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eToys On the Ropes

By Beth Cox

An on-the-ropes eToys Inc. posted fiscal third quarter results that were worse than analysts had expected, reporting an operating loss excluding charges of $74.5 million or 52 cents per share. Analysts had expected a loss of about 46 cents a share.

The stock, which has been below $1 for some time now, closed Thursday at 31 cents a share. Its 52-week high is $28. In early trading this morning it was down to 22 cents a share.

The company said in a statement accompanying the dismal earnings report that it expects to run out of cash on or about Mach 31 and "will require an additional, substantial capital infusion" in order to continue operations in 2001.

"There can be no assurance that additional capital will be available to the company on acceptable terms, or at all," the company said.

eToys said net sales for the quarter ending Dec. 31 were $131.2 million, a 23 percent increase over net sales of $106.8 million in the same period a year ago but well down from the $210 million to $240 million it had estimated on Oct. 30.

The quarterly loss compares with a loss of $62.5 million or 52 cents per share in the same period a year earlier. The one ray of sunshine in the earnings report was that the company added nearly one million new customers in the quarter, bringing total customer accounts to nearly 3.4 million.

The company, which is shutting down its European operation and has laid off 700 of its 1,000 U.S.-based employees, has hired Goldman, Sachs to explore options for the company, including a merger, asset sale, investment in the company or a financial restructuring.

eToys has even gone so far as to set up a recorded message to handle all those pesky calls from creditors.

The company said its third quarter operating losses represented 57 percent of net sales for the quarter. On Dec. 15, the company had estimated that these operating losses would represent between 55 percent and 65 percent of net sales, up from the 22 percent to 28 percent of net sales it had estimated on Oct. 30.

eToys said a newly formed committee of creditors, including representatives from Mattel, Hasbro, Lego Systems, R.R. Donnelley & Sons, Staffmark, Fir Tree Partners and Pacific Asset Management, has agreed to forebear from taking any action to collect on their debts through Jan. 31, and the company has agreed not to pay any past due debts and to operate under a budget designed to maintain its current operations.

What actually went wrong at eToys? Goldman, Sachs analysts, in an advisory to clients, explained it this way:

"The company decided in early 2000 to bring fulfillment in-house because of the poor performance of its fulfillment outsourcing partner last holiday season. • Unfortunately, in the current capital constrained environment, the company was unable to invest sufficient marketing dollars to drive the required revenue levels commensurate with the infrastructure costs.

"In addition, it appears that the online toy category in aggregate suffered from the perception that customer service by online toy companies was poor based on negative experiences last year."

Meanwhile, as if things weren't bad enough, a European Internet artists group called etoy -- with all lower-case letters -- said on Thursday it is suing eToys for alleged trademark infringement.

The action was filed in the U.S. District Court of Southern California in San Diego, according to a Reuters report. etoy is an international artist's collective whose medium is the Internet. etoy contends that because it was around before eToys, the toy retailer should not be allowed to use a similar name that could be confused with its own.