

Net.B@nk, Inc. (NASDAQ: NTBK)

Initiating Coverage: HOLD

September 15, 1999

KEY CONSIDERATIONS

- Netbank.com continues to maintain a dominant position in the online banking market as the largest federally-insured bank that operates exclusively over the internet.
- Net.Bank is the first internet-only bank in the United States to achieve profitability. Net.Bank has now remained profitable for five consecutive quarters.
- We expect Net.Bank to face strong competition in the future from both traditional and pure online-banks.
- Net.Bank has already realized the importance of customer satisfaction and a strong brand name. Consequently, it has already increased its expenditures for improving customer service and building a strong brand name. Early this year, as the result of a secondary offering, it has raised \$105 million to finance these expenditures.
- Depending on how committed and successful Net.Bank is at improving customer service, building its brand name, and expanding its product line, Net.Bank could be the financial experience of the future or one of the many online banks.

| | |
|-----------------------|------------------|
| Recent Price | \$21.75 |
| 52WK High | \$83.00 |
| 52WK Low | \$3.583 |
| P/E | 171.26 |
| P/Book | 2.68 |
| P/Sales | 16.59 |
| Market Capitalization | \$639.06 million |
| Shares Outstanding | 29.38 million |
| Float | 24.10 million |
| Daily Volume | 1.80 million |
| (3-month Average) | |
| Short Ratio (5/99) | 2.18 |
| Year | EPS |
| 1996 | (4.30) |
| 1997 | (1.66) |
| 1998 | 0.58 |
| 1999E | 0.14 |
| 2000E | 0.20 |

ONE-YEAR PRICE AND VOLUME GRAPH



COMPANY PROFILE

Based in Atlanta, Georgia, Net.Bank, Inc., is a financial services company whose only subsidiary – Net.Bank – is the largest FDIC-insured bank that operates exclusively over the Internet. The company’s mission is to profitably provide a broad range of banking and financial services to the growing number of Internet users. Net.Bank went public in July 1997. Currently, Net.Bank has close to a billion dollars in total assets and over 40,000 accounts. Net.Bank’s Web site can be reached at www.netbank.com.

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ONLINE BANKING INDUSTRY

Net.Bank was at the forefront of Internet banking when it opened its virtual doors in 1996. By 1998, Net.Bank had become the defining company in Internet banking, being the only full-service bank operating exclusively on the Internet.

Net.Bank led the way in the public's switch from PC banking to Internet banking and proved that a bank can thrive without branch offices.

As Net.Bank succeeded in attaining profitability during 1998, the whole arena of Internet commerce simultaneously exploded. E-commerce, which affects Internet banking, is most certainly here to stay. According to International Data Corporation, the total worldwide commerce on the Internet will grow from about \$32.4 billion in 1997 to an estimated \$425.7 billion in 2002. Consumers are showing strong preferences for transacting certain types of businesses – bill paying, booking airline tickets, trading securities, and purchasing consumer products such as computers, books and cars – electronically.

In addition to the increased use of the Internet for general commerce, the web became a popular means of making financial transactions. According to Jupiter Communications, the number of online banking households in the United States is projected to grow from 27.4 million in 1997 to an estimated 319.8 million in 2002. A demographic study by Jupiter Communications indicates that Internet users tend to be young professionals with relatively high incomes. These reports clearly suggest a significantly growing and desirable market for the convenient, attractive interest rates and low fees that characterize Net.Bank.

BUSINESS MODEL

Net.Bank was launched with the belief that a bank could operate within a different business model – one that capitalized on the Internet as its principal delivery vehicle rather than brick-and-mortar branches. This business model has proven itself to be sound and viable, as demonstrated by the remarkable successes achieved by Net.Bank in 1998.

One of the most significant successes is that Net.Bank recorded profitability in the second, third, and fourth quarters of 1998. This achievement is significant for several reasons. First of all, very few public Internet companies move into profitability so rapidly. Second, the Company was the first Internet-only bank in the United States to achieve profitability. Third, profitability is still uncommon among Internet-based businesses.

Net.Bank attained profitability so swiftly by combining low overhead costs with interest income from high quality loans and investments and noninterest income from fees generated by cross-marketing products and services.

- **Low Overhead Expenses.** Compared with traditional banks, Net.Bank's overhead expenses are low because there are no branch offices to support. These low overhead expenses translate into added benefits such as higher interest rates and no fees for Net.Bank customers.
- **Interest Income.** Net.Bank generates interest income by originating and purchasing loans. The Company focuses on high credit quality to minimize losses. Net.Bank emphasizes a conservative investment strategy by investing in securities such as U.S. Treasury obligations, collateralized mortgage obligations and mortgage-backed securities issued by agencies such as Fannie Mae and Freddie Mac.
- **Noninterest Income.** Net.Bank creates noninterest income by cross-marketing loan originations, credit cards, brokerage services and other-income generating products. The Company markets these products and services via their web site, bank e-mail and online advertising.

NETBANK'S PRODUCT LINE

During 1998 and 1999, Net.Bank solidified its foothold in the highly competitive financial services industry by significantly broadening its line of products and services. With these new additions, Net.Bank proved that virtually any banking service a customer might desire can be successfully delivered by an Internet-only bank.

- **Online Lending.** Net.Bank collaborates with several top Internet lenders to finance loans they originate. In 1999, Net.Bank entered into a consumer loan processing and servicing agreement with PNC Bank Corp. This agreement allows Net.Bank to offer consumer loan products on-line. Through such type of partnerships, Net.Bank is fast becoming the lender of choice online. It offers web-based mortgage services with unprecedented convenience, low origination costs and a range of financing options. Net.Bank has formed a partnership with First Mortgage Network to enable customers to obtain quotes on interest rates and apply for home loans online through the Company's website. As of June 30, 1999, Net.Bank has closed over \$260 million in first mortgage loans.
- **Online Trading.** In 1998, Net.Bank introduced an innovative asset management account. The NetWorth Investment Account permits customers to make securities trades without having to wire money or write checks to their brokers. Instead, trading fees are automatically debited from their Net.Bank deposit accounts. Similarly, when customers sell stock, their accounts are automatically credited with the investment proceeds. The NetWorth Investment Account was made possible through Net.Bank's association with UVEST Investment Services, one of the nations' leading discount brokerages.
- **Improved Checking Account.** Net.Bank's current checking account is a no-fee, high-interest account that includes free, unlimited online bill payment, free checks and unlimited ATM use. This improvement in the checking account has resulted in a dramatic increase in new Net.Bank accounts.
- **Credit Cards.** Net.Bank added credit cards from VISA and Mastercard in 1998.
- **Equipment Lease Financing.** To serve the growing small business market, an important customer base, Net.Bank linked up with Republic Leasing Company during 1998 to offer equipment lease financing on an array of goods, with same-day service, no down payment and approval with little or no financial information required.

THE CUSTOMER'S POINT OF VIEW: INTERNET BANKING OR TRADITIONAL BANKING

Because pure Internet banks like Net.Bank are based on different business models than traditional banks, they offer different benefits to their customers.

Advantages of Internet Banking over Traditional Banking.

- **No Monthly Fee.** Net.Bank charges no monthly fee for its checking accounts customers. Traditional banks, such as Chase and Citibank usually charge a monthly fee or require a certain minimum balance in order to be exempt from this monthly fee. Usually, this minimum balance is anywhere from several hundreds to several thousands of dollars. The minimum balance to qualify for a no-fee Net.Bank checking account, on the other hand, is currently \$100.
- **High Interest Rate.** Net.Bank's most attractive feature to its customers is that it offers a high percentage interest rate on its checking account. Because standard brick-and mortar banks have relatively higher overhead costs, these banks cannot profitably offer the higher interest rate on checking accounts that Net.Bank can.

| | Rate | APY |
|---------------------------------|-------|-------|
| Net.Bank's Super Value Checking | 3.93% | 4.00% |
| Net.Bank's NetValue Checking | 3.00% | 3.05% |
| National Average | 0.84% | 0.85% |

- **Free, Unlimited Online Bill Payment.** Net.Bank offers all of its checking account customers free, unlimited online bill payment. Through online bill payment, money is electronically transferred from the customer's checking account to the payee. If, for whatever reason, an electronic transfer cannot be made or is undesirable, a check is sent though US mail by Net.Bank.

Unlimited Online Bill Payment provides the customer with convenience. First of all, online bill payment cuts the bill payment time, because electronic transfers can take place immediately. Usually, when a check is written out to pay a bill, it must be sent several days in advance in order to account for the number of days it takes to mail a check. In addition, because online bill payment is free, the customer does not have to pay for the price of the stamp to mail a check.

- **Free Online 24-Hour Account Access.** Net.Bank provides its customers with 24-hour account access with real-time up-to-date balances.
- **Free Checks.** Whereas traditional banks charge their customers a fee for printing a certain number of checks, Net.Bank offers its customers free checks.
- **Unlimited ATM Use.** Whereas Net.Bank offers it checking account customers unlimited ATM use, traditional brick-and-mortar banks often charge a higher monthly fee if the number of transactions in a certain month are higher than a standard amount.

Disadvantages of Internet Banking over Traditional Banking.

- **Mail-in Deposits.** Because Net.Bank does not have any branches, it inconveniences its customers by making them mail in their deposits. This is inconvenient mainly because of the time delay that results from having in to mail in a deposit.

However, in order to accommodate for this inconvenience, Net.Bank, like other traditional banks, offers a direct deposit system in which a company or government check can automatically be transferred to the customer's account.

- **ATM Fee.** Although NetBank offers its customers unlimited ATM use, this does not mean that the ATM itself will not charge a fee to the Net.Bank customer for withdrawing money. Usually, this fee is anywhere from \$1 to \$2.

However, in order to accommodate for this inconvenience, Net.Bank is trying to form partnerships with firms that operate ATMs so that Net.Bank' customers will not be charged this additional fee by the ATM. Net.Bank has already formed several such partnerships, and currently has a list of free ATMs its customers can use on its website.

BUSINESS STRATEGY

Expanded Product Line. In the future, Net.Bank will continue to add new products, and services typically offered by traditional banks as well as other new services more ideally suited to web-based delivery. This year, Net.Bank customers can look forward to expanded consumer loan products including second mortgages, equity line and auto loans. Other new products and services in development or under consideration include electronic bill presentment, insurance products, proprietary credit cards, consolidated account statements, and financial planning and asset allocation services. Net.Bank has already announced earlier this year that it will provide its banking customers with a new web-based safe-deposit box service for the secure online storage of valuable and confidential electronic documents. Net.Bank's goal is to continue to be inventive in providing customers a single, convenient channel from which to manage all their banking and financial needs.

Expanded Marketing Program. During 1998, Net.Bank's innovative Internet advertising campaign enabled it to reduce acquisition cost to among the lowest in the industry. For 1999, it has increased its marketing budget about six-fold in order to grow its customer base and core deposits while continuing to build its brand name.

Net.bank implemented a new advertising campaign early this year. The main purpose of this campaign was to inform the public of the cost savings that Net.bank is able to achieve, cost savings which translate into higher-yielding and lower-fee deposit products for its customers. The goal of the program is to cost-effectively amass as many new customers, and thus accounts, as possible this year. The company plans to accomplish that by further building its brand-name awareness and developing partnerships that will enhance its service offerings. Unlike 1998, Net.Bank's 1999 marketing efforts extend beyond online advertising to include both print and broadcast advertising, as well as targeted direct mail campaigns, both online and off.

Customer Service Improvements. As one of the fastest growing, lowest-cost banks in America, Net.Bank walks a fine line between efficiency and quality customer service. The delivery of proficient customer service is vital to Net.Bank's continued success.

Net.Bank realizes that the best way to ensure customer loyalty is by providing excellent customer service. Net.bank dedicates about 10 percent of its annual advertising budget to programs and activities that help build relationships with its customers. The Company conducts online customer satisfaction surveys, invests in customer service training programs and continually upgrades and expands its e-mail capabilities as necessary.

- **Dedicated People.** Fully half of Net.Bank's employees are dedicated to customer service. Net.Bank has increased its customer support staff by over 70% in order to maintain high-quality customer service. These customer support representatives are available six days a week via telephone or bank e-mail. During 1999, Net.Bank remains committed to closely monitoring the workloads of its customer service and banks operations staff to ensure its people resources meet the day-to-day needs of its expanding customer base.
- **Effective Technology.** In anticipation of handling its increasing number of customer accounts, Net.Bank has upgraded its banking technology platform in order to provide the highest possible level of service. Net.Bank has also redesigned its web site to allow quicker and more direct access for its growing account base. The new web site showcases its products and services in an organized manner while providing straightforward, easy navigation.

Net.bank is committed to making certain that its technology serves its customers as competently and efficiently as possible. Last year, Net.Bank inaugurated a multi-vendor agreement joining forces with Checkfree Corporation, NCR Corporation and Edify Corporation to upgrade and improve its online banking technology.

Net.Bank is currently implementing several other customer care enhancements designed to increase the speed and automation of many of its financial services. Future systems and tools include check and document imaging for online viewing of all account documents; an instant messenger system in which the customer, while online, will be able to immediately send and receive e-mails with a customer service representative; online checking reordering, and new systems that allow for faster credit approvals.

STRENGTH OF MANAGEMENT

- **Outstanding Banking and Financial Services Expertise.** Net.Bank's management team consists of highly capable and qualified members who have vast and diverse experience in the areas of banking and financial services. Experience lies in the fields of banking, banking technology, banking consulting, marketing, sales, systems engineering, controller, insurance, financial management, retail banking, corporate banking, and bank regulation.

COMPETITION

Net.Bank's success has attracted competitors with both Internet-only and traditional brick-and-mortar banks entering the online banking arena.

Traditional Brick-and-Mortar Bank Competitors. Net.Bank's account growth rate at 114% far outpaces the growth rate of the traditional banking market. Since the Company has no branches, this growth is a result of the Company luring customers away from traditional banks. Net.Bank is able to steal customers from these traditional banks by providing higher interest rates, lower transactions fees, and added convenience. The phenomenal growth that Net.Bank has experienced is concrete evidence that internet-only banking could be the financial experience of the future. Because traditional brick-and-mortar banks cannot provide the same benefits that internet-only banks can (due to higher overhead costs), we believe that traditional brick-and-mortar banks will not be strong competition for those customers who desire higher interest rates, lower transactions fees, and added convenience.

Internet-only Competitors. Many entrepreneurs have realized the success that Net.Bank's business model has given the Company and consequently have tried to start their own internet-only banks by using a similar business model. Because all of these pure Internet banks are based on similar business models to Net.Bank, they are all able to offer similar advantages and benefits to its customers. Thus, we believe that customer service and brand name will be the most crucial factors determining which internet-only bank will maintain the dominant position in the Internet banking market. It is for these reasons that Net.Bank devotes so much of its time, energies, and resources to developing its brand name, giving customers the best possible online banking experience and improving its customer service.

Although Net.Bank still maintains a dominant position in the online banking market, there are possibilities that increasing competition from both traditional and internet-only banks could deteriorate the Company's leading position. However, much like the other blue-chip Internet firms such as America Online and Yahoo!, Net.Bank's dominance as an internet-only bank (i.e. first-mover advantage) could be a significant obstacle for its pure internet bank competitors to overcome. In addition, the fact that Net.Bank is based on a different business model should be an obstacle for its traditional bank competitors to overcome.

ANALYSIS OF RISK FACTORS

- **Competition.** Due to the huge success of Net.Bank, many companies have entered the online banking field. Therefore, while the ultimate beneficiary will be the consumer, the competition risks faced by both internet-only and traditional banks as they begin their push on to the Internet may be substantial. Net.Bank has built its brand name through word-of-mouth, superior customer service, and heavy advertising. As the

first and largest federally-insured bank that operates exclusively on the internet, it has been relatively easier for Net.Bank to build its brand name. While the Company has a lead, other competitors can duplicate Net.Bank's business model and strategy. Therefore, in addition to brand, as more users of the Internet bank online, loyalty may ultimately be based on good customer service as well as interest rates and convenience. We believe that it is absolutely vital that Net.Bank support its products and services with satisfactory customer service. Due to the increasing competition in the online banking market, the benefits to online banking will become less distinguishable from bank to bank, making customer satisfaction and brand keys to any online banking company's success.

- **Interest Rates.** Because Net.Bank is still a bank, it faces interest rate risk because the amount of interest-bearing assets and interest-bearing liabilities that mature within a given period of time are not similar. Net.Bank's main sources of interest-bearing liabilities are deposits and borrowed funds (debt). The difference, or the interest rate sensitivity "gap," provides an indication of the extent to which an institution's interest rate spread will be affected by changes in interest rates. A gap is considered positive when the amount of interest-rate sensitive assets exceeds the amount of interest-rate sensitive liabilities and is considered negative when the amount of interest-rate sensitive liabilities exceeds the amount of interest-rate sensitive assets. Net.Bank's interest-rate sensitivity gap was \$190,745,570. In a rising interest rate environment, an institution with a positive gap would be in a better position than an institution with a negative gap to invest in higher yielding assets or have its assets yields adjusted upward, which would result in the yield on its assets increasing at a faster pace than the cost of its interest-bearing liabilities. During a period of falling interest rates, however, an institution with a positive gap would tend to have its assets maturing at a faster rate than one with a negative gap, which would tend to reduce or restrain the growth of its net interest income.
- **Security.** There is always the risk of computer hackers breaking in and distorting Net.Bank's data base, regardless of how sophisticated and secure online banking is becoming. In general, currently this is not an issue and is becoming less of an issue.

RECENT PARTNERSHIPS

- **Armed Forces Financial Network (AFFN).** Net.Bank has recently joined the Armed Forces Financial Network (AFFN) to provide financial services to US military personnel around the world. This alliance will make Net.Bank a participating financial institution with the AFFN, allowing members who open Net.Bank accounts use of the 30,000 AFFN ATM machines nationwide with no added fees.

As Net.Bank's CEO D.R. Grimes stated, "This alliance with the AFFN gives Net.Bank access to a vital market of ideal customers." One of the inherent benefits of Internet banking is 24 hour-a-day account access from anywhere in the world. "This will be particularly valuable to military personnel who frequently transfer from one base to another or who are deployed on active duty for extended periods of time and would enjoy the stability of keeping the same bank account and having access to it no matter where in the world they may be stationed."

- **Virtuallender.com.** Net.Bank has expanded its mortgage lending capabilities through a mortgage loan origination partnership with Virtuallender.com.
- **PNC Bank Corp.** Recently, Net.Bank entered into a consumer loan processing and servicing agreement with PNC Bank Corp. This agreement allows Net.Bank to offer consumer loan products on-line. PNC will provide origination and loan servicing for these consumer loans as well as substantially all consumer loans for which Net.Bank retains servicing rights on a scalable basis at a favorable cost.
- **First Mortgage Network.** Net.Bank formed a partnership with First Mortgage Network to enable customers to obtain quotes on interest rates and apply for home loans online through the Company's website. Applications go directly to First Mortgage Network, which reviews loan applications, contacts customers – usually within 24 hours of receiving the application – and closes the loans.

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- **Republic Leasing Company.** Net.Bank linked up with Republic Leasing Company during 1998 to offer equipment lease financing on an array of goods, with same-day service, no down payment and approval with little or no financial information required.
 - **UVEST Investment Services.** The NetWorth Investment Account was made possible through Net.Bank's association with UVEST Investment Services, one of the nations' leading discount brokerages.
 - **Checkfree Corporation, NCR Corporation, and Edify Corporation.** Net.Bank inaugurated a multi-vendor agreement in 1998 joining forces with Checkfree Corporation, NCR Corporation and Edify Corporation to upgrade and improve its online banking technology. Through the agreement, Net.Bank relies on NCR's World Mark Server as the host for its feature-rich Electronic Banking System provided through Edify. Its enhanced state-of-the-art web banking solution includes a fully integrated, ready-to-deploy suite of Internet banking applications fitted with incomparable end-to-end security. CheckFree Corporation provides Net.Bank's electronic bill paying system and the BISYS Group, Inc. continues to process the bank's transactions through its TotalPlus line.

EXPLANATION OF FINANCIALS

Revenues. Net.Bank's two main sources of revenues are interest income and non-interest income. Interest income is related to the company's loan and investment portfolio and includes short-term investments, investment securities and loans. Net.Bank generates interest income by originating and purchasing loans. The company focuses on high credit quality to minimize loan losses and emphasize a conservative investment strategy by investing in securities such as US treasury obligations, collateralized mortgage obligations and mortgage-backed securities issued by agencies such as Fannie Mae and Freddie Mac. Non-interest income consists primarily of loan and deposit service charges and fees. The Company also creates non-interest income by cross-marketing loan originations, credit cards, brokerage services and other income-generating products via its web site, bank e-mail and online advertising. A significant increase in service charges in 1998 was driven by the significant increase in both the loan and deposit portfolios. We estimate that revenues (the sum of interest and non-interest income) will continue to increase at a rapid rate.

Interest Expenses. Net.Bank pays interest to depositors of funds and to institutions from which it borrows funds. We estimate that this expense will continue to grow at a rapid rate as its business expands.

Operating Expenses. As mentioned earlier, Net.Bank's marketing goal for 1999 is to cost-effectively amass as many new customers, and thus accounts, as possible. Operating expenses represent a significant portion of Net.Bank's cash outflows as the Company spends heavily on marketing and product development. We believe that with the expansion of Net.Bank's product lines through creative partnerships, the Company will continue to spend heavily to increase its reach in E-Commerce. Therefore, we estimate that these expenses will increase at a rapid rate.

Margins. As with most startups, during Net.Bank's first years of operations margins have been unstable but now we expect them to stabilize near the current levels.

Taxes. Net.Bank has deferred income taxes for operating loss carryforwards and for temporary differences between financial statements and tax bases of assets and liabilities using the enacted tax rates for the year in which the temporary differences are expected to reverse. As of December 31, 1998, the Company had state and federal net operating loss carryforwards of \$6,182,993 that will expire in 2012 and 2011, if not utilized. The Company did not incur any income taxes during 1996 and 1997. For the year ended December 31, 1998, the Company's income tax benefit results from the reversal of the valuation allowance as of December 31, 1997, relating to net operating loss carryforwards offset taxable income for the period. As the company achieved profitability in 1998, we now believe that it is more likely than not that such assets should be realized.

Profits. Even with the increased rate of expenses, we expect the Company to remain profitable in the foreseeable future.

VALUATION

Internet-Only Banking Sector. As shown below, the Internet financial services stocks have been more volatile than the Internet sector (IIX) but, in general, have been moving with strong correlation to the sector. The recent downward movement in the Internet sector, since April, can be traced to investors' fears of the sector being overvalued and the effect of the Fed possibly raising interest rates on the stock market.



Price-to-Sales. The emergence of Net.Bank as an Internet-only bank creates difficulty in straight comparisons with other companies in that Net.Bank is one of the few public banks in existence that operates solely over the Internet. Most publicly traded banks are traditional brick-and-mortar banks that do not operate solely over Internet.

| | \$ Price | Market Cap in \$ Millions | Accounts | P/S |
|------------------------------|----------|---------------------------|-----------|-------|
| Net.Bank | 21.75 | 639.06 | 40,000 | 16.59 |
| TeleBanc Fin. Corp. | 26.00 | 864.27 | 70,000 | 4.52 |
| Charles Schwab | 42.69 | 34,910.29 | 6,300,000 | 10.38 |
| E*trade Group | 38.25 | 8,745 | 909,000 | 25.2 |
| Industry: S&Ls/Savings Banks | | | | 2.79 |
| Sector: Financial | | | | 3.84 |
| S&P 500 | | | | 5.08 |

In the table above, we compare the Company to Telebank, which is another profitable leading Internet bank. Telebank provides high-value financial products and services to customers in all 50 states and overseas through

low-cost electronic delivery platforms, including the Internet, telephone, ATM and facsimile. Telebank has more than 70,000 accounts, more than \$1.3 billion in deposits and more than \$2.6 billion in assets. Telebank and E-TRADE have recently signed a merger agreement that will position Telebank ahead of Net.Bank. Since most of the emerging Internet companies have yet to turn a profit, the price-to-sales (P/S) ratio is an essential ratio for determining relative value within the industry. The above table shows that Net.Bank commands a higher price to sales ratio than its closest competitors. We believe that this could be a sign of overvaluation even though it might be possible to marginally justify it by the fact that Net.Bank is a leading online bank and it is profitable. Nevertheless, since we expect Net.Bank to face strong competition in the future, we believe that this stock should be priced more in line with other Internet companies in e-commerce sectors with strong competition. In particular, Ubid and Onsale trade at P/S ratios of 4 and 2, respectively, because they are companies in a low margin, strong competition sectors.

Customer Accounts. Net.Bank began the year with 17,408 accounts and has recently reached the 40,000 accounts mark. As Net.Bank continues to expand its product line, increase its advertising efforts, and improve customer service, we expect customer growth to remain strong as people make the transition to the more cost-effective, beneficial, and convenient Internet banking. In addition, as shown in our income statement, increases in customer accounts will directly translate into increases in revenue.

Investment Opinion

As mentioned above, we believe that Net.Bank is currently richly priced at a price to sales ratio of 16.59. Because of the success that Net.Bank has experienced with its unique business model, many competitors – both traditional and non-traditional banks – have entered the online banking market. Therefore, we expect Net.Bank to face strong competition in the future.

Online banking should be the financial experience of the future but we are not fully confident that Net.Bank will be able to maintain its dominant position as an internet-only bank in the online banking market.

The Company must solidly accomplish several things to maintain its position in the online banking market. First, it must build its brand name in order to attract more and more customers. Secondly, it must maintain its customer service focus. With many competitors entering the online banking, customers will survey a variety of online banks until they find one which they are satisfied with. We believe that providing an excellent banking experience and customer service are the main vehicles through which Net.Bank can maintain customer loyalty.

The good news for Net.Bank is that it has already realized the importance of customer satisfaction and a strong brand name. Consequently, it has already increased its expenditures on improving customer service and building a strong brand name.

Nevertheless, we do believe in the potential of the Internet and that the financial and banking experience of the future will be online and through the Internet. We also believe that banking customers of the future will desire to take care of all of their banking and financial needs through one channel such as Net.Bank. The problem is that the online banking market is a new lucrative market, and every competitor wants to build its market share. With so many competitors fighting for more and more market share, Net.Bank's potential seems less encouraging.

In conclusion, we place a "hold" rating on Net.Bank. Depending on how committed and successful Net.Bank is at improving customer service, building its brand name, and expanding its product line, Net.Bank could be the financial experience of the future or one of the many online banks.

| | <u>1996</u> | <u>1997</u> | <u>1Q1998</u> | <u>1998</u> | <u>1Q1999</u> | <u>2Q1999</u> | <u>1999E</u> | <u>2000E</u> |
|---|-------------|-------------|---------------|-------------|---------------|---------------|--------------|--------------|
| INTEREST INCOME: | | | | | | | | |
| Short-term investments | 7,709 | 944,743 | 395,003 | 633,893 | 331,118 | 1,018,078 | 2,092,480 | 7,459,643 |
| Investment securities | 0 | 183,184 | 453,376 | 2,905,404 | 1,214,914 | 1,698,100 | 1,436,992 | 2,583,857 |
| Loans | 0 | 1,095,238 | 1,358,235 | 14,548,747 | 6,011,818 | 7,705,102 | 41,849,602 | 59,192,870 |
| Total interest income | 7,709 | 2,223,165 | 2,206,614 | 18,088,044 | 7,557,850 | 10,421,280 | 45,312,003 | 70,491,088 |
| INTEREST EXPENSE: | | | | | | | | |
| Deposits | 0 | 1,259,743 | 1,303,628 | 10,249,533 | 4,023,760 | 4,845,865 | - | - |
| Short-term borrowings | 0 | 0 | 0 | 0 | 0 | 884,580 | - | - |
| Other borrowed funds | 0 | 0 | 0 | 1,174,899 | 535,947 | - | - | - |
| Total interest expense | 0 | 1,259,743 | 1,303,628 | 11,424,432 | 4,559,707 | 5,730,445 | 25,486,187 | 43,806,930 |
| NET INTEREST INCOME(LOSS) | 7,709 | 963,422 | 902,986 | 6,663,612 | 2,998,143 | 4,690,835 | 20,825,816 | 27,684,158 |
| PROVISION FOR LOAN LOSSES | 0 | 471,706 | 3,661 | 20,132 | 49,806 | 55,000 | 200,000 | 300,000 |
| NET INTEREST INCOME(LOSS) (after provision) | 7,709 | 491,716 | 899,325 | 6,643,480 | 2,948,337 | 4,635,835 | 20,625,816 | 27,384,158 |
| NON-INTEREST INCOME(service charges & fees) | 60,000 | 62,607 | 122,495 | 683,092 | 245,715 | 231,534 | 1,414,701 | 2,920,462 |
| NON-INTEREST EXPENSES: | | | | | | | | |
| Salaries and Benefits | 836,427 | 2,396,347 | 434,353 | 1,429,675 | 506,921 | 748,425 | 3,289,402 | 5,160,809 |
| Marketing | 288,584 | 288,584 | 240,018 | 694,631 | 593,897 | 840,614 | 6,515,670 | 7,300,578 |
| Depreciation and amortization | 18,934 | 217,440 | 40,037 | 272,354 | 387,158 | 210,704 | 2,357,835 | 1,460,231 |
| Outside services | 4,951 | 4,951 | 191,661 | 1,377,635 | 228,980 | 949,688 | - | - |
| Other | 94,947 | 355,066 | 86,872 | 685,976 | 141,268 | 554,301 | - | - |
| Data Processing | 148,159 | 539,013 | 91,226 | 316,590 | 84,424 | 233,499 | - | - |
| Occupancy | 19,330 | 107,304 | 26,093 | 147,169 | 39,485 | 35,135 | - | - |
| Office expenses | 56,765 | 177,054 | 47,566 | 175,019 | 22,092 | 101,725 | - | - |
| Travel and entertainment | 38,794 | 64,759 | 15,441 | 88,341 | 143,311 | 29,620 | - | - |
| Amortization of service contract with affiliate | 2,400,000 | 1,440,000 | 0 | 0 | 0 | 210,704 | - | - |
| Total non-interest expenses | 3,906,891 | 6,131,762 | 1,173,267 | 5,187,390 | 2,147,536 | 3,703,711 | 16,447,011 | 21,010,888 |
| INCOME(LOSS) BEFORE INCOME TAXES | - | -5,577,439 | - | 2,139,182 | 1,046,516 | 1,163,658 | 5,609,693 | 9,108,663 |
| INCOME TAX BENEFIT (EXPENSE) | 0 | 0 | - | -2,324,830 | -355,000 | -396,000 | -2,001,564 | -2,998,566 |
| NET INCOME | - | -5,577,439 | -151,447 | 4,464,012 | 691,516 | 767,658 | 3,509,693 | 7,308,663 |
| Other comprehensive income, net of tax | 0 | -83,063 | 110,947 | 81,539 | 0 | 0 | 0 | 0 |
| COMPREHENSIVE INCOME (LOSS) | - | -5,660,502 | -40,500 | 4,545,551 | 691,516 | 767,658 | 3,509,693 | 7,308,663 |
| NET INCOME (LOSS) PER SHARE: | | | | | | | | |
| Basic | -4.33 | -1.66 | -0.02 | 0.60 | 0.03 | 0.03 | 0.14 | 0.20 |
| Diluted | -4.33 | -1.66 | - | 0.58 | 0.03 | 0.03 | 0.14 | 0.20 |
| WEIGHTED AVERAGE SHARES OUTSTANDING: | | | | | | | | |
| Basic | 886,000 | 3,354,000 | 6,143,562 | 6,149,000 | 22,536,000 | 26,917,093 | 25,000,000 | 36,000,000 |
| Diluted | 886,000 | 3,354,000 | - | 6,384,000 | 23,424,000 | 28,045,107 | 26,000,000 | 37,000,000 |
| Revenue (Int.+Non-Int. Income) | 67,709 | 2,285,772 | 2,329,109 | 18,771,136 | 7,803,565 | 10,652,814 | 47,156,704 | 73,011,550 |
| Margin Analysis (% of revenue) | | | | | | | | |
| Interest Income Margin | 11.38548 | 97.261013 | 94.74069 | 96.360945 | 96.851247 | 97.82654611 | 97 | 96 |
| Non-interest Income Margin | 88.61451 | 2.7389871 | 5.259307 | 3.6390552 | 3.1487532 | 2.173453887 | 3 | 4 |
| Interest expense Margin | 0 | 55.11 | 55.97 | 60.86 | 58.43 | 53.79278189 | 55 | 60 |
| Non-interest expense Margin | 5770.12 | 268.26 | 50.37 | 27.63 | 27.52 | 35.75 | 35 | 29 |
| Salaries and Benefits Margin | 1235.326 | 104.83753 | 18.64889 | 7.6163478 | 6.4960182 | 7.025608445 | 7 | 7 |
| Marketing Margin | 426.2121 | 12.625231 | 10.30514 | 3.7005272 | 7.6105857 | 7.891004199 | 14 | 10 |
| Depreciation and amortization Margin | 27.96378 | 9.5127598 | 1.718984 | 1.4509191 | 4.9612965 | 1.977918698 | 5 | 2 |
| Net Income Margin | - | -244.0068 | -6.50236 | 23.781256 | 8.8615396 | 7.20615229 | - | - |
| Revenue Growth Rate(%) | N/A | 3157 | - | 753 | - | - | 161 | 55 |