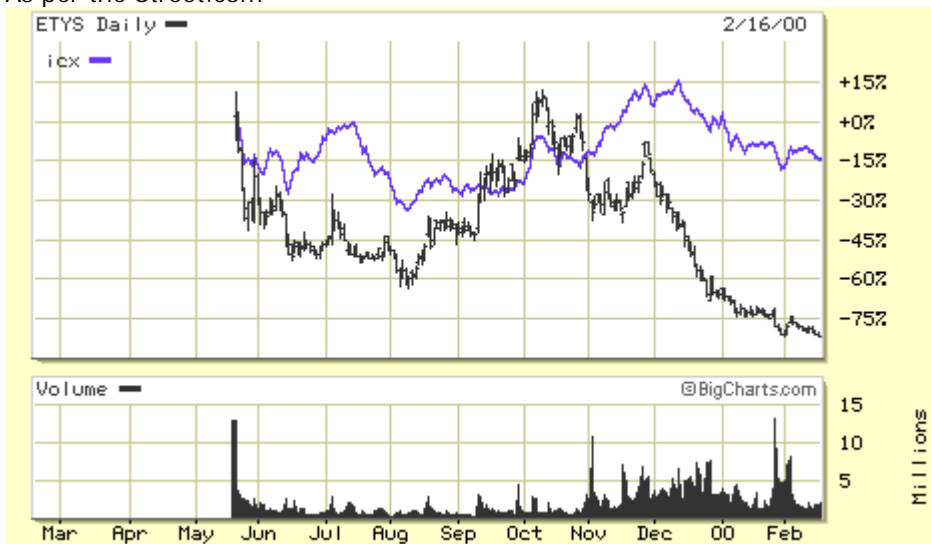
General and Administrative. General and administrative expenses are expected to increase as the company continues to expand globally. However as sales continue to grow G&A as a % of sales will fall significantly.

Net Income. Net income has been negative since the company's inception and we expect it to remain negative in the near future.

VALUATION

Internet Sector. After having moved together with the Street.com's E-commerce Index for a little while, eToys has under performed this index from Nov 1999 to the present. The stock does seem correlated to the index and will likely follow its direction. The decline was instigated by (1) insider selling, (2) concerns over competitive pressures, especially in view of Wal-Mart's plans for an analogous online presence, and (3) unsubstantiated worries over levels of service, even though eToys had a 96% rate of order fulfillment, which was high relative to those of other e-commerce sites that were overwhelmed by the high Christmas season demand. It does appear as if the stock has been oversold and should rebound in the near term and move closer to the E-commerce index.

As per the Street.com



Value Comparison 2/17/00					
	<i>\$ Price</i>	<i>Market Cap. In millions</i>	<i>Trailing 12 Month Sales in millions</i>	<i>P/S</i>	<i>Gross Margin %</i>
eToys	13.63	1,640	134.1	12.23	19.1
Amazon	70.66	24,100	1,640	14.70	19.8
Garden.com	6.875	120.4	8.84	13.62	25.8
Barnes & Noble	10.5	1,510	202.6	7.45	-15.7
Drugstore.com	22.18	962.2	34.8	27.65	20.8

Margins. eToys gross margin is of a comparable level with other major e-tailers. The gross margin has fallen by 1% in the last quarter due to a higher portion of low margin CD's and videos in the sales mix.

Price to Sales. eToys has one of the lowest price to sales ratios of the major e-tailers. This could be due to fears of increased competition that could slow growth. The low level in the price to sales ratio shows that the company has been valued conservatively and may be an indicator that that the stock is oversold and there is significant upside potential in the valuation.

Investment Opinion

EToys has a highly accomplished management team who has a strong execution track record in the management of growth and in maintaining high levels of service. The company has the ability to leverage off its strong brand and make significant inroads into the international toy market worth over \$68 billion. Furthermore, the Babycenter subsidiary presents a great growth opportunity in the \$15 billion baby products market. The recent weakness in the share price presents a great opportunity and we rate the stock currently as a BUY.