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New Rec: NextCard (NXCD-$25.81) Feb. 21, 2000

Position: Sell Target: $12.50 Timing: 2 (1=aggressive; 5=cautious)

000$	Q499a	Q100e	Q200e	Q300e	Q400e	1999a	2000e	2001e
Revs	13894	31619	26288	34983	44943	26560	137833	295614
EPS$	-0.53	-0.33	-0.45	-0.46	-0.36	-1.67	-1.61	-1.50
Y/Y gro	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
PE						n/a	n/a	n/a
PSR						50	10	4
Consens	n/a	-0.40	-0.46	-0.40	-0.34	n/a	-1.61	-0.97

Shs Out: 51.0M Mkt. Cap: $1,317M FYE: December

Summary: NextCard was an early on-line consumer credit card issuer. The company launched its Web site www.nextcard.com in December 1997. NextCard derives revenue primarily from finance charges on managed loans. By some metrics, recent results have been impressive. Although it lost $0.52 per share in Q4, revenues increased 73% sequentially and credit card accounts increased 64% sequentially. NextCard is still a small player in the consumer credit card market. Importantly, its loan loss experience is very limited since it began only two years ago. At December 31, 1999 NextCard had accumulated $95 million in losses.

NXCD sells at an enterprise value of 3.5 times its managed loan portfolio, or at $6,500 per account. This is more than twice as expensive as CompuCredit, measured on the same basis, and ten times Providian and twenty times Metris. It is difficult to value NextCard on a relative PE basis since NextCard has consistently lost money and predicts it will begin to make money only in 2002. CompuCredit, the most expensive credit card issuer after NextCard, makes money. This makes NextCard's valuation appear to be even more out of line.

Moreover, we think that NextCard will find it very difficult to ever break even on its operations. This is due to a combination of key problems.

NextCard is a company between a rock and a multiple hard places. Its main problems include too low yields, too high charge-offs, and too high acquisition costs. We think it will be very difficult for NextCard to overcome this triple threat to its business plan.

NextCard's loan yields, at 10.78%, are lower than those of its competitors. MBNA, for example, a prime card issuer, averages 13.4%. Others are much higher. The problem is that NextCard has a high percentage of teaser rates in addition to its 9.9% fixed rate cards and its approximately 18% cards. While these rates are expected to increase as teasers become less of the mix, it does not appear that NextCard can achieve rates high enough to overcome its other problems.

Charge-offs appear to be very high. We calculate charge-offs on a twelve month lagging basis in order to eliminate the distorting effect of NextCard's high loan portfolio growth rate. We compare NextCard's lagging charge-offs to its peers. On that basis, NextCard's charge-off rate appears to be about 9.5% of the loan portfolio. This is far higher than prime lender MBNA and Capital One, also measured on a lagging basis, and more in line with sub-prime lenders Providian and Metris. The trouble is, Providian and Metris have average yields of about 19% to compensate for the high charge-offs, but Next Card does not.

Another important problem facing NextCard is high acquisition costs and high turnover. Acquisition costs were $180 per account in Q3 and $95 in Q4, and, based on the experience of other credit card issuers, we estimate that churn is about 30%, slightly higher than the company's estimate of 25%. Remember, NextCard has little basis for its churn projections, since it is only two years old. Even if NextCard could improve its net interest margin by increasing yields or by lowering charge-offs, it still might not be able to overcome its problem of high acquisition costs. Although acquisition cost per account fell to $95 in Q4, this number is expected to rise substantially near term. The company predicts acquisition costs will moderate in the $90 range, longer term. We think that NextCard will have difficulty reaching a $90 acquisition cost consistently, but even at $90 NextCard's acquisition costs are too high for it to make money on an account. We calculate that given its current acquisition costs, yields would have to be far higher in order for NextCard to just break even on an account.

The problem is adverse, but expensive customer selection. Although NextCard claims to be a prime credit issuer, it does not appear that NextCard issues to only prime credits. Indeed, the charge-off experience so far is more characteristic of a sub-prime card issuer. It is possible that the prime credits take the 2.9% teaser rate offered by the company, but may not use the card after the teaser rate has expired. The new accounts who keep using the account are not prime credits, and are causing high loan losses. The nature of customer acquisition on the internet is different from the traditional direct marketing methods. NextCard has to cast a wide net, but this is expensive. Application volume is high, but customers are surfers. Clients looking for credit tend to be weaker than those who are solicited. Applications are simple and can be made quickly. Credit decisions are also made quickly. Approvals are given in 30 seconds. The process lends itself to a lack of loyalty and rapid switching between cards. Consumers are looking for the best deals, and they are bombarded with offers. There is even software available that helps consumers take advantage of the companies offering teaser rates by switching from one to the next before the rate expires.

In this brave new world of on-line credit, it does not appear that NextCard has a model with which it can succeed. Although we have set our target price at $12.50 per share, we think that the share value is probably much lower. NXCD should probably be valued by the acquisition cost per replacement account method. If we were to take year end 2000 estimated accounts of 550,000 at $100 per account, for example, we get a value of about $1.00 per NXCD share.

Discussion:

1. Net margins are inadequate:

In Q4 NXCD had a net interest margin of 5.5% which was up 100 bp from 4.5% in Q3. To understand NextCard's earnings quality we calculated net interest spreads and net interest margins less net chargeoffs on a 12 month lagging basis, and then compared the result to others in the industry using the same 12 month lagging formula. (For an understanding of net charge-offs on a lagging basis, see section 4.) Note: the information below has been taken from the September 30, 1999 quarterly results of each company.

Chart 1: The calculations of net interest spreads and net interest margins.

For quarter ended September 30, 1999	NextCard	Capital One	MBNA	Metris	Providian
Loan yield	10.78%	19.86%	13.40%	19.20%	18.88%
Interest yield on cash	4.71%	5.35%	5.33%	5.10%	5.25%
Interest earning assets	8.54%	17.01%	11.07%	16.40%	17.41%
Borrowing funds rate	7.31%	6.14%	5.74%	8.00%	5.60%
Net Interest spread	1.23%	10.87%	5.33%	8.40%	11.81%
Net chargeoffs – 12 month lagging (Q3)	10.3%	0.90%	3.10%	14.19%	7.80%
Net Interest spread after net chargeoffs	-9.07%	9.97%	2.23%	-5.79%	4.01%
Interest income to avg. assets	8.54%	17.01%	11.07%	19.20%	18.88%
Interest expense to avg. assets	4.03%	5.53%	6.82%	5.80%	4.66%
Net Interest margins	4.51%	11.48%	4.25%	13.40%	4.25%
Net chargeoffs - 12 month lagging	10.3%	0.90%	3.10%	14.19%	7.80%
Net Interest margin after net chargeoffs	-5.79%	10.58%	1.15%	-0.79%	-3.55%

As noted in the chart NXCD had a –9.07% net interest spread, net of lagging charge-offs and a –5.79% net interest margin, net of lagging charge-offs. These percentages are much lower than any of the industry competitors. Can NXCD ever make them positive and become profitable? Note that NXCD's consumer loan yield is only 10.78%, significantly lower than both prime and sub-prime lenders. NXCD is issuing a large number of teaser rate 2.9% cards. These rates revert to about 18% after a three month period. NXCD also offers a 9.9% fixed rate card.

Because of the teaser rate offering, NextCard's loan yields should improve as account growth slows. The big problem will be turnover. According to industry veterans the higher the increase from the "teaser" rate to the "go to" rate the higher the turnover. Since NXCD's "teaser" is 2.9% and its "go to" is 18%, other industry participants with teaser rate experience, including First USA and Capital One estimate churn could be about 30%. This is very high turnover. Most fixed rate issuers have between 9% to 15% churn. How many of NXCD's teaser rate accounts will stay on as the teaser rate expires? If they do not stay on as active customers at higher rates, NXCD will be forced to keep up its acquisition spending to maintain its customer count, and at the same time overall rates will not increase as much as they would if accounts stayed on.

2. Financing needs:

NXCD has funded its credit card portfolio through commercial paper conduit facilities. As of December 31 the company had the following facilities: a $300 million facility arranged with Barclays Bank, a $150 million facility arranged with ING Barings and a $220 million facility arranged by First Union Securities. There was approximately $350 million outstanding under these facilities as of December 31. Under agreements like these, the company must maintain certain liquid assets, like cash and marketable securities, equivalent to approximately 20% of the managed loans outstanding.

In Q1 NXCD will begin to securitize a pool of credit card receivables. Management has reported to the "street" that the credit card pool will total between $300 and $400 million. The accounting for this transaction calls for the loans to be taken off the balance sheet and for a gain-on-sale to be recognized. "Street" analysts have been given guidance that this gain could total as much as $12 million. This could cause revenue to spike to about $32M in the quarter, up $18M from just $14M in Q4. However revenue in Q2 will be lower at an estimated $27M, and then revenue should continue to move up through the second half of 2000. Note that there is nothing unusual about the bookkeeping behind this transaction as it is fully prescribed by GAAP (SFAS125).

Securitizations involve the sales of receivables to a separate entity. The entity is usually a trust that has been created by the company exclusively to purchase the receivables. The entity purchases the receivables from the cash generated from selling interests in the entity to investors. The investors require the company to provide credit support for the receivables to reduce their risk of loss resulting from uncollected accounts. The amount of the credit support is negotiated between the company and the investors and is typically 20% of the securitization.

This interest is then retained by the company on its books as credit card receivables.

In upcoming periods NXCD will need to maintain sufficient capital to support the interest in credit card receivables securitized in Q1 and forward. NXCD has informed the "street" that it intends to securitize a new pool of receivables each quarter. The company has estimated these pools at 75% to 80% of the new receivables generated each quarter. Based on future securitizations and continued losses, we estimate that NXCD will need to raise additional capital as early as Q2 2000.

Chart 2: Capital surplus/(deficit) at NXCD in 2000.

000's	Q100E	Q200E	Q300E	Q400E
Securitized receivables Balance	372,500	571,050	780,225	892,969
Rate	20%	20%	20%	20%
Retained interest in securitized rec	74,500	114,210	156,045	178,594
Receivables remaining in conduits	237,800	304,560	416,120	476,250
Rate	20%	20%	20%	20%
Minimum self funding required for conduits	47,560	60,912	83,224	95,250
Minimum self funding required by NXCD	122,060	175,122	239,269	273,844
Capital surplus/(deficit)	68,940	-17,122	-113,769	-160,844

We project the company should need to raise \$170M and \$200M in Q2'00 and in Q1'01, respectively. Even if it is successful, and given its own growth rate projections, NXCD will still need to raise another \$1 billion as early as 2002. Presumably NXCD will raise funding through the issuance of equity securities. When this occurs stockholders will be diluted.

Chart 3: Capital surplus/(deficit) at NXCD in 2002 and 2003.

000's	2002E	2003E
Securitized receivables	2,960,880	4,911,075
Rate	20%	20%
Retained interest in securitized rec	592,176	982,215
Receivables remaining in conduits	1,579,136	2,619,240
Rate	20%	20%
Minimum self funding required for conduits	315,827	523,848
Minimum self funding required by NXCD	908,003	1,506,063
Capital surplus/(deficit)	-828,003	-1,438,063

Note on securitizations: The investors in the trust typically have no recourse against the company. However, the company always has a subordinated interest in the receivables until the investors have been paid in full. This means that the NXCD will absorb any loss against its interest before the investors will absorb any losses. Therefore NXCD will need to continue providing reserves to absorb future losses from managed loans even though the loans are held in the trust. (See section 4 on high net charge-offs.)

As a result, if NXCD has under reserved for loan losses prior to the selling of the loan portfolio, as we think it has, then it will also have under reserved against the 20% of the receivable that is carried on its books after the transaction takes place. The leverage of the potential additional losses to the receivable balance left on the books will be large. A small miscalculation will cause a disproportionate loss of the receivables on the books. The correct way to look at the potential for losses will be to look at the total amount of receivables and loans securitized to gauge how high the losses could really be.

3. Acquisition costs

Recently NXCD reported a drop in acquisition costs per new account from $180 in Q3 to $95 in Q4. Higher than expected account growth and, to a much lesser extent, lower marketing and advertising dollars spent were responsible for the decline. Q4 also benefited from Q3's high spending rate. According to the "street" NXCD was also the beneficiary of a strong E-Christmas that translated into especially greater demand for teaser rate products. See chart 4 for a calculation of acquisition costs in Q4, Q3 and Q2 of 1999.

Chart 4: Acquisition costs

000's	Q4'99a	Q3'99a	Q2'99a
Marketing and advertising	$8,200	$8,813	$4,997
Credit card accounts – beg. Bal.	134	85	55
Credit card accounts – ending bal.	220	134	85
Net adds	86	49	30
Cost per net add	$95	$180	$167
Q/Q change	-47.0%	8.0%	-

According to industry observers the most helpful way to analyze acquisition costs is to first calculate the expected net present value ("NPV") of an account. Then subtract the acquisition cost to determine the net surplus, or in other words, the profits that will be generated from that account over its life. The formula for this calculation is net interest spread – net charge-offs times average card balance times average account life = NPV. Note this calculation does not factor in items like operating costs, fee-based revenue and income taxes.

We used guidance given to the "street" for the numbers assumed in the NPV calculation. The only exception we made was for the average account life. NXCD thinks its average account life will probably be in the four to six year range. This estimate, however, is unreliable, as the company only has about two years of history. According to industry observers with direct experience in this area, the actual account churn on teaser rate products, the majority of NXCD's product, is much higher than churn on fixed rate products. This makes sense. Industry participants estimate that based on the experiences of other major credit card issuers like First USA and Capital One, NXCD will probably have a churn of around 30%. This translates into a 3.4-year average account life.

Chart 5: Calculation of NextCard's NPV surplus/(deficit)

Column number	I	II	III
Footnote		B	B
For period	Q3'99	2002E	2002E
Consumer loan yield	10.78%	14.00%	14.00%
Borrowing funds rate	7.31%	6.60%	6.60%
Net Interest spread	3.47%	7.40%	7.40%
Net chargeoffs - (A)	10.30%	9.40%	6.00%
Net Interest spread after net chargeoffs	-6.83%	-2.00%	1.40%

For period	Q3'99	2002E	2002E
Average balance per account	$2,000	$1,900	$1,900
Interest income	216	266	266
Interest expense	146	125	125
Profit before net chargeoffs	69	141	141
Net Chargeoffs	206	179	114
Profit(loss) per account after net chargeoffs	(137)	(38)	27
Average life of account in years	3.40	3.40	3.40
Max. cost to pay for breakeven (NPV)	(464)	(129)	90
Actual acquisition cost	180	90	90
Surplus(deficit) per account	($644)	($219)	$0

(A) – Column I based on 12 month actual lagging rate.
Column II based on Q4'99 12-month lagging rate.
Column III company projection.

(B) – Column II&III based on company projections, with exception
For note A – column II, net charge-off rate.

Above we calculate there was a -$644 NPV deficit per account for Q3. In this calculation we used a 12 month lagging net charge-off rate. (See section 4 for net charge-offs.) We also calculated 2002E using a 12 month lagging charge-off, and a $90 acquisition cost, the results in column II. We also used a 6.0% net charge-off rate, and a $90 acquisition cost, the results in column III. Even using a 6% rate shows the tremendous impact of high charge-offs on NextCard's NPV per account. Note that 6% is management's current estimate. Even if NXCD managed to have net charge-offs at 6.0%, the company just breaks-even with an acquisition cost of $90. We calculated the NPV for Capital One Financial (COF) and Providian Financial (PVN) and compared these to NXCD. Note that we used a 12 month lagging charge-off rate and a 30% churn for all three to get an apples to apples comparison.

Chart 6: NPV
For the quarter ended December 31, 1999

000's	NextCard	Capital One	Providian
Marketing spending	$8,200	$202,400	$110,967
Net new accounts added	86	2,860	1,100
Cost per account	$95	$71	$101
Net Interest spread after lagging net chargeoffs	-4.50%	9.95%	4.05%
Average balance per account	$1,892	$803	$1,696
Life of account	3.33	3.33	3.33
NPV before acq. Costs	-$284	$266	$229
NPV before operating expenses or fee-based income	-$379	$195	$128

We conclude that NXCD's acquisition costs are too high for NXCD to be profitable. We doubt this situation will improve. "Street" analysts have been led by the company to model acquisition costs to moderate eventually in the $90 range, which we take to mean in the next few years, which would still be high by industry standards, but especially high considering the company's low net interest margins, its high level of charge-offs and its high account churn. It does not appear that

NXCD can make money even at its target $90 acquisition cost. Moreover, we think acquisition costs will be higher than the company expects. As account growth slows quarter-to-quarter the company will be forced to raise spending to meet account growth expectations. This should result in acquisition costs higher than Q4 levels.

The problem appears to be that while the company's approach of casting a very wide net over the internet in order to generate sufficient application volume to yield enough approvable applications is working, it is also proving very expensive. Moreover, it appears from the high level of charge-offs that the company is actually not spending enough, because it is still letting too many weak credits slip through the cracks. NXCD is approving too many applications. It needs to generate still higher volumes of applicants and approve a lower percent.

4. High net charge-offs:

NextCard's net charge-offs have grown at the same pace as revenue. In Q4'99 revenue increased 73% to $13,894K from $8,019K in Q3'99, while net chargeoffs increased 72% to $1,569K from $915K in Q3'99.

Chart 7: Q/Q revenue and net charge-off growth.

000's	Q4'99a	Q3'99a	Q2'99a
Revenue	$13,894	$8,019	$3,644
Q/Q growth	73.3%	120.1%	263.3%
Net charge-offs	$1,569	$915	$425
Q/Q growth	71.5%	115.3%	142.9%

Chart 8: Net charge-off rate.

000's	Q4'99a	Q3'99a	Q2'99a
Managed loans – avg.	$334,323	$212,659	$127,595
Net charge-offs	$1,569	$915	$425
Net charge-off rate	1.9%	1.7%	1.3%

Net charge-offs as a percentage of average loans were 1.9% and 1.7% in Q4 and Q3, respectively. Initially these percentages look low, making loan portfolio quality appear high. However, given the rapid growth of accounts off a small base and given the young age of the portfolio, using these numbers to judge loan quality would be misleading.

To get a clearer picture of credit quality industry observers suggest examining net charge-offs on a lagging basis. Most observers think 12 months is probably the most accurate lagging indicator of the real charge-off rate. According to the December 9 prospectus, NXCD charges off credit card loans when the loan becomes contractually past due for 180 days, with the exception of bankrupt accounts, which are charged off no later than the month after delivery of notice. We calculated these number for three, six, nine, twelve and fifteen months lagging in Q4, Q3 and Q2 of '99. The formula is as follows, lagging net charge-off rates = net charge-offs over ending lagging loans times four (annualized).

Chart 9: Lagging net charge-off rates.

a. Current charge-offs as a % of total managed loan portfolio at 12 months prior:

000'	Q4'99a	Q3'99a	Q2'99a
Managed loans - 12 months prior:	$66,042	$35,534	$9,402
Current Chargeoffs as %	9.4%	10.3%	18.1%

b. Lagging net charge-off rates.

Months Prior	Q4'99a	Q3'99a	Q2'99a
3	2.3%	2.2%	1.8%
6	3.8%	3.8%	2.6%
9	6.5%	5.5%	4.8%
12	9.4%	10.3%	18.1%
15	17.7%	39.0%	-

NextCard's CFO recently stated that NXCD typically finds that it is charging off bad loans 18 to 20 months after having put them on the books. He also projected that, by his analysis of FICO scores, NextCard would experience about 6% charge-offs longer term. However, looking at the results in the table above, the company's experience at 15 months is a charge-off rate of about 18% currently, not even close to the CFO's long term assumption of 6%. We have more conservatively used 12 months lagging versus the 18 months lagging referred to by the CFO. An 18 month calculation bases on NextCard's current experience would have disastrous results for NXCD, and would imply a huge charge-off rate.

Interestingly, management admits that FICO scores on its approved credits have been declining, which is bad, but that investors should not worry because a proprietary scoring system running parallel to the FICO score especially designed for the internet is showing improving quality. We are especially wary of any proprietary system, developed with so little experience, being used to justify what appears to be a loosening of credit standards.

We also calculated net charge-off rates on a 12 month lagging basis for certain industry competitors, in order to have an apples to apples comparison, and compared them to NextCard's 12 month lagging rates, as shown below:

Chart 10: Q4 99 12 month lagging charge-off rates at competitors:

000's	Capital One	MBNA	Compucredit	Providian	Metris
Managed loans – 12 months prior	$17,395,000	$59,641,000	$504,000	$13,245,000	$5,315,000
Current Chargeoffs	$183,000	$760,000	$18,000	$330,000	$151,000
% 12 month lagging	4.2%	5.0%	14.3%	10.0%	11.4%

Capital One and MBNA are prime lenders with net charge-offs of 4.2% and 5.0%, respectively, while CompuCredit, Providian and Metris are all sub-prime lenders with net charge-offs of 14.3%, 10.0% and 11.4%, respectively. NextCard, according to analysts, is a "prime" market issuer. However, because NXCD's net charge-off experience appears to fall in the sub-prime range, we think it would be more correct to characterize NXCD's issuance as sub-prime. On a 12 month lagging basis, NextCard's charge-offs were 9.4% and 10.3% for Q4'99 and Q3'99, respectively. These rates are like those of sub-prime lenders Providian and Metris.

"Street" analysts accept the company's notion that it is a prime lender, and therefore they mistakenly project charge-offs at a prime issuer rate. This means that their net margin projections are too high. These high lagging charge-off levels will begin to catch up with NXCD when loan growth slows.

Rapid managed loan growth may hide the problem for a while, but this can not last. A high percentage of new loans in the portfolio means that the portfolio has not seasoned and that losses have not begun to show. When growth slows, however, charge-offs as a % of the current portfolio should increase substantially, and loan loss provision growth should have to increase faster than the growth in the loan portfolio. As a result, earnings will be below expectations. In our view, this is not so much a matter of "if" but rather "when".

5. Adverse selection

NextCard's problem is adverse selection on the Internet. NextCard is seen by lots of eyeballs, and attracts a lot of click throughs. Applications are very easy to make. Approvals are also rapid. The problem is trying to find the right balance between credit quality and number of approvals and cost per approved new customer.

According to the April/May '99 edition of the Online Banking Report, from the period of Q2'98 through Q1'99 NXCD received 1.7 million applications for credit, and opened 66,000 new accounts, for an approval rate of just 3.9%. The company has recently said that it now has an approval rate between 20% and 25%. This appears to be far too high and is probably a result of attempting to meet account growth targets. Other credit card companies say that they only accept 5% to 8% of on-line applicants. They fear adverse selection and higher charge-offs. In our opinion, the poor credit and profit characteristics of the on-line applicant that NXCD approves and that ends up maintaining balances is the root cause of NXCD's charge-off problem.

Many good credits may be attracted by the teaser rate and may sign up for a card. However, these good credits are unlikely to maintain balances later when their rates go to 18%. On the other hand, a high percentage of the credits that do get through the system and that do accept the 18% rate do not appear to be prime credits. In other words, NextCard may be approving a lot of prime credits, but these are not the credits that are maintaining large balances.

Industry observers have noted another problem with internet accounts. First, they say that internet applicants are mostly sub-prime. Second they note that an applicant who is seeking credit has proven to be a poorer credit than one who is solicited. They also note the tendency of people to seek additional credit just before their credit rating deteriorates, which leads to FICO scores that are not reflective of the true current status of the credit.

6. Q4 results.

Q4 will probably prove to be a good example of the problem of adverse selection in a short space of time. The holiday shopping season attracted a lot of first time on-line buyers. These buyers were also treated to a barrage of NextCard advertising. They were offered teaser rates just when they needed extra credit for holiday purchases. What could be better than a temporary 2.9% credit line for holiday shopping? When the consumer is done paying off the 2.9% loan using a NextCard, the consumer can go back to a lower rate card from another issuer for the rest of the year rather than accept NextCard's high rates after the teaser expires. Of course, a large number of consumers who do stay on after the teaser expires may have trouble paying loans off. Especially when after they begin to miss payments their rates can go well over 20%.

As a result, while Q4 customer acquisition results were impressive, coming in at 86,000, we doubt that this new crop of customers will prove to be any more credit worthy than the previous groups, and perhaps even less so. The problem will be with the credits NXCD keeps as customers after the holidays are over.

7. On-line competition:

Many of NextCard's competitors have significantly longer operating history, greater name recognition and larger financial, technical and marketing resources. We think that their longer underwriting experience gives them a big edge over NextCard, which seems to have underwriting difficulties. Competition in the industry could even pressure NXCD into reducing interest rates charged on some customer accounts to remain competitive for the better credits. Some of these competitors may be able to get better funding rates on their conduit facilities. Industry observers think the consumer is saturated with cards, but still expect even more competition for market share from other credit card issuers and commercial banks moving to the Internet. Chart 11 contains a listing of the top online issuers competing against NextCard.

Chart 11: Online credit card issuers:

Bank One/First USA	Fleet
MBNA	Household
American Express	Bank of America
Capital One	Associate First Capital
Citigroup	Schwab
Providian/Aria	Intuit
Chase	E*Trade

8. Recently management said that it expects the company to turn profitable in early 2002. According to the "street" models, breakeven in Q1'02 would require about 1.4 million accounts under management, or $2.6 billion in assets, times a 7.9% net interest spread. At that point, the company would have also built a loan loss reserve of 3.8% of managed loans. As of December 31 NextCard had only 220,000 accounts, and $416 million in assets, and a net interest spread using 12 month lagging loan losses of –3.9%versus the 5.5% reported.

We can go along with the 1.4 million accounts by Q1'02, but we also estimate a net interest spread of 7.4% and a net charge-off rate of 9.4%on a lagging 12 month basis. These percentages will translate into a net loss of approximately $11 million for Q1'02.

Industry observers point out that while NXCD was early, the Internet is becoming an even more competitive market for card issuers. Many competitors already have brand recognition. We think that in order for NXCD to hit its acquisition targets it may have to increase spending well beyond expectations, or it will further relax credit standards. For this reason we believe that "street" analysts have either over estimated account growth, or they have underestimated acquisition costs and charge-offs in their models for years beginning after 2001.

9. Co-branding deals:

NextCard recently entered an agreement with Priceline.com (PCLN) whereby NXCD will offer a co-branded credit card on Priceline's web site. According to some observers this agreement will only hurt portfolio quality. In their opinion the credit standards of a large portion of Priceline's customers are well below even the current credit standards of NXCD. (Credit standards in the credit card industry are measured using the Fair Isaac, or "FICO" score, which is a number between 350 and 850 calculated using different criteria from a person's credit profile. Higher is better.)

Capital One Financial (COF) and First USA (a subsidiary of Bank One) previously attempted deals with Priceline. Soon after, both credit card companies terminated the agreements. We have reported on the problems these credit card issuers faced with Priceline in our reports on Priceline. Both of these issuers could not make getting customers through Priceline work. This does not bode well for NextCard.

Co-branding deals often require guaranteed minimum payments over some period. NXCD has intentionally omitted these amounts from the publicly available agreements. These payments may be high. Note the $14M spike in prepaid expense in Q3, probably due to advertising and marketing.

Chart 12: Increase in prepaid expenses.

000's	Q4'98A	Q1'99A	Q2'99A	Q3'99A	Q4'99A
Assets					
Cash/equivalents	$40,134	$25,456	$131,327	$85,541	$223,233
Restricted cash	0	0	8,600	13,993	0
Credit card loans	0	68,353	142,532	268,014	418,475
Allowance for losses	0	-995	-2,007	-6,178	-11,500
Servicing rcvbl.	966	0	0	0	0
Prepaid loan fees	2,100	4,011	5,725	5,145	8,000
Equip./improv., net	2,102	3,358	6,002	6,939	8,385
Prepaid/other	240	1,089	1,376	15,452	15,717
Total assets	$45,542	$101,272	$293,555	$388,906	$662,310
Q/Q $ change in prepaid/other		$849	$287	$14,076	$265
Q/Q % change in prepaid/other		354%	26%	1023%	2%

This amount may represent minimum payments made to Amazon.com (AMZN) or some other marketing partner. These prepaid expenses will be probably be amortized through the income statement as marketing expenses and lower net income. This may also cause unusual fluctuations in acquisition costs. The company has given guidance to the "street" that marketing costs will rise substantially in Q1 to about $14 million. This should result in sharply higher acquisition costs, as we estimate below.

Chart 13:

	Q100E	Q200E	Q300E	Q400E
Acquisition cost per acct. $	250	167	147	110

In January management gave guidance to the "street" on expected growth for the next few years. Management intentionally omitted any growth from co-branding deals. While we applaud the conservatism, we note that if the proposed co-branding deals do not succeed, acquisition costs per average new account may be surprisingly high.

10. Sub-Prime:

Management recently stated said that to date NXCD has issued a small number of sub-prime cards. However, it said that NXCD will issue more sub-prime credit cards in 2000 and beyond. NXCD may try to boost net interest margins by offering a teaser rate higher than the current 2.9%. Given our estimates of the high charge-off rates that NXCD is experiencing, we agree that it needs to attempt to raise its yields. However, we also think that it will get fewer acceptances of its offer. Sub-prime applicants who may have been attracted by the 2.9% teaser and who now may be refused at the lower rate but who are accepted at a higher rate may now choose a competitor for a similar rate. This will raise acquisition costs. In addition, to the extent that NextCard succeeds in getting some higher yields, this will be offset by still higher charge-offs.

11. Other concerns:

Insiders have been selling. On December 9 insiders sold 1.8 million shares at $34. This transaction resulted in total proceeds of $24M to six executives and $39M to three directors. CEO Jeremy Lent sold 4,094,000 shares in May 1999. The proceeds to Mr. Lent were $76M. Mr. Lent also participated in the December 9 sale in which he received $15.3M. NXCD's VP of Technology resigned to pursue a better opportunity with a development stage company.

12. Comparative valuation:

Since NextCard has not earned money, and does not even hope to do so before 2000, we use an Enterprise Value to managed assets ratio and an enterprise value per account to compare NXCD to its competitors. We think this is a very conservative approach. Nevertheless, it is clear that NextCard's valuation is very high compared to its peers. It is more than twice as expensive as CompuCredit (CCRT) which is a money making operation and which has a much safer account profile with average balances much lower than NXCD. NXCD is about ten times as expensive as Providian, and twenty times Metris.

Chart 14:

$000's 12/31/99	NXCD	PVN	MXT	CCRT	MBNA	Capital One
Managed assets	$415,000	$21,000,000	$7,300,000	$899,000	$72,255,513	$20,237,000
# of credit card accounts	220	12,400	3,700	1,181	n/a	23,705
Bal per account	$1,886	$1,694	$1,973	$761	n/a	$854
Enterprise value	$1,439,767	$8,160,056	$1,262,579	$1,371,192	$11,427,948	$10,184,639
Enterprise val/managed assets	3.47	0.39	0.17	1.53	0.16	0.50
Enterprise val per accounts in $	$6,544	$658	$341	$1,161	n/a	$430
Market cap.	$1,317,000	$9,264,000	$1,112,000	$1,393,000	$16,000,000	$6,800,000
cash & MS	(223,233)	(2,062,000)	(194,433)	(21,808)	(4,572,052)	(2,096,954)
Debt	$346,000	$958,056	$345,012	$0	$0	$5,481,593
Enterprise value	$1,439,767	$8,160,056	$1,262,579	$1,371,192	$11,427,948	$10,184,639

13. Projections:

We assume that NXCD can meet or exceed “top-line” targets in 2000. The company can easily accept a higher level of poor accounts if it so chooses. What should concern investors more is low yields, high account churn, high net charge-offs and the poor prospects for profitability. The detailed assumptions behind our estimates are included in the tables, below.

12. Financials

$000's	Q199A	Q299A	Q399A	Q499A
Credit card loans interest	380	2,126	5,486	9,871
Interest expense	647	1,866	3,249	5,142
Spread income	-267	260	2,237	4,729
Loan loss provision	995	1,047	3,185	6,845
Income after loan loss provision	-1,262	-787	-948	-2,116
Non-interest income	343	613	1,133	2,417
Non-interest expense	-10,343	-19,421	-24,357	-26,660
Income before investment income	-11,262	-19,595	-24,172	-26,359
Investments income	280	905	1,400	1,606
Income before income taxes	-10,982	-18,690	-22,772	-24,753
Income taxes	0	0	0	0
Income after income taxes	-10,982	-18,690	-22,772	-24,753
Diluted average shs.	36,607	41,533	45,408	46,700
Dilutd EPS excl Xord	-0.30	-0.45	-0.50	-0.53

$000's	Q199A	Q299A	Q399A	Q499A
Customer accounts	55	85	134	220
Avg. balance/account	1,750	1,677	2,000	1,892
Managed loans	96,250	142,532	268,014	416,315
Asset yield	4.51%	8.26%	10.78%	11.80%
Cost of funds	8.05%	7.64%	7.31%	6.91%
Gain on sale income	0	0	0	0
Interchange fee income	96	318	717	1,530
Other fee income	247	295	416	887
Marketing & advertising	2,555	4,997	8,813	8,200
Account acquisition cost	-	167	180	95
Total other operating expenses	7,788	14,424	15,544	18,460
Cumulative securitizations	0	0	0	0

$000's	Q100E	Q200E	Q300E	Q400E
Credit card loans interest	14,135	17,762	24,247	31,598
Interest expense	4,242	2,262	2,878	3,956
Spread income	9,893	15,500	21,369	27,642
Loan loss provision	10,000	14,000	21,000	24,000
Income after loan loss provision	-107	1,500	369	3,642
Non-interest income	15,000	5,500	7,150	10,080
Non-interest expense	-32,900	-32,400	-34,900	-35,800
Income before investment income	-18,007	-25,400	-27,381	-22,078
Investments income	2,483	3,026	3,587	3,265
Income before income taxes	-15,523	-22,374	-23,794	-18,813
Income taxes	0	0	0	0
Income after income taxes	-15,523	-22,374	-23,794	-18,813
Diluted average shs.	46,700	49,276	51,852	51,852
Dilutd EPS excl Xord	-0.33	-0.45	-0.46	-0.36
Customer accounts	276	351	436	550
Avg. balance/account	1,850	1,850	2,000	1,950
Managed loans	510,600	649,350	872,000	1,072,500
Asset yield	12.20%	12.25%	12.75%	13.00%
Cost of funds	6.80%	6.75%	6.66%	6.61%
Gain on sale income	12,000	1,600	1,950	3,000
Interchange fee income	2,000	2,300	3,150	4,580
Other fee income	1,000	1,600	2,050	2,500
Marketing & advertising	14,000	12,500	12,500	12,500
Account acquisition cost	250	167	147	110
Total other operating expenses	18,900	19,900	22,400	23,300
Cumulative securitizations	298,000	389,610	523,200	643,500

$000's	Q101E	Q201E	Q301E	Q401E
Credit card loans interest	37,847	44,098	53,757	64,355
Interest expense	10,922	18,756	19,500	15,500
Spread income	26,925	25,342	34,257	48,855
Loan loss provision	23,000	31,000	44,000	47,000
Income after loan loss provision	3,925	-5,658	-9,743	1,855
Non-interest income	14,400	18,300	22,300	24,050
Non-interest expense	-40,950	-41,650	-43,650	-45,350
Income before investment income	-22,625	-29,008	-31,093	-19,446
Investments income	4,229	4,798	3,882	3,598
Income before income taxes	-18,395	-24,211	-27,210	-15,847
Income taxes	0	0	0	0
Income after income taxes	-18,395	-24,211	-27,210	-15,847
Diluted average shs.	54,883	57,913	57,913	57,913
Dilutd EPS excl Xord	-0.34	-0.42	-0.47	-0.27

Customer accounts	645	745	855	990
Avg. balance/account	1,880	1,880	2,020	1,970
Managed loans	1,212,600	1,400,600	1,727,100	1,950,300
Asset yield	13.25%	13.50%	13.75%	14.00%
Cost of funds	6.60%	6.60%	6.60%	6.60%
Gain on sale income	6,100	7,200	9,000	9,100
Interchange fee income	5,200	6,950	8,350	9,350
Other fee income	3,100	4,150	4,950	5,600
Marketing & advertising	16,500	16,000	16,500	16,500
Account acquisition cost	174	160	150	122
Total other operating expenses	24,450	25,650	27,150	28,850
Cumulative securitizations	727,560	840,360	1,036,260	1,170,180

$000's	1999A	2000E	2001E
Credit card loans interest	17,863	87,742	200,057
Interest expense	10,904	13,338	64,678
Spread income	6,959	74,404	135,379
Loan loss provision	12,072	69,000	145,000
Income after loan loss provision	-5,113	5,404	-9,621
Non-interest income	4,506	37,730	79,050
Non-interest expense	-80,781	-136,000	-171,600
Income before investment income	-81,388	-92,866	-102,171
Investments income	4,191	12,362	16,507
Income before income taxes	-77,197	-80,504	-85,664
Income taxes	0	0	0
Income after income taxes	-77,197	-80,504	-85,664
Diluted average shs.	46,319	49,920	57,155
Dilutd EPS excl Xord	-1.67	-1.61	-1.50

$000's	1999A	2000E	2001E	
Customer accounts	220	550	990	
Avg. balance/account	1,892	1,950	1,970	
Managed loans	416,315	1,072,500	1,950,300	
Asset yield	11.80%	13.00%	14.00%	
Cost of funds	6.91%	6.61%	6.60%	
Gain on sale income	0	18,550	31,400	
Interchange fee income	2,661	12,030	29,850	
Other fee income	1,845	7,150	17,800	
Marketing & advertising	24,565	51,500	65,500	
Account acquisition cost	123	156	149	
Total other operating expenses	56,216	84,500	106,100	
Cumulative securitizations	0	643,500	1,170,180	
ASSETS	Q1'99A	Q2'99A	Q3'99A	Q4'99A
Cash/equivalents	25,456	139,927	99,534	223,233
Credit card loans	68,353	142,532	268,014	418,475
Allowance for losses	-995	-2,007	-6,178	-11,454
Prepaid loan fees	4,011	5,725	5,145	8,000
Equip./improv., net	3,358	6,002	6,939	8,385
Prepaid/other	1,089	1,376	15,452	15,671
Total assets	101,272	293,555	388,906	662,310
LIABILITIES				
Deposits	0	0	2,541	3,800
Accounts payable	2,721	5,139	3,914	7,962
Accrued expenses	5,509	6,712	16,821	14,554
Other borrowings	5,000	10,000	11,879	11,359
Subord borrowings	54,069	126,629	229,129	346,000
Total long term debt	55,226	126,629	229,129	346,000
Total liabilities	68,456	148,480	264,284	383,675
SHAREHOLDER EQUITY				
Common stock	38	46	46	51
Paid in capital	77,070	213,460	209,918	385,736
Accumulated deficit	-28,932	-47,622	-70,394	-95,149
Dfrd compensation	-15,334	-20,783	-14,935	-12,003
Notes receivable	-26	-26	-13	0
Total equity	32,816	145,075	124,622	278,635
Allowance for loan losses:				
Beg bal	0	995	2,007	6,178
Provisions	995	1,047	3,185	6,845
Other adj.	0	0	1,901	0
Net Credit losses - (net charge-offs)	0	-35	-915	-1,569
Ending bal	995	2,007	6,178	11,454
reserve as % of managed loans	1.46%	1.41%	2.31%	2.74%
Net Charge-offs	0	34	915	1,569
12 month lagging as % of managed loans	-	-	-10.36%	-9.50%
As a % of current managed loans			1.37%	1.51%

ASSETS	Q1'00E	Q2'00E	Q3'00E	Q4'00E
Cash/equivalents	191,000	305,000	275,000	245,000
Credit card loans	212,600	259,740	348,800	429,000
Allowance for losses	-19,184	-29,834	-44,534	-58,734
Prepaid loan fees	9,500	11,449	13,159	15,059
Equip./improv., net	10,780	12,410	14,392	17,027
Prepaid/other	14,550	13,326	16,444	18,291
Total assets	419,246	572,091	623,261	665,643
LIABILITIES				
Deposits	5,096	10,763	22,769	44,915
Accounts payable	8,500	9,501	8,523	9,041
Accrued expenses	17,500	18,250	17,500	16,500
Other borrowings	8,897	6,000	10,920	12,500
Subord borrowings	118,073	118,271	175,103	211,053
Total long term debt	118,073	118,271	175,103	211,053
Total liabilities	158,066	162,785	234,815	294,009
SHAREHOLDER EQUITY				
Common stock	51	103	103	103
Paid in capital	385,736	555,684	555,684	555,684
Accumulated deficit	-110,672	-133,046	-156,841	-175,653
Dfrd compensation	-13,935	-13,435	-10,500	-8,500
Notes receivable	0	0	0	0
Total equity	261,180	409,306	388,446	371,634
Allowance for loan losses:				
Beg bal	11,454	19,184	29,834	44,534
Provisions	10,000	14,000	21,000	24,000
Other adj.	0	0	0	0
Net Credit losses - (net charge-offs)	-2,270	-3,350	-6,300	-9,800
Ending bal	19,184	29,834	44,534	58,734
reserve as % of managed loans	3.76%	4.59%	5.11%	5.48%
Net Charge-offs	2,270	3,350	6,300	9,800
12 month lagging as % of managed loans	-9.43%	-9.40%	-9.40%	-9.42%
As a % of current managed loans	1.78%	2.06%	2.89%	3.66%

ASSETS	Q1'01E	Q2'01E	Q3'01E	Q4'01E
Cash/equivalents	425,000	335,000	280,000	290,000
Credit card loans	485,040	560,240	690,840	780,120
Allowance for losses	-69,734	-84,834	-107,534	-128,834
Prepaid loan fees	13,375	13,608	15,464	14,250
Equip./improv., net	19,485	22,623	27,938	31,122
Prepaid/other	15,463	14,328	17,484	18,317
Total assets	888,629	860,965	924,192	1,004,975
LIABILITIES				
Deposits	56,214	75,000	100,000	125,000
Accounts payable	10,500	9,800	10,820	11,100
Accrued expenses	17,100	16,800	17,500	18,057
Other borrowings	13,500	14,000	13,200	14,000
Subord borrowings	233,777	212,138	276,555	346,334
Total long term debt	233,777	212,138	276,555	346,334
Total liabilities	331,091	327,738	418,075	514,491
SHAREHOLDER EQUITY				
Common stock	164	164	164	164
Paid in capital	755,623	755,623	755,623	755,623
Accumulated deficit	-194,049	-218,260	-245,470	-261,318
Dfrd compensation	-4,200	-4,300	-4,200	-3,985
Notes receivable	0	0	0	0
Total equity	557,538	533,227	506,117	490,484
Allowance for loan losses:				
Beg bal	58,734	69,734	84,834	107,534
Provisions	23,000	31,000	44,000	47,000
Other adj.	0	0	0	0
Net Credit losses - (net charge-offs)	-12,000	-15,900	-21,300	-25,700
Ending bal	69,734	84,834	107,534	128,834
reserve as % of managed loans	5.75%	6.06%	6.23%	6.61%
Net Charge-offs	12,000	15,900	21,300	25,700
12 month lagging as % of managed loans	-9.40%	-9.79%	-9.77%	-9.59%
As a % of current managed loans	3.96%	4.54%	4.93%	5.27%

ASSETS	1999A	2000E	2001E
Cash/equivalents	223,233	245,000	290,000
Credit card loans	418,475	429,000	780,120
Allowance for losses	-11,454	-58,734	-128,834
Prepaid loan fees	8,000	15,059	14,250
Equip./improv., net	8,385	17,027	31,122
Prepaid/other	15,671	18,291	18,317
Total assets	662,310	665,643	1,004,975
LIABILITIES			
Deposits	3,800	44,915	125,000
Accounts payable	7,962	9,041	11,100
Accrued expenses	14,554	16,500	18,057
Other borrowings	11,359	12,500	14,000
Subord borrowings	346,000	211,053	346,334
Total long term debt	346,000	211,053	346,334
Total liabilities	383,675	294,009	514,491
SHAREHOLDER EQUITY			
Common stock	51	103	164
Paid in capital	385,736	555,684	755,623
Accumulated deficit	-95,149	-175,653	-261,318
Dfrd compensation	-12,003	-8,500	-3,985
Notes receivable	0	0	0
Total equity	278,635	371,634	490,484
Allowance for loan losses:			
Beg bal	0	11,454	58,734
Provisions	12,072	69,000	145,000
Other adj.	1,901	0	0
Net Credit losses - (net charge-offs)	-2,519	-21,720	-74,900
Ending bal	11,454	58,734	128,834
reserve as % of managed loans	2.74%	5.48%	6.61%
Net Charge-offs	2,518	21,720	74,900
12 month lagging as % of managed loans	-9.50%	-9.42%	-9.59%
As a % of current managed loans	0.60%	2.03%	3.84%