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Net.B@nk (NASDAQ: NTBK)

Increasing competition and expanded marketing program

Rating: Maintain Hold

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KEY CONSIDERATIONS

- Net.Bank continues to be one of the nation's leading Internet banks, having reached \$1.3 Billion in assets at the end of 4Q99.
- Net.Bank has more than tripled its deposit account base since January 1, 1999. Deposit accounts have increased from 17,400 to 66,000. From September to December 1999, the bank added nearly 20,000 new deposit accounts.
- The account growth was mostly attributed to an expanded marketing program in the fourth quarter 1999. The growth was primarily in high interest checking (up to 4.00 A.P.Y.) and money market accounts.
- The online banking segment, however, is becoming saturated with increased competition. Traditional banks and financial institutions are now offering online banking and trading. There is a growing trend to become "financial supermarkets" by offering one-stop shopping. We see Net.Bank's competition increasing to include traditional banks such as Citigroup (NYSE: C), online brokers such as Ameritrade (NASDAQ: AMTD), in addition to other "branchless" banks such as TeleBanc (NASDAQ: TBFC).
- This intense competition in the online banking market causes us to reiterate our HOLD rating. We recommend that investors use caution as a result of the stock's 78% decline from its 52 week high.

Recent Price	\$18.00
52WK Low	\$11.58
52WK High	\$83.00
P/E	136.36
P/Book	2.22
P/Sales	11.22
Market Capitalization	\$529.09 million
Shares Outstanding	29.39 million
Float	24.10 million
Daily Volume (3-month Average)	0.96 million
Year	EPS
1996	(4.30)
1997	(1.66)
1998	0.58
1999	0.11
2000E	0.28

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 a leading 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 \$1.3 billion in total assets and over 66,000 customer accounts. Net.Bank's Web site can be reached at www.netbank.com

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COMPANY SUMMARY

Net.Bank continues to grow its assets and customer base. With \$1.3 Billion in assets, and customers in all 50 states and 20 different foreign countries, Net.Bank is one of the largest FDIC-insured banks operating solely on the Internet. The Company thrives on its ability to offer higher interest rates because of its low overhead costs of its branchless bank. Some key areas include:

Online Lending. The Company offers "armchair lending" in which applicants, for example, can apply for home equity loans over the Internet. A response is generated in as little as 30 seconds and the loan is delivered in 7 days. This is known as the Company's 30/7 lending process.

Checking Accounts. As stated before, the Company offers various attractive checking account options. *NetValue Checking* earns the customer an interest rate of 3.00 % and 3.05 % APY (annual percentage yield) for no monthly service fee. The *SuperValue Checking* option offers a 3.93 % rate with a 4.00 % APY for a \$4.50 service charge per statement.

Online Bill Pay. Net.Bank offers online bill pay services, free of charge.

Online Trading. The Company's online trading, through its association with UVEST Investment Services, compares to that of other online brokers. Their commissions are competitive at \$25 up to 2,000 shares. (Competitive if you are not a heavy trader.) Idle investment cash is automatically swept into the checking account, earning interest. 50 free real time quotes for every trade, in addition to 50 free real time quotes are available to trading customers.

Credit Cards. In mid-December the Company announced that it is offer new low-rate, e.card™ enabled VISA® credit card through a marketing agreement with First USA. Customers can apply online for the Net.Bank Platinum VISA credit card that refunds the cardholder 5% on purchases made at popular e-vendors such as Amazon, CDNOW, and eToys.

Equipment Lease Financing. Net.Bank continues to serve its small-business customer base with its online equipment lease financing with Republic Leasing Service.

INDUSTRY OUTLOOK AND COMPETITION

As mentioned briefly above, the online banking industry has come under some intense competition during the past year. We feel that the competition includes traditional brick and mortar banks as well as other Internet-only competitors. Net.Bank has one distinct advantage over the traditional banks, in that it can offer more attractive rates on its checking accounts and CD's. Net.Bank experiences much lower overhead costs and can pass these savings along to its customers.

As of January 23, Net.Bank was offering a 6-month CD for 6.40%, compared to the national average of 4.68%; and a 1-year CD at 6.70%, compared to the national average of 5.05%. These rates of 6.40% and 6.70% were the highest 6-month rate and the third highest 1-year rate respectively in the nation. Only Providian National Bank in New Hampshire and Providian Bank in Utah offered higher rate for the 1-year CD.

Despite online banks offering attractive rates and posting good revenue and asset numbers, some in the industry appear to be ripe for consolidation. Recently, Telebanc (TBFC) announced fourth quarter revenues up 120% and annual revenues up 133% from the prior year. On January 12, 2000 however, an industry defining merger was closed between Telebanc and E*TRADE® Group Inc. to create a leading pure-play e-commerce financial network to unite banking, brokerage services and related financial products and services. Through its recent merger with E*TRADE® Group, Inc., the combined Company is now set to compete head-on with the leading financial services companies worldwide.

We feel that this might be an indication of what is to come in the industry. Many of the brokerages will be looking to partner up with a bank to create synergies. The overall goal of the industry appears to be the production of one-stop shopping centers in order to satisfy customer needs.

GROWTH STRATEGY

Net.Bank's growth strategy remains in building its customer base. They have been doing this through marketing and advertising campaigns as well as customer referrals. Its advertising focuses on informing the public on the advantages and ease of on-line banking. On December 2, 1999, the company launched a new customer referral promotion that rewards customers who refer others to open a Net.Bank checking, money market, or CD account. In The Net.Bank Tell-A-Friend promotion, Internet-savvy customers were targeted online through the Web site and rewarded with entries into a random sweepstakes including a Grand Prize of a \$1,000 CD. The company clearly recognizes the role of customer referrals in its success. It must continue expanding itself with similar programs.

RECENT PARTNERSHIPS AND STRATEGIC ALLIANCES

During the fourth quarter of 1999 and the beginning of first quarter 2000, Net.Bank has been busy partnering with widely known, popular establishments. Under a one year deal, which began on January 1 of this year, Net.Bank started to advertise and show off its content on MSN Money Central, which attracts a reported 5 million viewers each month. This was the first portal pact for the Company.

In mid-December of last year, Net.Bank announced that it was expanding its web-based loan center with a new low-rate e.card™-enabled VISA® credit card through a marketing agreement the bank signed with First USA. As mentioned above, customers and consumers can now apply online for a Net.Bank Platinum VISA credit card that refunds the cardholder 5% on purchases made at popular e-vendors such as Amazon, CDNOW, and eToys

Most recently, the Company announced an agreement with Yahoo! Inc., the leading global Internet company which serves more than 105 million users. This arrangement offers Net.Bank customers a new channel from which they can view their account information. Registered Yahoo!® users can view their Net.Bank account information on Yahoo! Finance. As Net.Bank's CEO D.R. Grimes stated, "Our goal is to offer our customers a broad array of financial services conveniently through the Internet. This agreement with Yahoo! Allows us to expand the anytime, anywhere banking convenience our customers already enjoy by giving them the ability to view their account information on Yahoo!. Additionally, this relationship gives Net.Bank the opportunity to bring its full array of banking products and services to a tremendously broad service."

KEY RISK FACTORS

The biggest threat Net.Bank faces is increased competition. The Company must make it a priority to both retain and increase its customer base through superior service. Many people are aware of what online banking has to offer, and the Company should focus its marketing on building these customer relationships. One year ago, companies mostly had to inform, educate and convince people of the benefits of their services. Net.Bank must now keep their customers and pursue others who haven't experienced online banking.

Although the public is more accepting of online banking than it was a year ago, we feel people are not totally convinced of its merits. A recent Wall Street Journal article highlighted the concern that customers seem to have with online only banks and their preference of the security of established banks. The article pointed out that people generally enjoy the comfort of being able to visit an office and see a human face. As many brick and mortar banks go online, customers have the luxury of both options. Customers of these traditional banks have the advantage of Internet banking along with the use of branches for check cashing

and other transactions that are more difficult in cyberspace. If this trend continues, online banks could be in for some choppy times.

INVESTMENT OPINION

With many larger banks in the mix, many smaller online banks are in danger of being swallowed up by a traditional bank or simply might be left behind. Many of these online banks and trading companies appear very similar at face value. For example, in comparing P/Sales ratios of a few major players, the similarities are telling. Recently, Net.Bank (11.22 down to a more recent 7.74), Charles Schwab (7.63), E*TRADE® Group Inc (6.25) and Ameritrade (7.38) are all within percentage points of each other. In order to differentiate between them, the marketing and branding of the individual company names will be important in the game of survival. We see some of these companies reducing fees in order to gain a competitive advantage. This increased competition will result in downward pressure on many of the stock prices.

Net.Bank could experience a downturn in the short term. In fact, the company just announced lower than expected earnings for 1999 of \$0.11 per share, but we expect a rebound to \$0.28 per share in 2000. With the stock price staying a few points below \$20, we are at this time, maintaining a Hold rating on Net.Bank. Net.Bank shares are not behaving like those of an Internet stock, with minimal volatility lately. Depending on the company's desire to remain independent or not, Net.Bank could face consolidation as well. With its growing customer base, the company could make an attractive acquisition target by a larger bank or brokerage firm.

	1996	1997	1Q1998	2Q1998	3Q1998	4Q1998	1998	1Q1999	2Q1999	3Q1999	1999E	2000E
INTEREST INCOME												
Short-term investments	7,709	944,743	395,003	107,656	57,266	73,968	633,893	331,118	1,018,078	452,754	2,301,950	7,459,643
Investment securities	0	183,184	453,376	702,098	726,066	1,023,864	2,905,404	1,214,914	1,698,100	4,372,656	9,785,670	12,583,857
Loans	0	1,095,238	1,368,235	3,442,783	4,500,723	5,247,006	14,548,747	6,011,818	7,705,102	11,497,496	42,684,416	59,192,870
Total interest income	7,709	2,223,165	2,206,614	4,252,537	5,284,055	6,344,838	18,088,044	7,557,850	10,421,280	16,322,906	54,772,036	79,236,370
INTEREST EXPENSE												
Deposits	0	1,259,743	1,303,628	2,279,515	3,049,422	3,616,968	10,249,533	4,023,760	4,845,865	6,114,551	22,984,176	34,476,264
Short-term borrowings	0	0	0	434,333	170,350	-604,683	0	0	884,580	2,750,906	7,881,486	11,822,229
Other borrowed funds	0	0	0	0	0	1,174,899	1,174,899	535,947	0	0	535,947	0
Total interest expense	0	1,259,743	1,303,628	2,713,848	3,219,772	4,187,184	11,424,432	4,559,707	5,730,445	8,865,457	31,401,609	46,298,493
NET INTEREST INCOME (LOSS)	7,709	963,422	902,986	1,538,689	2,064,283	2,157,654	6,663,612	2,998,143	4,690,835	7,457,449	23,370,427	32,937,877
PROMISION FOR LOAN LOSSES	0	471,706	3,661	6,011	5,887	4,573	20,132	49,806	55,000	2,000	107,000	200,000
NET INTEREST INCOME (LOSS) (after provision)	7,709	491,716	899,325	1,532,678	2,058,396	2,153,081	6,643,480	2,948,337	4,635,835	7,455,449	23,263,427	32,737,877
NONINTEREST INCOME (service charges & fees)	60,000	62,607	122,495	103,727	189,626	267,244	683,092	245,715	231,534	311,450	1,660,000	2,920,000
NONINTEREST EXPENSES												
Salaries and Benefits	836,427	2,396,347	434,353	310,823	288,611	395,888	1,429,675	506,921	748,425	876,116	3,331,462	4,160,809
Marketing	288,584	524,494	240,018	180,238	143,773	130,602	694,631	593,897	840,614	2,571,277	6,505,788	7,300,578
Depreciation and amortization	18,934	217,440	40,037	58,279	79,398	94,640	272,354	387,158	210,704	337,617	2,235,479	1,460,231
Customer services	4,951	310,285	191,661	359,908	336,029	490,037	1,377,635	228,980	949,688	1,320,849	4,584,517	5,272,195
Other	94,947	355,066	86,872	302,150	146,605	150,349	685,976	141,268	554,301	302,243	1,497,812	1,647,593
Data processing	148,159	539,013	91,226	78,888	41,762	104,714	316,530	84,424	233,499	369,449	1,487,372	1,636,109
Occupancy	19,330	107,304	26,093	39,996	34,682	46,398	147,169	39,485	35,135	98,427	258,047	283,852
Office expenses	56,765	177,054	47,566	42,792	12,208	72,453	175,019	22,082	101,725	121,798	345,615	380,177
Travel and entertainment	38,794	64,759	15,441	23,584	0	49,316	88,341	143,311	29,620	66,373	314,304	345,734
Amortization of service contract with affiliate	2,400,000	1,440,000	0	0	206,652	-206,652	0	0	0	0	0	0
Total non-interest expenses	3,906,891	6,131,762	1,173,267	1,396,658	1,289,720	1,327,745	5,187,390	2,147,536	3,703,711	6,064,149	20,560,396	22,487,278
INCOME (LOSS) BEFORE INCOME TAXES	-3,839,182	-5,577,439	-151,447	239,747	958,302	1,092,580	2,139,182	1,046,516	1,163,658	1,702,750	4,363,031	13,170,599
INCOME TAX BENEFIT (EXPENSE)	0	0	0	3,029,063	-345,000	-359,233	2,324,830	-355,000	-396,000	-579,000	-1,316,000	-2,970,000
NET INCOME	-3,839,182	-5,577,439	-151,447	3,268,810	613,302	733,347	4,464,012	691,516	767,658	1,123,750	3,047,031	10,200,599
Other comprehensive income, net of tax	0	-83,063	110,947	-57,557	57,260	-29,101	81,539	0	0	0	0	0
COMPREHENSIVE INCOME (LOSS)	-3,839,182	-5,660,502	-40,500	3,211,243	670,562	704,246	4,545,551	691,516	767,658	1,123,750	3,047,031	10,200,599
NET INCOME (LOSS) PER SHARE:												
Basic	-4.33	-1.66	-0.02	0.53	0.10	0.12	0.73	0.03	0.03	0.04	0.11	0.28
Diluted	-4.33	-1.66	—	0.51	0.10	0.12	0.70	0.03	0.03	0.04	0.11	0.28
WEIGHTED AVERAGE SHARES OUTSTANDING:												
Basic	886,000	3,354,000	6,143,562	6,145,936	6,147,460	6,149,388	6,149,000	22,536,000	26,917,093	29,346,213	27,000,000	36,000,000
Diluted	886,000	3,354,000	—	6,446,303	6,443,196	6,200,000	6,384,000	23,424,000	28,045,107	30,352,801	28,000,000	37,000,000
Revenue (Int.+ Non-Int. Income)	67,709	2,285,772	2,329,109	4,356,264	5,473,681	6,612,082	18,771,136	7,803,565	10,652,814	16,634,366	56,432,036	82,156,370
Margin Analysis (% of revenue)												
Interest Income Margin	11.39	97.26	94.74	97.62	96.54	95.96	96.36	96.85	97.83	98.13	97.06	96.45
Non-interest Income Margin	88.61	2.74	5.26	2.38	3.46	4.04	3.64	3.15	2.17	1.87	2.94	3.55
Interest expense Margin	0.00	55.11	55.97	62.30	58.82	63.33	60.86	58.43	53.79	53.30	55.65	56.35
Non-interest expense Margin	5770.12	268.26	50.37	32.06	23.56	20.08	27.63	27.52	34.77	36.46	36.43	27.37
Salaries and Benefits Margin	1235.33	104.84	18.65	7.14	5.27	5.99	7.62	6.50	7.03	5.27	5.90	5.06
Marketing Margin	426.21	22.95	10.31	4.14	2.63	1.98	3.70	7.61	7.89	15.46	11.53	8.89
Depreciation and amortization Margin	27.96	9.51	1.72	1.34	1.45	1.43	1.45	4.96	1.98	2.03	3.96	1.78
Net Income Margin	-5670.12	-244.01	-6.50	75.04	11.20	11.09	23.78	8.86	7.21	6.76	5.40	12.42
Revenue Growth Rate (%)	NA	3276					721				201	46