



ebay™

Annual Report



2000

To Our Stockholders, Partners, Employees and the eBay Community:

A Year of Accomplishments

The year 2000 was a time of great accomplishments at eBay. In just 12 months, we dramatically expanded our marketplace in several important ways. For starters, we added thousands of new product categories as well as dozens of new services and site features. Our marketing and promotions efforts produced growing ubiquity for eBay, both on and off the Internet, making more people in more places aware of eBay and bringing them to the site in greater numbers than ever before. We introduced fixed-price trading to our community, reaching a whole new type of user for the first time. And we continued to extend the eBay marketplace to the most productive e-commerce markets on the planet.

Perhaps what makes our accomplishments in 2000 even more impressive is that they were achieved during a period of great turmoil in our industry and in a manner that significantly improved our already solid financial base.

Come what may, eBay and its community prospered in 2000, and we are extremely pleased by the momentum we have going into 2001.

A Thriving Marketplace

At eBay we do one thing. We work every day to be the world's largest and most compelling Internet commerce platform. To further that goal in 2000, our seasoned management team stayed focused on attracting more customers, expanding the goods traded on the site, making the user experience easier, safer, more fun and exciting, and spreading the eBay marketplace to more places around the world.

eBay ended the year with over 22 million registered users, representing 125 percent growth over the 10 million users we had at the end of 1999. To put that in perspective, eBay's community is now larger than the population of Texas, the second largest state in the Union. And our community is more diverse than ever, featuring homemakers, major corporations and everyone in between, buying and selling practically anything. Our users listed more than 265 million items on the site in 2000, up 104 percent from 1999.

Our deepening integration into AOL's site throughout the year, as well as our enhanced affiliates program, which in Q4 reached 13,000 partners, helped drive user growth by putting eBay in front of more people than ever before. Marketing promotions with such powerful and diverse brands as AOL Time Warner, Disney, Visa, The History Channel and General Motors, to name just a few, were also critical in reaching new users and in user retention.

In 2000, eBay stepped up its offline marketing efforts by running its first national advertising campaign. And on the public relations front, eBay continued to be at the center of popular culture, receiving attention in hit TV shows, movies, and in thousands of local, regional and national news stories.

One of the reasons so many people come to eBay is the variety of goods and services they can find in our marketplace. During 2000, eBay added more than 5,000 new categories, including new meta-categories such as personal care, clothing and accessories and home and garden. In the fourth quarter alone, eBay users in the clothing and accessories category transacted over \$40 million in gross merchandise sales. And people are just beginning to realize that in 2000, eBay became the largest online destination for computers and electronics, used cars, toys, sporting goods, and jewelry and gemstones.

The acquisition of Half.com in July was an important milestone in our history. With the acquisition, eBay formally introduced fixed-price trading to its community. In just a few short months, Half.com achieved tremendous results. By December, Half had more than 10 million items listed on the site and was the #3 online retailer in terms of traffic, according to Media Metrix. Half's success, combined with the early success of our new "Buy-It-Now" feature, makes it clear that fixed-price trading will play a growing role in eBay's future.

Another important milestone for eBay in 2000 was the introduction of eBay's API (application programming interface). The API will allow eBay to be fully integrated into other sites across the Internet. In addition, the API will make it possible for our commercial partners to more easily and quickly expand our services to new devices, such as wireless telephones and handhelds. Finally, the API will improve the user experience by allowing developers to create new and more robust services for eBay users.

In March of 2001, eBay and Microsoft agreed to an alliance that is intended to supercharge eBay's API, extending it to Microsoft's legions of developers worldwide. Microsoft will also integrate eBay's marketplace into a number of its web properties, including select MSN sites worldwide, CarPoint, bCentral and WebTV.

Throughout 2000, eBay introduced dozens of features to make the site easier and more fun to use. We added new ways for our users to list, search, trade and pay for items. Our efforts were rewarded with increased trading velocity. We also saw the number of transactions that closed using Billpoint, eBay's payment service, significantly increase during the second half of the year, indicating that more buyers are relying on the safety and convenience of the Billpoint payment service than ever before.

Customer support was again a priority for eBay in 2000. We're happy to report that our latest surveys show that once again more than 90 percent of our users would recommend eBay to a friend. And eBay recently received the "Best Customer Satisfaction" award from Satmetrix.

All of our accomplishments in 2000 were achieved on a strong and robust technology platform that consistently delivered at least 99 percent up time. While we are very pleased with our technology progress this past year, we know that our job is never done. We will continue to make significant investments to expand and strengthen our technology infrastructure and will begin rolling out the third generation of our platform in 2001.

International Expansion

To create a truly global trading platform, eBay is establishing a strong presence in countries whose populations generate the majority of the world's e-commerce revenue. In 2000, we entered four new markets — Japan, Canada, France and Austria. In the first eight weeks of 2001, we announced the launch of our Italian site and our entry into South Korea through the acquisition of a controlling interest in Internet Auction, South Korea's largest auction-style web site. eBay also announced the acquisition of iBazar, the pioneer in online auction-style trading in Europe. With the close of the iBazar acquisition, currently scheduled for the second quarter of 2001, as well as the recent launches of sites in Ireland, Switzerland and New Zealand, eBay will have a strong leadership position in 15 of the top 20 global markets which represent approximately 90 percent of the world's e-commerce dollars and a vast majority of the world's Internet users.

Financial Stability

In 2000, eBay again had record bottom line profits, which were driven by record user growth, revenues and gross merchandise sales. For the year, eBay reported consolidated net revenues of \$431.4 million, a 92 percent increase over 1999. Consolidated pro forma net income for the full year, which excludes certain non-cash, merger and stock related charges, reached \$58.6 million, or 21 cents per diluted share. This represents a more than three-fold increase in pro forma net income compared to 1999. Online net revenues totaled \$392 million for the year, a 115% increase over 1999. With strong growth in the core U.S. business, rapidly growing international operations, and continuing success in adding value for both buyers and sellers, we continue to be pleased with the diversity of our revenue streams. eBay's balance sheet ended the year at \$1.2 billion in total assets, including approximately \$901 million in cash and financial instruments.

Our Future

As we push into 2001, eBay will stay focused on attracting a broad range of buyers and sellers to the site. We will introduce more categories and services to eBay as we identify relevant opportunities in the estimated \$1.7 trillion market we address today. We will continue to enhance our technology infrastructure, making it possible for an ever-growing number of users to reliably transact increasing amounts of business. And we will

continue to expand across the U.S. and the world, increasing our presence in both local and international markets that will ultimately enable seamless worldwide trading.

eBay's goal is to be the Internet's marketplace. We strive to provide the best and most efficient way for our community of users to buy and sell almost anything, anytime, anywhere. We hope that our success in 2000 demonstrates that we're on our way!

In 2001, eBay will continue to develop all parts of its culture. That culture includes a belief that we must contribute to the communities around us and help those who are less fortunate. The eBay Foundation will continue its efforts to assist non-profit organizations as they struggle to serve people in need of important services. And we will move forward with our efforts to help the nation's senior citizens overcome the "digital divide" by helping to provide easy access to technology and education. eBay has pledged to bring more than one million seniors online, working with its partner, SeniorNet, the largest non-profit trainer of seniors in the country. We have also promised to help SeniorNet establish ten education centers nationwide.

As always, we want to extend our profound thanks to eBay's stockholders, partners, employees and the eBay community. In particular, we want to acknowledge the many contributions of our wonderful global community. From the beginning, eBay has been blessed to be the home of some of the most creative, hardworking and dedicated users on the Internet. Our community makes every eBay triumph possible and our site one of the most interesting and fun places around. Every eBay employee spends his or her day thinking about how eBay can be a better place for our community to trade. When our community succeeds, we succeed.

We look forward to much shared success in the months and years ahead.



Pierre Omidyar
Founder & Chairman of the Board



Meg Whitman
President & Chief Executive Officer

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

FORM 10-K

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2000.

OR

- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

For the Transition Period from _____ to _____ .

Commission file number 000-24821

eBay Inc.

(Exact name of Registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)
2145 Hamilton Avenue
San Jose, California
(Address of principal executive offices)

77-0430924
(I.R.S. Employer
Identification Number)

95125
(Zip Code)

(408) 558-7400
(Registrant's telephone number, including area code)

Check whether the registrant: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

As of March 1, 2001 there were 269,310,946 shares of the Registrant's common stock, \$0.001 par value, outstanding, which is the only class of common or voting stock of the registrant issued as of that date. The aggregate market value of the voting stock held by non-affiliates computed by reference to the closing price for the common stock as quoted by the Nasdaq Stock Market as of March 1, 2001 was approximately \$5,395,955,138.

DOCUMENTS INCORPORATED BY REFERENCE

Items 10 through 13 are incorporated by reference to eBay's Proxy Statement for the 2001 Annual Meeting of stockholders to be filed by April 30, 2001.

PART I

Item 1: *Business*

This Annual Report on Form 10-K contains forward-looking statements based on our current expectations about our company and our industry. You can identify these forward-looking statements when you see us using words such as “expect,” “anticipate,” “estimate” and other similar expressions. These forward-looking statements involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of the factors described in the “Risk Factors” section of Management’s Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this report. We undertake no obligation to publicly update any forward-looking statements for any reason, even if new information becomes available or other events occur in the future.

Corporate Background

eBay Inc. was formed as a sole proprietorship in September 1995, and was incorporated in California in May 1996. In March 1998, we reincorporated in Delaware and completed our initial public offering in September 1998. Our principal executive offices are located at 2145 Hamilton Ave., San Jose, California, 95125, and our telephone number is (408) 558-7400. When we refer to “we” or “eBay” in this Annual Report on Form 10-K, we mean the current Delaware corporation (eBay Inc.) and its California predecessor, as well as all of our consolidated subsidiaries. When we refer to “eBay.com”, we mean the U.S.-based dynamic pricing online trading platform located at www.ebay.com.

The Company

eBay owns and operates eBay.com, which, based upon the aggregate value of goods traded, is the world’s largest and most popular online marketplace. Our mission is to develop a global online trading platform that will help practically anyone buy or sell practically anything.

eBay pioneered online personal trading by developing a Web-based community in which buyers and sellers are brought together in an efficient and entertaining format to buy and sell items such as collectibles, automobiles, high-end or premium art items, jewelry, consumer electronics and a host of practical and miscellaneous items. The eBay dynamic pricing (i.e. auction-style) format permits sellers to list items for sale, buyers to bid on items of interest and all eBay users to browse through listed items. eBay’s service is fully automated, topically arranged, intuitive and easy to use.

As of March 1, 2001, through our wholly-owned and partially-owned subsidiaries and affiliates, we operated dynamic pricing online trading platforms in the United States, Germany, the United Kingdom, Australia, Japan, Canada, France, Austria, Italy and South Korea. In February 2001, we announced an agreement to acquire 100% of the outstanding stock of iBazar S.A., a leading provider of online trading services in Europe and Brazil. With the completion of this acquisition, currently scheduled for the second quarter of 2001, we expect to broaden our international reach in online trading to include Spain, the Netherlands, Belgium, Portugal, Sweden and Brazil. eBay also owns and operates Half.com, which provides an alternative, fixed-price format for trading books, recorded music, movies (VHS, DVD) and video games. Through our 65 percent owned subsidiary Billpoint Inc., we also facilitate online trading transactions by providing sellers and buyers with the necessary tools to conduct person-to-person credit card and electronic check payments safely over the Web.

From December 31, 1998 to December 31, 2000, the number of registered eBay users grew from approximately 2 million to approximately 22 million. eBay users listed over 79 million items for sale in more than 8,000 categories during the fourth quarter of 2000, up from 41 million items in the fourth quarter of 1999. This includes items listed on eBay.com, eBay’s international sites and items sold on Half.com. The aggregate value of goods sold, or gross merchandise sales, on the various eBay and Half.com sites in the fourth quarter of 2000, was approximately \$1.6 billion, up from \$901 million in the fourth quarter of 1999. In 2000, eBay users listed more than 264.7 million items and completed transactions with an aggregate value of more than \$5.4 billion.

eBay also owns and operates Butterfields Auctioneers (“Butterfields”) and Kruse International (“Kruse”), which provide traditional offline auction services for fine art, antiques and collectibles and collector cars, respectively.

Butterfields, established in 1865, is the largest auction house in the Western United States, with full-service galleries in San Francisco and Los Angeles and a regional office in Seattle.

Kruse is one of the world’s leading collector car auction companies and sold thousands of cars per year in more than 20 events. In addition to collector cars, the company has auctioned distinctive real estate, vintage aircraft, islands, zoos, railroads and three entire towns.

Industry Background

Growth of the Internet and Online Commerce

The Internet has emerged as a global medium enabling millions of people worldwide to share information, communicate and conduct electronic commerce transactions. According to Nua Internet Surveys, as of November 2000, more than 400 million people worldwide had access to the Internet either at home or work. And, according to Forrester Research, the total value of global e-commerce transactions in 2001 is expected to be more than \$1.2 trillion, up from approximately \$657 billion in 2000.

The Internet offers the first opportunity to create a compelling global business that overcomes the inefficiencies associated with traditional trading among buyers and sellers of all types. An Internet-based, centralized trading place offers the following benefits:

- facilitates buyers and sellers meeting, listing items for sale, exchanging information, interacting with each other and, ultimately, consummating transactions;
- allows buyers and sellers to trade directly, bypassing traditional intermediaries and lowering costs for both parties;
- is global in reach, offering buyers a significantly broader selection of goods to purchase and providing sellers the opportunity to sell their goods efficiently to a broader base of buyers;
- offers significant convenience, allowing trading at all hours and providing continuously updated information;
- fosters a sense of community through direct buyer and seller communication, thereby enabling interaction between individuals with mutual interests; and
- establishes fair market prices for items where no efficient market is in place (e.g. rare items, distressed and surplus goods).

The Opportunity of Online Trading

eBay’s online trading platform has historically offered the exchange of goods among buyers and sellers of all types, competing with classified advertisements, collectibles shows, garage sales, flea markets and other venues such as auction houses. As eBay’s service has evolved, its applicability has expanded to broader categories of items, and to a broader and more global user base. As a result, eBay’s product mix has shifted from primarily collectible items to practical everyday items, such as household goods, computers, consumer electronics and other items. With the shift to a broader product offering, its competition has also broadened, and now includes distributors, liquidators, retailers, import and export companies, catalog and mail order companies, and virtually all online and offline commerce participants (consumer-to-consumer, business-to-consumer, and business-to-business).

Many of these traditional trading forums are inefficient because:

- they often have a fragmented, regional nature making it difficult and expensive for buyers and sellers to meet, exchange information and complete transactions;

- they may offer a limited variety or breadth of goods;
- they often have high transaction costs; and
- they are often information inefficient, as buyers and sellers lack a reliable and convenient means of setting prices for sales or purchases.

The eBay Online Trading Platform

The core eBay online trading platform permits sellers to list items for sale, buyers to bid for and purchase items of interest and all eBay users to browse through listed items from any place in the world at any time. The eBay website offers buyers a large selection of new and used items that can be difficult and costly to find through traditional distribution channels and offers sellers one of the most efficient and vibrant online distribution channels available. The Half.com fixed price platform permits sellers to list books, recorded music, movies (VHS and DVD) and video games for sale, buyers to purchase items at a price pre-established by the seller, and all Half.com users to browse through listed items from any place at any time.

The eBay service was originally introduced in September 1995 to create an efficient forum for individuals to trade with one another. Since its beginning as a grassroots online trading community, eBay has primarily attracted buyers and sellers through word of mouth and by providing buyers and sellers a place to socialize, discuss topics of common interest and ultimately to trade goods with one another. The number of categories under which eBay users list goods for sale has grown from 10, when eBay was first introduced, to more than 8,000 as of December 31, 2000. The main categories on eBay.com currently include, antiques and art, books, movies, music, coins and stamps, collectibles, computers, dolls, dollhouses, jewelry, photo and electronics, pottery and glass, real estate, sports, toys and miscellaneous items (“everything else”). Specialty marketplaces have also been added to serve the specialized needs of buyers and sellers, for example eBay Motors was developed to serve the automotive marketplace, including vehicles, parts and accessories; eBay Premier was developed to leverage the premium art and collectibles marketplace in conjunction with Butterfields and Half.com is focused on providing a fixed-price trading environment, initially for books, music, videos and video games.

The principal reasons for eBay’s success to date are as follows:

Largest Online Trading Forum. Unlike other commerce trading forums, eBay has aggregated a critical mass of buyers, sellers and items listed for sale, which in turn has resulted in an extremely vibrant and robust trading environment. eBay sellers enjoy generally high sell-through or conversion rates and buyers enjoy an extensive selection of broadly priced goods and services. At December 31, 2000, eBay had over 22 million registered users, offered more than 8,000 product categories and listed more than 6 million items for sale in an auction-style format and more than 8 million items for sale in fixed-price format on Half.com.

Compelling Trading Environment. eBay has created a distinctive trading environment by utilizing entertaining pricing formats, establishing procedural rules and promoting community values that are designed to facilitate trade and communications between buyers and sellers. The trading environment’s efficiency is illustrated by the limited need for eBay to intervene or play a significant role in the trading process. The auction pricing format found on eBay creates a sense of urgency among buyers to bid for goods because of the uncertain future availability of unique items on the website. Similarly, by accepting multiple bids at increasing prices, the auction pricing format provides sellers a more efficient means of obtaining a fair market price for their products. While the dynamic and exciting auction format appeals to certain users and is particularly appropriate for unique and other hard-to-value items, many mass-market product categories are more effectively merchandised in a fixed price format, and certain users prefer the immediacy and convenience of a fixed price purchase. Our acquisition of Half.com in July 2000, and the implementation of our “Buy it Now” fixed price feature on eBay.com, have expanded our marketplace by attracting a new consumer demographic and accelerated the velocity of trading by reducing the length of time between listing an item and completing the transaction.

Trust and Safety Programs. eBay has developed a number of programs designed to make users more comfortable dealing with an unknown trading partner over the Web. eBay’s Feedback Forum encourages every

user to provide comments and feedback on other eBay users with whom they interact and offers user profiles that provide feedback ratings and incorporate user experiences. In addition, eBay's expanded SafeHarborTM program provides guidelines for trading, helps provide information to resolve user disputes, responds to reports of misuse of the eBay service and, if necessary, warns or suspends users who violate the terms of its user agreement. eBay's ongoing trust and safety initiatives, including user verification, credit card requirements for sellers, insurance, integrated escrow, authentication and methods to help keep previously suspended users from re-registering on eBay, are all intended to bolster eBay's reputation as a safe place to trade. eBay has also developed an extensive set of rules and guidelines designed to educate users and help implement its policy of prohibiting the sale of illegal or pirated items.

Cost-Effective, Convenient Trading. eBay allows its buyers and sellers to bypass traditionally expensive, regionally fragmented intermediaries and transact business on a 24 hour, seven days a week basis. Because sellers bypass costly intermediaries, they frequently have lower selling costs and an increased likelihood of finding buyers willing to pay the target price. Listing an item on eBay requires sellers to generally pay a nominal placement fee ranging from \$0.30 to \$3.30 and an additional success fee from 1.25% to 5% of the transaction value if the sale is successfully concluded. Certain categories, namely autos and real estate, have a different fee policy that consists of a \$25 and \$50 listing fee, respectively, and a \$25 success fee for autos and no success fee for real estate. Listing an item on Half.com is free; successful sellers are charged a commission equal to 15% of the final sale price at the time a buyer pays the seller as well as a shipping fee. As a result of these pricing policies, sellers can cost-effectively sell relatively inexpensive items that had previously been prohibitively expensive to list through most traditional trading forums. By allowing sellers to conveniently and easily reach a broad range of buyers, eBay also addresses the time-consuming, logistical inconvenience of individual selling. Buyers have access to a broad selection of items and avoid the need to pay expensive markups or commissions to intermediaries. The critical mass of items listed on eBay provides a mutual benefit for buyers and sellers allowing both to effectively determine an appropriate price for an item.

Strong Community Affinity. eBay believes that fostering direct interaction between buyers and sellers with similar interests has enabled it to create a loyal, active community of users. eBay has introduced a variety of features and services designed to strengthen this sense of community among eBay users. eBay facilitates communications between buyers and sellers by offering chat rooms, bulletin boards, threaded discussion boards, customer support assistance from its personnel or other eBay users and by providing "About Me" user pages. These community features encourage consumer loyalty and repeat usage.

Intuitive User Experience. The eBay trading platform is a fully automated, topically arranged, intuitive and easy-to-use online service that is available on a 24 hour, seven day a week basis. On the dynamic trading platform, a seller can list items for sale within minutes of completing a simple online form and buyers can submit bids for items quickly and easily. Buyers can easily search the millions of items listed by category or specific item. During the course of the transaction, bidders are notified by email of the status of their bids on a daily basis and are notified immediately if they are outbid. Sellers and successful bidders are automatically notified when a transaction is completed. To assist users further, eBay offers email customer support staffed on a seven day a week basis. On the Half.com fixed price platform, sellers can easily list items by simply entering the ISBN or UPC bar code number of their item, along with the item's condition and selling price. Half.com automatically adds descriptions and pictures to each listing, so sellers do not need to do it themselves. Buying at Half.com is similar to the shopping experience at other leading online retailers. Buyers can browse by category or search by title or artist/author. When they want to buy, they simply put items in their cart, enter their credit card number and check out. Customers can also see real-time price comparisons of new versions of the same item through an on-screen shopping agent.

eBay Strategy

eBay's objective is to build upon its position as the world's leading community-commerce model and the most compelling commerce platform on the Internet. Our vision is to help practically anyone buy or sell practically anything in the world. The key elements of eBay's strategy are to:

Broaden the eBay Trading Platform. eBay has pursued a multi-pronged strategy for growing the eBay platform in several dimensions: within existing product categories, across new product categories, through geographic expansion, both local and international, and through introduction of additional pricing formats such as fixed price sales. eBay targeted key product categories in its user programs and marketing activities. eBay has expanded and developed existing product categories by introducing category-specific bulletin boards and chat rooms, integrating category-specific content, advertising its service in targeted publications and participating in targeted trade shows. In addition, eBay broadened the range of users and added product categories, content, features and other services to meet this new user demand. The increasing number and importance of practical (as opposed to collectible) items on the site is illustrative of this broadened range. eBay has also broadened the range of products that it offers to facilitate trading on the site, including payment services, shipping services, authentication, appraisal, vehicle inspection and escrow services. In addition, eBay has successfully introduced two fixed-price formats through Half.com and the “Buy It Now” feature.

During 2000, a number of improvements intended to broaden the eBay trading platform were introduced, including:

- the acquisition of Half.com, a fixed-price, person-to-person trading website where buyers and sellers can trade used books, CDs, movies and video games at fixed prices that are less than the list price;
- the launch of eBay Motors in association with AutoTrader.com, which created the Internet’s largest auction-style website for consumers and dealers to buy and sell used cars;
- the launch of additional eBay Regional sites. In 2000, eBay launched eight regional sites to encourage the sale of items that are too bulky or expensive to ship, items of local interest and items that people prefer to view before purchasing;
- the launch of over 5,000 new categories that make it easier to find items in diverse categories;
- the launch of the eBay “Application Program Interface (API) and Developers Program”, which allows other companies to use eBay content to drive their own businesses. The API provides three basic benefits. First, it allows eBay to be fully integrated into independent sites across the Internet. A new site will be able to use the eBay commerce engine to power its business, eliminating time and expense from the start-up process. As a second benefit, the API will allow eBay and its commercial partners to more easily and rapidly add eBay’s services to new devices, such as wireless telephones and handheld computers. Finally, the new platform interface will improve the user experience by allowing more companies to provide services to eBay users;
- the introduction of Live Auctions technology on eBay Premier. Providing real-time bidding via the Internet, this new feature allows individuals to participate in the excitement of traditional live sales from auction house floors anywhere in the world;
- the launch of Electronic Checks as a new payment option. Electronic Check is the latest innovation in Internet-based payments, providing buyers and sellers with a means for faster transactions without returned checks, with no paperwork and no charge back risk. For eBay buyers, Electronic Check combines the convenience of paper checks with the safety, convenience and speed of electronic payments. For eBay sellers, Electronic Check is a cost-effective alternative to paper checks and credit cards where payment is guaranteed;
- the launch of eBay Anywhere, a comprehensive mobile strategy that aims to make eBay accessible from any Internet-enabled mobile device. From WAP mobile phones to the latest PDAs, eBay Anywhere brings together leading technology companies, mobile carriers, portals and hardware vendors with the goal of making eBay accessible to any user’s choice of handheld Internet device;
- the launch of a new category called eBay Real Estate, intended to make property transactions on eBay easier for buyers and sellers, and to provide a dedicated home for eBay’s emerging real estate marketplace.

Foster eBay Community Affinity. eBay continues to enhance what is already the largest and one of the most loyal online trading communities on the Web. By instilling a vibrant eBay community experience, eBay seeks to maintain a critical mass of frequent buyers and sellers with a vested interest in the eBay community. eBay believes that new community tools, such as About Me personal pages and threaded message boards will continue to contribute to the community vibrancy. eBay's trust and safety initiatives, including user verification, requirements for new sellers to have a credit card on file, insurance, integrated escrow, authentication and appraisal are intended to bolster eBay's reputation as a safe place to trade. Consistent with its desire to foster community, eBay has organized a charitable fund, known as the eBay Foundation, and involves the members of the eBay community in determining to which charitable purposes the eBay Foundation's funds will be applied. See "The eBay Service — Community Services."

Enhance Features and Functionality. eBay intends to continually update and enhance the features and functionality of the eBay and Half.com websites to ensure continuous improvement to the trading experience. During 2000, eBay added many new features and services to help buyers and sellers trade with greater ease, including a single login feature, smart search, counters for sellers, Highlight and Feature Plus!, integrated photo hosting, "List in Two Categories," a feature that allows users to cross merchandise their items in two categories simultaneously, a pre-approve bidder tool that gives sellers the ability to set up their own pre-qualification guidelines for bidders, and "Buy It Now," a feature that allows buyers to purchase items immediately and skip the auction process.

Expand Value-Added Services. In order to offer an end-to-end personal trading service, eBay provides a variety of "pre-trade" and "post-trade" services to enhance the user experience and make trading easier. "Pre-trade" services make listing items for sale easier and include photo hosting, authentication and seller productivity software. "Post-trade" services make transactions easier and more comfortable to consummate, such as payment facilitation, insurance, vehicle inspections, escrow, shipping and postage. eBay currently provides, or will provide, these services directly or through strategic partnerships with third parties.

Value-added services introduced during 2000 include:

- the launch of eBay Picture Services, powered by iPIX, which provides eBay users with an easy-to-use, robust set of imaging services that allow sellers to simply drag and drop images into image wells on the eBay Sell Your Item form. Users may also preview their images on the Sell Your Item form and have their images automatically resized and formatted for optimal viewing;
- the addition of Saturn and its retailers to provide a nationwide automobile inspection service. The new inspection service, developed and offered by Saturn, is now part of eBay Motors and AutoTrader.com's co-branded automobile site; and
- the integration of Keen.com, the first Live Answer Community™, into key areas of eBay's online trading platform. The integration is intended to make it more convenient for eBay's 22 million users to contact Keen.com's members and get live answers to questions on many topics, including trading and collectibles.

Continue to Develop United States and International Markets. eBay believes that the Internet provides a significant opportunity for the creation of efficient trading platforms in local, national and international markets and that over time, these platforms can be transformed into a seamless, truly global trading environment. eBay intends to take advantage of this opportunity by developing eBay for selected local, national and international markets and actively marketing and promoting these services. On the local level, eBay has already rolled out local trading for 60 geographic regions in the United States and has launched a similar regional service offering in Germany, the United Kingdom, Canada and Australia. The creation of regional trading sites makes it easier and more practical to buy and sell items of local interest and items too large, expensive or complex to effectively trade on a wider geographical level. eBay will continue to consider the addition of regional sites in U.S. and international markets that offer a critical mass of users and a significant electronic commerce opportunity. Internationally, eBay has introduced country-specific services for Canada, the United Kingdom, Australia, Germany, Japan, France, Austria, Italy and through the February

2001 acquisition of Internet Auction Company Ltd., South Korea. eBay believes that its user base already includes users located in over 200 countries.

eBay can choose from several strategies to enter new international markets, including building a user community solely through internal efforts, acquiring a company already in the local trading market or partnering with strong local companies. eBay has employed each of these strategies where appropriate, as follows:

- our presence in the United Kingdom, Canada, France, and Italy was built with local management teams and a combination of grass roots and online marketing programs;
- our presence in Germany was built primarily through the June 1999 acquisition of alando.de.ag, an existing German trading service;
- we entered into a joint venture with a subsidiary of one of the largest media companies in Australia to penetrate this market;
- in February 2000, we announced a relationship with NEC to jointly address the market in Japan. As part of that agreement, NEC agreed to purchase a 30% equity interest in eBay Japan;
- in February 2001, we acquired a majority ownership interest in Internet Auction Co. Ltd., South Korea's largest online trading service; and
- in February 2001, we announced an agreement to acquire 100% of iBazar S.A., Europe's largest online trading platform. iBazar has a leading presence in 7 of its 8 markets, which include France, Italy, Spain, Portugal, the Netherlands, Belgium, Brazil and Sweden.

The eBay Dynamic Pricing Format

The eBay dynamic pricing trading platform is a robust, Internet-based, centralized trading environment that facilitates buying and selling of a wide variety of items.

Registration. While any visitor to eBay can browse through the eBay service and view the items listed for sale, in order to bid for an item or to list an item for sale, buyers and sellers must first register with eBay. Users register by completing a short online form and thereafter can immediately bid for an item or list an item for sale. Users in Canada, Germany, Japan, Australia, the United Kingdom, France, Italy, Austria may instead register through country-specific home pages.

Buying on eBay. Buyers typically enter eBay through its home page, which contains a listing of product categories that allows for easy exploration of current items for sale. Bidders can search for specific items by browsing through a list of items within a category or subcategory and then "clicking through" to a detailed description for a particular item. Bidders also can search specific categories, interest pages or the entire database of item listings using keywords to describe the types of products in which they are interested. eBay's search engine will then generate a list of relevant items with links to the detailed descriptions. Each item is assigned a unique identifier so that users can easily search for and track specific items. Users also can search for a particular bidder or seller by name in order to review his or her item for sale and feedback history as well as search for products by specific region or search in the "Gallery" mode. Once a bidder has found an item of interest and registered with eBay, the bidder enters the maximum amount he or she is willing to pay at that time. In the event of competitive bids, the eBay service automatically increases bidding in increments based upon the then current highest bid for the item, up to the bidder's maximum price. As eBay encourages direct interaction between buyers and sellers, bidders wishing additional information about a listed item can contact the seller through email functionality. eBay believes that this interaction between bidders and sellers enhances the personal, one-on-one nature of trading on the Web and is an important element of the eBay experience. Once each bid is made, eBay sends a confirmation to the bidder via email, an outbid notice to the next highest bidder and automatically updates the item's auction status. During the course of the sale, eBay notifies bidders immediately via email if they are outbid. Bidders are not charged for making bids or purchases through eBay. In addition, buyers can also specify items of interest on a service called "Favorite Searches" (previously called "Personal Shopper") and receive automated email messages when these particular items are available for sale

on eBay. In November 2000, eBay implemented the “Buy it Now” feature. Sellers can choose to use the Buy It Now feature at the time of listing, which allows sellers to name a price at which they would be willing to sell the item to any buyer. Listings are run in the normal auction format, but will also feature a Buy It Now icon and price. Until the first bid is placed, or in the case of a reserve auction, until the reserve price is met, buyers have the option to buy the item instantly at the specified price without waiting for the listing to end.

Selling on eBay. Sellers registered with eBay can list a product for sale by completing a short online form or using “Mr. Lister,” “Auction Assistant” or third party tools that facilitate the listing of multiple items. The seller selects a minimum price for opening bids for the item and chooses whether the sale will last three, five, seven or ten days. Additionally, a seller may select a reserve price for an item, which is the minimum price at which the seller is willing to sell the item and is typically higher than the minimum price set for the opening bid. The reserve price is not disclosed to bidders. A seller can elect to sell items in individual item listings or, if he or she has multiple identical items, can elect to hold a “Dutch Auction.” For example, an individual wishing to sell 10 identical watches could hold 10 individual auctions or hold a Dutch Auction in which the 10 highest bidders would each receive a watch at the same price and all lower bids would be rejected. To be eligible to hold a Dutch auction, a seller must have a sufficiently high feedback rating and must have been a registered seller for at least 60 days. A seller may also specify that an auction will be a private auction. With this format, bidders’ e-mail addresses are not disclosed on the item screen or bidding history screen.

Throughout 2000, sellers generally paid a nominal placement fee to list items for sale — \$0.25 for an item listing with a minimum starting price of less than \$10.00; \$0.50 for a minimum starting price of \$10.00 to \$24.99; \$1.00 for a minimum starting price of \$25.00 to \$49.99; and \$2.00 for a minimum starting price of \$50.00 or more. As of January 31, 2001, listing fees were increased as follows — \$0.30 for an item listing with a minimum starting price of less than \$10.00; \$0.55 for a minimum starting price of \$10.00 to \$24.99; \$1.10 for a minimum starting price of \$25.00 to \$49.99; \$2.20 for a minimum starting price of \$50.00 to \$199.99; and \$3.30 for a minimum starting price of \$200 or more. By paying an additional \$0.50 for items with a starting price of \$0.01 to \$24.99 or \$1.00 for items with a starting price of \$25 or more, sellers can choose to have a reserve selling price, which establishes a minimum level at which they are obligated to sell the item. By paying incremental placement fees, sellers can have items featured in various ways. A seller can highlight his or her item for sale by utilizing a bold font for the item heading for an additional fee of \$2.00. A seller with a favorable feedback rating can have his or her auction featured as a “Featured Auction” for \$99.95, which allows the seller’s item to be rotated on the eBay home page, or as a “Featured Plus!” for \$19.95, which allows his or her item to appear in its category Featured Item section and in bidder’s search results, and the item may be selected for display in another area — the category index page Featured Items section. A seller can also include a description of the product. In addition, a seller can include a photograph in the item’s description if the seller posts the photograph on a website and provides eBay with the appropriate Web address. Items may be showcased in the Gallery section with a catalog of pictures rather than text. A seller who uses a photograph in his or her listing can have this photograph included in the Gallery section for \$0.25 or featured in the Gallery section for \$19.95. Certain categories of items, including real estate, automobiles and “Premier” have different pricing. A seller can choose to list his or her item with the “List in Two Categories” feature, which gives the item added visibility by listing it in two separate categories. The charge for “List in Two Categories” is double the insertion and optional feature fees (excluding home page featured). In addition, for \$0.10 a seller can choose to list his or her item for 10 days, the longest available duration. All pricing is subject to change.

How Transactions are Completed. When an auction ends, the eBay system validates if a bid exceeded the minimum price, and the reserve price if one has been set. If the sale was successful, eBay automatically notifies the buyer and seller via email and the buyer and seller can then consummate the transaction independent of eBay. At the time of the email notification, eBay generally charges the seller a success fee equal to 5% of the first \$25 of the purchase price, 2.5% of that portion of the purchase price from \$25.01 to \$1,000, and 1.25% of that portion of the purchase price over \$1,000. At no point during the process does eBay take possession of either the item being sold or the buyer’s payment for the item. Rather, the buyer and seller must independently arrange for the shipment of and payment for the item, with the buyer typically paying for

shipping. Under the terms of eBay's user agreement, if a seller receives one or more bids above the stated minimum or reserve price, whichever is higher, the seller is obligated to complete a transaction, although eBay has no power to force the seller or buyer to complete the transaction other than to suspend them from using the eBay service. In the event the buyer and seller are unable to complete the transaction and the seller notifies eBay, eBay credits the seller the amount of the success fee. When items that have a reserve price sell, sellers are credited the \$1.00 reserve fee. Invoices for placement fees, additional listing fees and success fees are sent via email to sellers on a monthly basis. All new sellers are required to have a credit card account on file with eBay. Sellers who pay by credit card are charged shortly after the invoice is sent.

Feedback Forum. eBay pioneered a feature to facilitate the establishment of reputations within its community by encouraging individuals to record comments about their trading partners on each transaction. Every registered eBay user has a feedback profile containing compliments, criticisms and other comments by users who have conducted business or interacted with the person. The Feedback Forum requires feedback to be related to specific transactions and provides an easy tool for them to match up transaction numbers with the user names of their trading partners. This information is recorded in a feedback profile that includes a feedback rating for the person and indicates comments from other eBay users who have interacted with that person over the past seven days, the past month, the past six months and beyond. A user who has developed positive reputations over time will have a color-coded star symbol displayed next to his or her user name to indicate the amount of positive feedback received by the user. eBay users may review a person's feedback profile to check on the person's reputation within the eBay community before deciding to bid on an item listed by that person or in determining how to complete the payment for and delivery of the item.

The terms of eBay's user agreement prohibit actions that would undermine the integrity of the Feedback Forum, such as a person's leaving positive feedback about himself or herself through other accounts or leaving multiple negative feedback for others through other accounts. The Feedback Forum system has several automated features designed to detect and prevent some forms of abuse. For example, feedback posting from the same account, positive or negative, cannot affect a user's net feedback rating (i.e., the number of positive postings, less the number of negative postings) by more than one point, no matter how many comments an individual makes. Furthermore, a user can only give feedback to his or her trading partners in completed transactions. Users who receive a sufficiently negative net feedback rating have their registrations suspended and are unable to bid on or list items for sale. eBay believes its Feedback Forum is extremely useful in overcoming initial user hesitancy when trading over the Internet, as it reduces the anonymity and uncertainty of dealing with an unknown trading partner. See "Risk Factors — We are subject to risks associated with information disseminated through our service."

Trust and Safety Initiatives. eBay developed a number of programs designed to make users more comfortable with dealing with an unknown trading partner over the Web. In addition to the Feedback Forum, eBay offers the SafeHarbor™ program, which provides guidelines for trading, helps provide information to resolve user disputes and responds to reports of misuses of the eBay service. eBay's SafeHarbor™ staff investigates users' complaints of possible misuse of eBay and take appropriate action, including issuing warnings to users or suspending users from bidding on or listing items for sale. Some of the complaints the SafeHarbor™ staff investigates include various forms of bid manipulation, malicious posting of negative feedback and posting illegal items for sale. The SafeHarbor™ group is organized into three areas; investigations, community watch and fraud prevention. The investigations group investigates reported trading infractions and misuse of eBay. The fraud prevention department provides information to assist users with disputes over the quality of the goods sold or potentially fraudulent transactions and, upon receipt of an officially filed, written claim of fraud from a user, will generally suspend the offending user from eBay. The community watch department investigates the listing of illegal, infringing or inappropriate items on the eBay site and violations of certain eBay policies. Upon receipt of a written claim of intellectual property infringement by the owner of the intellectual property, eBay will remove the offending item from eBay. Users who repeatedly infringe intellectual property rights are suspended. In addition, eBay has increased the number of personnel reviewing potentially illegal items. eBay's trust and safety initiatives, including user identity verification, insurance, integrated escrow and authentication, are intended to bolster eBay's reputation as a safe place to trade. See "Risk Factors — Our business may be harmed by fraudulent activities on our

website.” eBay has also partnered with Infoglide, a leading provider of similarity search technology, to help keep previously suspended users from re-registering on eBay. eBay has introduced a requirement that new sellers must provide a credit card or pass an identity verification check before being allowed to sell. The identify verification process is performed by Equifax.

What Can Be Purchased or Sold on eBay. The eBay service has grown from offering 10 product categories when it was first introduced in September 1995 to offering more than 8,000 categories as of December 31, 2000. As the number of product categories has grown, eBay periodically organizes the categories under different headings to reflect the major types of items currently listed. As of March 2001, these product categories were organized under the following headings:

Major Categories

- Antiques & Art
- Books
- Movies
- Music
- Business
- Clothing & Accessories
- Coins
- Stamps
- Collectibles
- Computers
- Network IT
- Dolls & Bears
- Home & Garden
- Jewelry, Gemstones

Specialty Sites

- Photo
- Electronics
- Pottery & Glass
- Real Estate
- Sports
- Tickets
- Travel
- Toys
- Hobbies & Crafts
- Everything Else
- eBay Motors
- eBay Premier
- Services for Business
- Half.com

Each major category has numerous subcategories. As of December 31, 2000, eBay offered a selection of over 6 million items, with the most popular items sold on eBay being those that are relatively standardized, well-represented with a photo (and therefore can be evaluated to some degree without a physical inspection), small and easily shipped and relatively inexpensive. As the eBay community grows and additional items are listed, eBay will continue to organize items for sale under additional categories to respond to the needs of the eBay community.

Community Services. Beyond providing a convenient means of trading, eBay has devoted substantial resources to building an online trading community, which eBay believes is one of the strongest on the Web. Key components of eBay’s community philosophy are maintaining an honest and open marketplace and treating individual users with respect. eBay offers a variety of community and support features that are designed to solidify the growth of the eBay community and to build eBay user affinity and loyalty such as announcement and bulletin boards, customer support boards as well as other topical or category-specific information exchanges.

eBay offers My eBay, which permits users to receive a report of their recent activity on eBay, including bidding activity, selling activity, account balances, favorite categories and recent feedback. Users with their own Web pages also can post links from the user’s page to eBay and to a list of items the user is selling on eBay. eBay also offers About Me, which offers users the opportunity to create their own personal home page free of charge on eBay using step-by-step instructions provided by eBay. The About Me home page can include personal information, items listed for sale, eBay feedback ratings, images and links to other favorite sites.

In addition, in June 1998, eBay donated 643,500 shares of common stock to the Community Foundation Silicon Valley, a tax-exempt donor-advised public charity, and established a fund known as the “eBay Foundation.” Through the Community Foundation Silicon Valley, the eBay Foundation sponsors programs including a recent program in which teachers travel abroad and share their experiences with their students. Since its inception, the eBay foundation has made million of dollars in grants to dozens of programs and

initiatives focusing on education and expanded access to technology. eBay also solicits user suggestions for worthwhile charities through the eBay website, where charity auctions and other unique promotions are held to support such causes

Customer Support. eBay devotes significant resources to providing personalized, timely customer service and support. eBay offers customer support on a seven day a week basis. Most customer support inquiries are handled via email, with customer email inquiries typically being answered within 24 hours after submission. In 2000, eBay continued its relationship with SatMetrix (formerly known as Customer Cast), an online customer satisfaction survey company, to help eBay understand and improve overall customer support. Overall customer satisfaction with eBay's support services has remained extremely high. eBay also offers an online tutorial for new eBay users. In 2000, eBay completed the relocation of all customer support personnel to its center in Salt Lake City, Utah.

The Half.com Fixed-Price Format

Half.com offers a fixed-price, online website to buy and sell high quality, previously owned goods at discounted prices. Unlike auctions, where the selling price is based on bidding, the seller fixes the price for items at the time an item is listed.

Registration. While any visitor to Half.com can browse through the site and view the items listed for sale, in order to buy an item or to list an item for sale, buyers and sellers must first register with Half.com. To register, visitors must provide their name, address, phone number and email address. To become a buyer, visitors must provide valid credit card information. To become a seller, visitors must have a valid credit card, and, for some sellers, Half.com will require bank account information, tax identification number or a social security number.

Buying on Half.com. Buying at Half.com is similar to the shopping experience at other leading on-line retailers. Shoppers can easily search for specific books, CDs, movies and video games or browse for items that are categorized and surrounded with product descriptions, reviews and artwork. Just like any online retail store, shoppers fill their shopping cart and check out with a credit card. Customers can also see real-time price comparisons of new versions of the same item through an on-screen shopping agent that shows prices from other Internet retailers.

Selling on Half.com. Sellers wishing to sell items on the Half.com site simply type in the ISBN or UPC bar code number, select the item's condition, confirm the sale price, and the item is immediately listed. Half.com automatically adds descriptions and pictures to each listing, so sellers do not need to do it themselves. There are no fees to list items on Half.com.

Until recently, a Seller could enter any price they wished — as long as it was less than half-off the original list price. To increase the selection of items available to buy and sell, especially with newly released and hard-to-find items, Half.com now allows sellers to list items above half price in each category

In an effort to help users price their products competitively, Half.com provides a suggested selling price. The suggested selling price for an item is calculated as a percentage of the best on-line retail price for a new copy of the item, depending on the quality of the item. The Half.com pricing recommendations as a percentage of the best online retail price are as follows:

<u>Condition</u>	<u>Suggested Percentage</u>
Like New	50%
Very Good	45%
Good	40%
Acceptable	35%

How transactions are completed. When a buyer selects an item for purchase, sellers are sent an email notifying them to ship the item. Once the seller confirms that the item is being shipped, the buyer's credit card is charged. At least once a month, sellers are sent a check from Half.com for all items sold during the previous period, less Half.com's 15% commission. Sellers also receive an allowance for shipping costs.

Buyer Protection Policy. Half.com reserves the right to suspend the membership of any Buyer or Seller that Half.com feels has attempted to commit fraud by misusing the Half.com Buyer Protection Policy for his or her own personal gain. Half.com also reserves the right to reduce a Seller's account balance, withdrawal from a Seller's ACH account or charge the Seller's credit card in order to recover damages related to fraud. In addition, abuse of this policy is a criminal offense and violators will be prosecuted to the fullest extent of the law.

Marketing

eBay's marketing strategy is to promote its brand and attract buyers and sellers to the eBay and Half.com services. To attract users, eBay historically has relied primarily on word of mouth and, to a lesser extent, on distribution or sponsorship relationships with high traffic websites. Today, eBay employs a variety of methods to promote its brand and attract potential buyers and sellers. Currently, eBay uses strategic purchases of online advertising to place advertisements in areas in which eBay believes it can reach its target audience. eBay also engages in a number of marketing activities in traditional media such as radio, broadcast and national and local TV advertising, print media, trade shows and other events. eBay also advertises in a number of category-specific publications. eBay continues to benefit from frequent and high visibility media exposure both nationally and locally. While eBay does not expect the frequency or quality of this type of publicity to continue, eBay promotes public relations through initiatives such as online eBay/special event tie-ins and executive speaking engagements. In March 1999, eBay expanded the scope of its preexisting strategic relationship with AOL. Under the amended agreement, eBay is given a prominent presence featuring it as the preferred provider of online trading services on AOL's proprietary services (both domestic and international), AOL.com, Digital Cities, ICQ, CompuServe (both domestic and international) and Netscape. eBay will pay \$75 million over the four-year term of the contract. eBay has developed a co-branded version of its service for each AOL property which prominently features each party's brand. AOL is entitled to all advertising revenue from the co-branded sites.

Operations and Technology

eBay has a scalable user interface and transaction processing system that is based on internally-developed proprietary software. The eBay system facilitates the sale process, including notifying users via email when they initially register for the service, when they place a successful bid, are outbid, place an item for sale, and when an auction ends. Furthermore, the system sends daily status updates to any active sellers and bidders regarding the status of their current auctions. The system maintains user registration information, billing accounts, current auctions and historical listings. All information is regularly archived for record-keeping and analysis purposes. Complete listings of all items for sale are generated regularly. The system regularly updates a text-based search engine with the titles and descriptions of new items, as well as pricing and bidding updates for active items. Every time an item is listed on the service, a listing enhancement option is selected by a seller, or an auction closes with a bid in excess of the seller-specified minimum bid, the system makes an entry into the seller's billing account. The system sends electronic invoices to all sellers via email on a monthly basis. For convenience, sellers may place a credit card account number on file with eBay, and their account balance is billed directly. Sellers that are new to the eBay service are now required to place a credit card account number on file. In addition to these features, the eBay service also supports a number of community bulletin board and chat areas where users and eBay customer support personnel can interact.

Half.com's technology is similarly scalable and multi-purpose. Also based on internally-developed software, the Half.com system facilitates the listing process and sale transaction for fixed price items in select categories including books, movies, music and video games. The Half.com system allows a seller to list inventory easily by providing the UPC, ISBN (or other similar product identification code), the price at which the seller desires to sell the item and the quality of the item. All other product information and descriptions are provided on the Half.com site. The Half.com system notifies a seller when a buyer places an offer, asks the seller to confirm within two days and, if the sale is accepted, ship the item within one day. The Half.com system further facilitates transactions by enabling a buyer's credit card or bank account to be debited (at the member's choice), and enabling a seller's bank account to be credited or sending the seller a check (again, at

the members' choice). Information on Half.com's systems is regularly archived for record-keeping and analysis purposes. Half.com is expecting to accelerate their ongoing effort to offer enhanced search features.

eBay's system has been designed around industry standard architectures and has been designed to reduce downtime in the event of outages or catastrophic occurrences. The eBay service provides 24 hour, seven day a week availability, subject to a maintenance period for a few hours during one night per week. eBay's system hardware is hosted at the Exodus and Abovenet facilities in Santa Clara, California, which provide redundant communications lines and emergency power backup. eBay's system consists of Sun database servers running Oracle relational database management systems with a mix of Sun and Hitachi storage and a suite of Pentium-based Internet servers running the Windows NT operating system. eBay uses Resonate Inc.'s load balancing systems and its own redundant servers to provide for fault tolerance. eBay has experienced periodic system interruptions, which it believes will continue to occur from time to time. These outages have stemmed from a variety of causes, including third-party hardware and software problems, human error and eBay proprietary software issues. The volume of traffic on eBay's website and the number of items being listed by users has been increasing continually, requiring eBay to expand and upgrade its technology, transaction processing systems and network infrastructure and add new engineering personnel. The process of upgrading and expansion is part of the routine maintenance and revision of the site. Hardware and software changes associated with the continuous revision have been capitalized in accordance with company policy and are included in computer equipment and software. Due to the speed of change and continuous nature of site revision, internal expenses often are judged to have useful lives of less than one year, or have been more appropriately classified as maintenance-related costs. As such, these costs are expensed as incurred. eBay may be unable to accurately project the rate or timing of increases, if any, in the use of the eBay service or expand and upgrade its systems and infrastructure to accommodate these increases in a timely manner. Any failure to expand or upgrade its systems at least as fast as the growth in demand for capacity could cause the website to become unstable and possibly cease to operate for periods of time. Unscheduled downtime could harm eBay's business.

eBay uses internally developed systems to operate its service and for transaction processing, including billing and collections processing. eBay must continually improve these systems to accommodate the level of use of its website. In addition, eBay may add new features and functionality to its services that would result in the need to develop or license additional technologies. eBay's inability to add additional software and hardware or to upgrade its technology, transaction processing systems or network infrastructure to accommodate increased traffic or transaction volume could have adverse consequences. These consequences include unanticipated system disruptions, slower response times, degradation in levels of customer support, impaired quality of the users' experience on its service and delays in reporting accurate financial information. eBay's failure to provide new features or functionality also could result in these consequences. eBay may be unable to effectively upgrade and expand its systems in a timely manner or integrate smoothly any newly developed or purchased technologies with its existing systems. These difficulties could harm or limit its ability to expand its business. See "Risk Factors — The inability to expand our systems may limit our growth and — System failures could harm our business."

eBay incurred \$4.6 million, \$24.8 million and \$55.9 million in product development expenses in 1998, 1999 and 2000, respectively. eBay anticipates that it will continue to devote significant resources to product development in the future as it adds new features and functionality to the eBay service. eBay capitalizes hardware and software associated with added features or functionality in accordance with company policy and includes such amounts in computer equipment and software. Internal expenses are often judged to have useful lives of less than one year, or have been more appropriately classified as maintenance-related costs. As such, these costs are expensed as incurred. The space in which eBay competes is characterized by rapidly changing technology, evolving industry standards, frequent new service and product announcements, introductions and enhancements and changing customer demands. Accordingly, eBay's future success will depend on its ability to adapt to rapidly changing technologies, adapt its services to evolving industry standards and to improve the performance, features and reliability of its service in response to competitive service and product offerings and evolving demands of the Internet. To address the need for rapid change as well as stability, eBay has undertaken a project to enhance its current architecture. The new architecture is intended to facilitate

continued stability, improved availability and load balancing. The proposed architecture should also improve search and listing functionality. This project, which is in the analysis and design phase, is expected to be ongoing, with phased rollouts through 2003. We plan to time these rollouts so as to minimize the impact to our community. The failure of eBay to adapt to these changes would harm eBay's business. In addition, the widespread adoption of new Internet, networking or telecommunications technologies or other technological changes could require substantial expenditures by eBay to modify or adapt eBay's services or infrastructure. See "Risk Factors — Our failure to manage growth could harm us, — We must keep pace with rapid technological change to remain competitive and — We need to develop new services, features and functions in order to expand."

Competition

Depending on the category of product, eBay currently or potentially competes with a number of companies serving particular categories of goods as well as those serving broader ranges of goods. The Internet is a new, rapidly evolving and intensely competitive area. eBay expects competition to intensify in the future as the barriers to entry are relatively low, and current and new competitors can launch new sites at a nominal cost using commercially available software. eBay's broad-based competitors include the vast majority of traditional department and general merchandise stores as well as emerging online retailers. These include most prominently: Wal-Mart, Kmart, Target, Sears, Macy's, JC Penney, Costco, Sam's Club as well as Amazon.com, Buy.com, AOL.com, Yahoo! shopping and MSN.

Antiques: Christie's, eHammer, Sotheby's/Sothebys.com

Coins & Stamps: Collectors Universe, Heritage, Numismatists Online, US Mint

Collectibles: Franklin Mint

Musical Instruments: Guitar Center, Harmony-Central.com, MARRS, MusicHotBid.com

Sports Memorabilia: Beckett's, Collectors Universe

Toys, Bean Bag Plush: Amazon.com, KB Toys, Toys.com

Premium Collectibles: Christies, DuPont Registry, Greg Manning Auctions, iCollector, Lycos/Skinner Auctions, Millionaire.com, Phillips (LVMH), Sotheby's, Sothebys.com

Automotive (used cars): Autobytel.com, AutoVantage.com, AutoWeb.com, Barrett-Jackson, CarOrder.com, CarPoint, Collectorcartraderonline.com, eClassics.com, Edmunds, CarsDirect.com, Hemmings, imotors.com, vehix.com, newspaper classifieds, used car dealers

Books, Movies, Music: Amazon.com, Barnes & Noble, Barnesandnoble.com, BigStar, Blockbuster, BMG Columbia House, CDNow, DVD Express, Warehouse, Alibris.com, Emusic.com, Bookfinders.com

Clothing: Bluefly.com, Dockers.com, FashionMall.com, The Gap, J. Crew, LandsEnd.com, The Limited, Macys, The Men's Wearhouse, Ross, 3Dshopping.com

Computers & Consumer Electronics: Best Buy, Buy.com, Circuit City, Compaq, CompUSA, Dell, Egghead, Fry's Electronics, Gateway, The Good Guys, IBM, MicroWarehouse, The Sharper Image, Shopping.com

Home & Garden: IKEA, Crate & Barrel, Home Depot, Garden.com, Pottery Barn, Ethan Allen, Frontgate, Lowes

Jewelry: Ashford.com, Mondera.com

Sporting Goods/Equipment: dsports.com, FogDog.com, Footlocker, Gear.com, golfclubexchange, MVP.com, PlanetOutdoors.com, Play It Again Sports, REI, Sports Authority, Sportsline.com

Tool/Equipment/Hardware: Home Depot, HomeBase, Amazon.com, Ace Hardware, OSH, Lowes

Business-to-Business: Ariba, BidFreight.com, BizBuyer.com, bLiquid.com, CloseOutNow.com, Commerce One, Concur Technologies, DoveBid, FreeMarkets, Oracle, PurchasePro.com, RicardoBiz.com, Sabre, SurplusBin.com, UnionStreet.com, Ventro, VerticalNet

Additionally, eBay faces competition from various online auction sites including: Amazon.com, the Fairmarket Auction Network (an auction network including Microsoft's MSN, Excite@Home, Dell Computer, ZD Net, Lycos and more than 100 others), First Auction, Surplus Auction, uBid, Yahoo! Auctions and a large number of other companies using an auction format for consumer-to-consumer or business-to-consumer sales. Overseas, we face competition from Yahoo! Auctions in most countries and from a large number of regional and national competitors in each country.

The principal competitive factors for eBay include the following:

- ability to attract buyers;
- volume of transactions and selection of goods;
- customer service; and
- brand recognition.

With respect to eBay's online competition, additional competitive factors are:

- community cohesion and interaction;
- system reliability;
- reliability of delivery and payment;
- website convenience and accessibility;
- level of service fees; and
- quality of search tools.

Some current and potential competitors have longer company operating histories, larger customer bases and greater brand recognition in other business and Internet spaces than eBay does. Some of these competitors also have significantly greater financial, marketing, technical and other resources. Other online trading services may be acquired by, receive investments from or enter into other commercial relationships with larger, well-established and well-financed companies. As a result, some of eBay's competitors with other revenue sources may be able to devote more resources to marketing and promotional campaigns, adopt more aggressive pricing policies and devote substantially more resources to website and systems development than we are able to. Increased competition may result in reduced operating margins, loss of market share and diminished value of our brand. Some of eBay's competitors have offered services for free, and others may do this as well. eBay may be unable to compete successfully against current and future competitors.

In order to respond to changes in the competitive environment, eBay may, from time to time, make pricing, service or marketing decisions or acquisitions that could harm its business. For example, eBay has implemented an insurance program that generally insures items up to a value of \$200, with a \$25 deductible, for users with a non-negative feedback rating at no cost to the user. New technologies may increase the competitive pressures by enabling our competitors to offer a lower cost service. Some Internet-based applications that direct Internet traffic to certain websites may channel users to trading services that compete with eBay.

Although eBay has established Internet traffic arrangements with several large online services and search engine companies, these arrangements may not be renewed on commercially reasonable terms. Even if these arrangements are renewed, they may not result in increased usage of its service. In addition, companies that control access to transactions through network access or Internet browsers could promote eBay's competitors or charge eBay substantial fees for inclusion.

The offline auction business is intensely competitive. Butterfields competes with two larger and better known auction companies, Sotheby's Holdings, Inc. and Christie's International plc, as well as numerous regional auction companies. To the extent that these companies increase their focus on the middle market properties that form the core of Butterfields' business or in the western United States, its business may suffer. Kruse is subject to competition from numerous regional competitors. In addition, competition with Internet-based auctions may harm the land-based auction business. Although Billpoint's business is new, several new companies have entered this space, including competitors who are offering free services and significant promotional incentives, and large companies, including banks and credit card companies, are also beginning to enter this space. Half.com competes directly with online retailers in its product categories such as Amazon.com which offers a directly competitive service, as well as with traditional sellers of used books, videos and CDs.

Employees

As of March 1, 2001, eBay had 1,927 full-time employees. eBay's future is substantially dependent on the performance of its senior management and key technical personnel, and its continuing ability to find and retain highly qualified technical and managerial personnel. See "Risk Factors — We are dependent on key personnel."

Issues Related to the Listing or Sale by Users of Unlawful Items

eBay has received in the past, and we anticipate we will receive in the future, communications alleging that certain items listed or sold through our service by its users infringe third-party copyrights, trademarks and tradenames or other intellectual property rights. Although eBay has actively sought to work with the content community to eliminate infringing listings on its website, some content owners have expressed the view that our efforts are insufficient. Content owners have been active in defending their rights against online companies, including eBay. An allegation of infringement of third-party intellectual property rights may result in litigation against eBay. Any such litigation could be costly for eBay, could result in increased costs of doing business through adverse judgment or settlement, could require eBay to change its business practices in expensive ways, or could otherwise harm its business. Litigation against other online companies could result in interpretations of the law that could also require eBay to change its business practices or otherwise increase its costs. See "Legal Proceedings" and "Risk Factors — We are subject to intellectual property and other litigation."

Fraudulent Activities on the eBay Website

eBay's future success will depend largely upon sellers reliably delivering and accurately representing their listed goods and buyers paying the agreed purchase price. eBay has received in the past, and anticipates that it will receive in the future, communications from users who did not receive the purchase price or the goods that were to have been exchanged. In some cases individuals have been arrested and convicted for fraudulent activities using eBay's website. While eBay can suspend the accounts of users who fail to fulfill their delivery obligations to other users, eBay does not have the ability to require users to make payments or deliver goods or otherwise make users whole other than through its limited insurance program. Other than through this program, eBay does not compensate users who believe they have been defrauded by other users. eBay also periodically receives complaints from buyers as to the quality of the goods purchased. Negative publicity generated as a result of fraudulent or deceptive conduct by users of its service could damage our reputation and diminish the value of our brand name. eBay expects to continue to receive requests from users requesting reimbursement or threatening or commencing legal action against us if no reimbursement is made. This sort of litigation could be costly for us, divert management attention, result in increased costs of doing business, lead to adverse judgments or could otherwise harm its business. See "Risk Factors — Our business may be harmed by fraudulent activities on our website."

Government Inquiries

On January 29, 1999, eBay received initial requests to produce certain records and information to the federal government relating to an investigation of possible illegal transactions in connection with its website.

eBay was informed that the inquiry includes an examination of its practices with respect to these transactions. eBay has provided further information in connection with this ongoing inquiry. In order to protect the investigation, the court has ordered that no further public disclosures be made with respect to the matter.

On March 24, 2000, Butterfields received a grand jury subpoena from the Antitrust Division of the Department of Justice requesting documents relating to, among other things, changes in Butterfields' seller commissions and buyer premiums and discussions, agreements or understandings with other auction houses, in each case since 1992. eBay believes this request may be related to a publicly reported criminal investigation of auction houses for price fixing. eBay has provided the information requested in the subpoena.

Should these or any other investigations lead to civil or criminal charges against eBay, we would likely be harmed by negative publicity, the costs of litigation, the diversion of management time and other negative effects, even if eBay ultimately prevails. eBay's business would suffer if it were not to prevail in any actions like these. Even the process of providing records and information can be expensive, time consuming and result in the diversion of management attention.

A large number of transactions occur on eBay's websites. eBay believes that government regulators have received a substantial number of consumer complaints about eBay which, while small as a percentage of its total transactions, are large in aggregate numbers. As a result, eBay has from time to time been contacted by various foreign, federal, state and local regulatory agencies and been told that they have questions with respect to the adequacy of the steps eBay takes to protect its users from fraud. eBay is likely to receive additional inquiries from regulatory agencies in the future, which may lead to action against it. eBay has responded to all inquiries from regulatory agencies by describing its current and planned antifraud efforts. If one or more of these agencies is not satisfied with eBay's response to current or future inquiries, the resultant investigations and potential fines or other penalties could harm its business.

eBay has provided information to the antitrust division of the Department of Justice in connection with an inquiry into its conduct with respect to "auction aggregators" including our licensing program and our recently settled lawsuit against Bidder's Edge. Should the division decide to take action against eBay, we would likely be harmed by negative publicity, the costs of the action, possible private antitrust lawsuits, the diversion of management time and effort and penalties we might suffer if we ultimately were not to prevail.

Privacy Policy

eBay believes that issues relating to privacy and the use of personal information relating to Internet users are becoming increasingly important as the Internet and its commercial use grow. eBay has adopted a detailed privacy policy that outlines how eBay uses information concerning its users and the extent to which other registered eBay users may have access to this information. Users must acknowledge and agree to this policy when registering for the eBay service. eBay does not sell or rent any personally identifiable information about its users to any third party; however, eBay does disclose information to sellers and winning bidders that contains the seller's and winning bidder's name, email address and telephone number. eBay also discloses certain personally identifiable information to its subsidiaries and business partners in connection with the provision of services by these entities. eBay also will disclose customer information in its possession (other than credit card information) to a law enforcement agency or member of the eBay's Verified Rights Owner program that requests this information in connection with a civil, criminal or regulatory investigation. eBay also uses information about its users for internal purposes in order to improve marketing and promotional efforts, to analyze website usage statistically, and to improve content, product offerings and website layout. eBay is a member of the TRUSTe program, a non-profit independent organization that audits websites' privacy statements and audits their adherence thereto.

New and Existing Regulation of the Internet

eBay is subject to the same federal, state and local laws as other companies conducting business on the Internet. Today there are relatively few laws specifically directed towards online services. However, due to the increasing popularity and use of the Internet and online services, many laws relating to the Internet are being debated at the state and federal levels (both in the U.S. and abroad) and it is possible that laws and

regulations will be adopted with respect to the Internet or online services. These laws and regulations could cover issues such as user privacy, freedom of expression, pricing, fraud, content and quality of products and services, taxation, advertising, intellectual property rights and information security. Applicability to the Internet of existing laws governing issues such as property ownership, copyrights and other intellectual property issues, taxation, libel, obscenity and personal privacy is uncertain. The vast majority of these laws were adopted prior to the advent of the Internet and related technologies and, as a result, do not contemplate or address the unique issues of the Internet and related technologies. Those laws that do reference the Internet, such as the Digital Millennium Copyright Act, are only beginning to be interpreted by the courts and their applicability and reach are therefore uncertain. In addition, numerous states, including the State of California, where our headquarters is located, have regulations regarding how “auctions” may be conducted and the liability of “auctioneers” in conducting such auctions. No final legal determination has been made with respect to the applicability of the California regulations to its business to date and little precedent exists in this area. Several states are considering imposing these regulations upon us or our users, which could harm our business. In addition, as the nature of the products listed by our users change, we may become subject to new regulatory restrictions.

Several states have proposed legislation that would limit the uses of personal user information gathered online or require online services to establish privacy policies. The Federal Trade Commission has also settled several proceedings regarding the manner in which personal information is collected from users and provided to third parties. Changes to existing laws or the passage of new laws intended to address these issues could directly affect the way we do business or could create uncertainty on the Internet. This could reduce demand for its services, increase the cost of doing business as a result of litigation costs or increased service delivery costs, or otherwise harm our business. In addition, because our services are accessible worldwide, and we facilitate sales of goods to users worldwide, foreign jurisdictions may claim that we are required to comply with their laws. For example, a French court has recently ruled that a U.S. website must comply with French laws regarding content. As we have expanded our international activities, we have become obligated to comply with the laws of the countries in which we operate. Laws regulating Internet companies outside of the United States are in many ways less favorable than those in the United States, giving greater rights to consumers, content owners and users or placing more extensive restrictions on our operations than exist in the U.S. Compliance may be more costly or may require us to change our business practices or restrict its service offerings relative to those in the United States. Our failure to comply with foreign laws could subject eBay to penalties ranging from fines to bans on our ability to offer our services. See “Risk Factors — There are many risks associated with our international operations.”

Item 2: *Properties*

On March 1, 2000, eBay entered into a five-year lease for approximately 460,000 square feet of which the online segment occupies approximately 190,000 square feet of general office facilities located in San Jose, California. Payments under this lease, which commenced during 2000, are based on a spread over the London Interbank Offering Rate (“LIBOR”) applied to the \$126.4 million cost of the facility funded by the lessor. eBay has an option to renew the lease for up to two five-year extensions subject to specific conditions. Under the terms of the lease agreement, eBay was required to place \$126.4 million of cash and investment securities as collateral for the term of the lease. The cash and investment securities are restricted as to their withdrawal from the third party trustee and are classified as long-term restricted cash and investments in the accompanying balance sheet.

eBay entered into two interest rate swaps on June 19 and July 20, 2000, totaling \$95 million, to reduce the impact of changes in interest rates on a portion of the floating rate operating lease for our facilities. The interest rate swaps allow eBay to receive floating rate receipts based on LIBOR in exchange for making fixed rate payments which effectively changes the interest rate exposure on our operating lease from a floating rate to a fixed rate on \$95 million of the total \$126.4 million operating lease.

The online segment leases an additional 140,000 square feet of office space. This office space is primarily for eBay’s customer call center in Utah and Half.com’s administrative offices in Pennsylvania. Office space for

the online segment's international subsidiaries is leased in Australia, England, Germany, Japan, Italy, Switzerland and France.

The offline segment owns facilities in California and Indiana with an aggregate of approximately 700,000 square feet. Of the 700,000 square feet, eBay is a majority interest holder in 187,000 square feet of office space and the sole owner of the remaining balance.

eBay believes that its existing facilities are adequate to meet its needs for the immediate future and future growth can be accommodated by leasing additional or alternative space.

Item 3: Legal Proceedings

On September 1, 1999, eBay was served with a lawsuit filed by Randall Stoner, on behalf of the general public, in San Francisco Superior Court (No. 305666). The lawsuit alleged that eBay violated Section 17200 of the California Business & Professions Code, a statute that relates to unfair competition, based upon the listing of "bootleg" or "pirate" recordings by eBay's users, allegedly in violation of California penal statutes relating to the sale of unauthorized audio recordings. The lawsuit sought declaratory and injunctive relief, restitution and legal fees. eBay filed a general demurrer which was sustained by the court with leave to amend. The plaintiff subsequently filed an amended complaint. eBay filed a motion for summary judgement. On November 7, 2000, eBay's motion for summary judgement was granted.

On December 10, 1999, eBay sued Bidder's Edge, Inc. in the United States District Court for the Northern District of California alleging trespass, unfair competition, violation of the computer fraud and abuse act, misappropriation, false advertising, trademark dilution, injury to business reputation, interference with prospective economic advantage, and unjust enrichment. On February 7, 2000, Bidder's Edge denied these claims and counterclaimed against eBay alleging that eBay violated the antitrust laws by monopolizing or attempting to monopolize a market, that eBay competed unfairly, and that eBay interfered with Bidder's Edge's contract with eBay magazine. Bidder's Edge sought treble damages, an injunction and its fees and costs. On May 24, 2000, the court granted us a preliminary injunction against the use by Bidder's Edge of robotic means to copy eBay's site. In February 2001, the parties settled this lawsuit. All claims by both parties were dismissed, and Bidder's Edge paid eBay an undisclosed amount.

On April 25, 2000, eBay was served with a lawsuit, *Gentry et.al. v. eBay, Inc. et.al*, filed in Superior Court in San Diego, California. The lawsuit was filed on behalf of a purported class of eBay users who purchased allegedly forged autographed sports memorabilia on eBay. The lawsuit claims eBay was negligent in permitting certain named (and other unnamed) defendants to sell allegedly forged autographed sports memorabilia on eBay. In addition, the lawsuit claims eBay violated Section 17200 and a section of the California Civil Code which prohibits "dealers" from selling sports memorabilia without a "Certificate of Authenticity." On January 26, 2001, the Court issued a ruling dismissing all claims against eBay in the lawsuit. The Court ruled that eBay's business falls within the safe harbor provisions of 47 USC 230, which grants internet service providers such as eBay with immunity from state claims based on the conduct of third parties. The Court also noted that eBay was not a "dealer" under California law and thus not required to provide certificates of authenticity with autographs sold over its site by third parties. All counts of the plaintiffs' suit were dismissed with prejudice as to eBay. Plaintiffs have appealed this ruling. We believe that we have meritorious defenses and intend to defend ourselves vigorously.

Other third parties have from time to time claimed and may claim in the future that eBay has infringed their past, current or future intellectual property rights. eBay may become more vulnerable to such claims as laws such as the Digital Millennium Copyright Act are interpreted by the courts. eBay expects that it will increasingly be subject to infringement claims as the number of services and direct competitors grow. These claims, whether meritorious or not, could be time-consuming, result in costly litigation, cause service upgrade delays, require expensive changes in our methods of doing business or could require eBay to enter into costly royalty or licensing agreements, if available. As a result, these claims could harm our business.

From time to time, eBay is involved in disputes that have arisen in the ordinary course of business. Management believes that the ultimate resolution of these disputes will not have a material adverse impact on eBay's financial position, results of operations or cash flows.

Item 4: *Submission of Matters to a Vote of Security Holders*

There were no submissions of matters to a vote of security holders during the fourth quarter ended December 31, 2000.

PART II

Item 5: Market for Registrant's Common Equity and Related Stockholder Matters

Price Range of Common Stock

eBay's common stock has been traded on The Nasdaq Stock MarketSM under the symbol "EBAY" since September 24, 1998. The following table sets forth the high and low sales prices of eBay's common stock for the periods indicated and are as reported on The Nasdaq Stock MarketSM. The stock quotes are adjusted to reflect the stock splits in 1999 and 2000.

	<u>High</u>	<u>Low</u>
Year Ended December 31, 1999		
First Quarter	\$ 88.69	\$27.67
Second Quarter	117.00	63.34
Third Quarter	80.50	35.14
Fourth Quarter	93.00	62.25
Year Ended December 31, 2000		
First Quarter	127.50	58.69
Second Quarter	93.88	48.56
Third Quarter	77.56	43.50
Fourth Quarter	70.25	26.75

As of March 1, 2001 there were approximately 1,500 stockholders of record of the eBay's common stock, although eBay believes that there is a significantly larger number of beneficial owners of its common stock.

Dividend Policy

eBay has never paid cash dividends on its stock, and anticipates that it will continue to retain any future earnings to finance the growth of its business.

Item 6: Selected Consolidated Financial Data

The following selected consolidated financial data should be read in conjunction with, and are qualified by reference to, the Consolidated Financial Statements and Notes thereto and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” appearing elsewhere in this report. The consolidated statement of income and the consolidated balance sheet data for the years ended December 31, 1996, 1997, 1998, 1999 and 2000, are derived from, and are qualified by reference to, the audited consolidated financial statements of eBay.

	Year Ended December 31,				
	1996	1997	1998	1999	2000
	(in thousands, except per share data)				
Consolidated Statement of Income Data:					
Net revenues	\$32,051	\$ 41,370	\$ 86,129	\$224,724	\$431,424
Cost of net revenues	<u>6,803</u>	<u>8,404</u>	<u>16,094</u>	<u>57,588</u>	<u>95,453</u>
Gross profit	<u>25,248</u>	<u>32,966</u>	<u>70,035</u>	<u>167,136</u>	<u>335,971</u>
Operating expenses:					
Sales and marketing	13,139	15,618	35,976	96,239	166,767
Product development	28	831	4,640	24,847	55,863
General and administrative	5,661	6,534	15,849	43,919	73,027
Payroll expense on employee stock options	—	—	—	—	2,337
Amortization of acquired intangibles . . .	—	—	805	1,145	1,433
Merger related costs	—	—	—	4,359	1,550
Total operating expenses	<u>18,828</u>	<u>22,983</u>	<u>57,270</u>	<u>170,509</u>	<u>300,977</u>
Income (loss) from operations	6,420	9,983	12,765	(3,373)	34,994
Interest and other income (expense), net . . .	<u>(2,607)</u>	<u>(1,951)</u>	<u>(703)</u>	<u>21,412</u>	<u>46,025</u>
Income before income taxes	3,813	8,032	12,062	18,039	81,019
Provision for income taxes	<u>(475)</u>	<u>(971)</u>	<u>(4,789)</u>	<u>(8,472)</u>	<u>(32,725)</u>
Net income	<u>\$ 3,338</u>	<u>\$ 7,061</u>	<u>\$ 7,273</u>	<u>\$ 9,567</u>	<u>\$ 48,294</u>
Net income per share(1):					
Basic	<u>\$ 0.20</u>	<u>\$ 0.14</u>	<u>\$ 0.07</u>	<u>\$ 0.04</u>	<u>\$ 0.19</u>
Diluted	<u>\$ 0.04</u>	<u>\$ 0.04</u>	<u>\$ 0.03</u>	<u>\$ 0.04</u>	<u>\$ 0.17</u>
Weighted average shares:					
Basic	<u>16,979</u>	<u>48,854</u>	<u>104,128</u>	<u>217,674</u>	<u>251,776</u>
Diluted	<u>90,119</u>	<u>169,550</u>	<u>233,519</u>	<u>273,033</u>	<u>280,346</u>
Supplemental Operating Data (unaudited):					
Number of registered users at end of period	41	341	2,181	10,006	22,472
Gross merchandise sales, in millions(2) . . .	\$ 7	\$ 95	\$ 745	\$ 2,805	\$ 5,422
Number of items listed, in millions	289	4,394	33,668	129,560	264,653

	December 31,				
	1996	1997	1998	1999	2000
	(in thousands)				
Consolidated Balance Sheet Data:					
Cash and cash equivalents	\$ 2,909	\$12,109	\$ 37,285	\$221,801	\$ 201,873
Short-term investments	—	—	40,401	181,086	354,166
Long-term investments	—	—	—	373,988	218,197
Restricted cash and investments	—	—	—	—	126,390
Working capital	(1,676)	(1,881)	72,934	372,266	538,022
Total assets	49,909	62,350	149,536	969,825	1,182,403
Long-term debt	19,709	16,307	18,361	15,018	11,404
Total stockholders' equity	6,600	9,722	100,538	854,129	1,013,760

- (1) See Note 2 of Notes to Consolidated Financial Statements for a description of the method used to compute basic and diluted net income per share, respectively.
- (2) Represents the aggregate sales prices of all goods for which an auction was successfully concluded (i.e., there was at least one bid above the seller's specified minimum price or reserve price, whichever is higher).

Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations

FORWARD LOOKING STATEMENTS

This document contains certain forward-looking statements that involve risks and uncertainties, such as statements of eBay's plans, objectives, expectations and intentions. When used in this document, the words "expects," "anticipates," "intends" and "plans" and similar expressions are intended to identify certain of these forward-looking statements. The cautionary statements made in this document should be read as being applicable to all related forward-looking statements wherever they appear in this document. Our actual results could differ materially from those discussed in this document. Factors that could cause or contribute to such differences include those discussed below.

Overview

We pioneered online person-to-person trading by developing a global online trading platform that will help practically anyone buy or sell practically anything. Our service permits sellers to list items for sale, buyers to bid on items of interest and all eBay users to browse through listed items in a fully-automated, topically-arranged, intuitive and easy-to-use online service that is available 24 hours a day, seven days a week. We have extended our online offerings to include regional and international trading, autos, "premium" priced items, and through our acquisition of Half.com and our recently introduced "Buy it Now" feature, we now offer fixed-price functionality. Additionally, Billpoint provides online billing and payment solutions. We also expanded into the traditional auction business, also called offline trading, with our acquisitions of Butterfields and Kruse.

Substantially all of our revenues come from fees and commissions associated with online and offline trading services. Online revenue is primarily derived from placement fees, success fees, commissions paid by sellers, and commissions paid by buyers for "premium" priced items. Sellers pay a nominal placement fee, and by paying additional fees, sellers can have items featured in various ways. Sellers also pay a success fee based on the final purchase price. In addition, we receive revenues from end-to-end service providers whose services increase the velocity of transactions to the site, revenues from commercial alliances designed to build out a category or other functions and from direct advertising which includes promotional payments from unrelated third parties. Although we expect these end-to-end, commercial alliance and direct advertising revenues to increase in the future, they are subject to considerable uncertainty. See "Risk Factors — Our revenue from end-to-end service providers, commercial alliances and advertising is subject to factors beyond our control." To date, online payment solutions provided by Billpoint and fixed price trading provided by Half.com have not made significant contributions to net revenues, although we expect Billpoint's and Half.com's revenues to increase in the future. Offline revenue is derived from a variety of sources including sellers' commissions, buyers' premiums, bidder registration fees, and auction-related services including appraisal and authentication. We expect that the online business will continue to represent the majority of revenue growth in the foreseeable future.

Acquisitions

Half.com

On July 11, 2000, we acquired Half.com. Half.com provides a fixed-price, person-to-person e-commerce site allowing people to buy and sell previously owned goods at discounted prices. In connection with the merger, we issued, or reserved for issuance, a total of approximately 5,484,000 shares of our common stock to Half.com's existing shareholders, option holders and warrant holders. The merger has been accounted for as a pooling-of-interests.

Internet Auction

On February 15, 2001, we acquired a majority interest in Internet Auction Co., Ltd., a South Korean company ("Internet Auction"). Internet Auction introduced person-to-person trading in Korea when it

launched in April 1998. Internet Auction is listed on the KOSDAQ and is expected to continue to trade on KOSDAQ.

We acquired 6,274,795 of the outstanding shares of Internet Auction, slightly more than 50%, at a fixed price of 24,000 Korean won per share or approximately \$120 million in the aggregate. The transaction will be accounted for using the purchase method of accounting and accordingly, the purchase price will be allocated to the tangible and intangible assets acquired and the liabilities assumed on the basis of their respective fair values on the acquisition date.

iBazar S.A.

On February 21, 2001, we signed a binding agreement to acquire iBazar S.A. (iBazar). iBazar is based in Paris and introduced online, person-to-person trading in France when it launched in October 1998. Currently, iBazar has websites in Belgium, Brazil, France, Italy, the Netherlands, Portugal, Spain, and Sweden.

As consideration for 100% of the outstanding shares of iBazar, we will issue approximately 2,250,000 shares of our common stock, subject to a minimum valuation of approximately \$66 million and a maximum valuation of approximately \$112 million, based on the value of our stock at closing. The acquisition will be accounted for as a purchase business combination and is subject to various regulatory approvals.

Results of Operations

The following table sets forth, for the periods presented, certain data from our consolidated statements of income as a percentage of net revenues. The information contained in the table below should be read in conjunction with the Consolidated Financial Statements and Notes thereto included elsewhere in this report.

	<u>Year Ended December 31,</u>		
	<u>1998</u>	<u>1999</u>	<u>2000</u>
Net revenues	100.0%	100.0%	100.0%
Cost of net revenues	<u>18.7</u>	<u>25.6</u>	<u>22.1</u>
Gross profit	<u>81.3</u>	<u>74.4</u>	<u>77.9</u>
Operating expenses:			
Sales and marketing	41.8	42.8	38.7
Product development	5.4	11.1	12.9
General and administrative	18.4	19.5	16.9
Payroll expense on employee stock options	—	—	0.5
Amortization of acquired intangibles	0.9	0.5	0.3
Merger related costs	<u>—</u>	<u>1.9</u>	<u>0.4</u>
Total operating expenses	<u>66.5</u>	<u>75.8</u>	<u>69.7</u>
Income/(loss) from operations	14.8	(1.4)	8.2
Interest and other income, net	2.2	10.6	10.7
Interest expense	<u>(2.5)</u>	<u>(1.0)</u>	<u>(0.8)</u>
Income before income taxes and minority interest	14.5	8.2	18.1
Provision for income taxes	(5.6)	(3.8)	(7.6)
Minority interest in consolidated companies	<u>(0.5)</u>	<u>(0.1)</u>	<u>0.7</u>
Net income	<u>8.4%</u>	<u>4.3%</u>	<u>11.2%</u>

It is difficult for us to forecast revenues or earnings accurately, and the operating results in one or more future quarters may fall below the expectations of securities analysts or investors. Although accurate revenue forecasts are difficult, we have begun to recognize the seasonal nature of our business because many of our users reduce their activities on our website during the Thanksgiving and Christmas holidays and with the onset of good weather. We have historically experienced our strongest quarter of online growth in our first fiscal quarter, although our shift to more “practical” items may cause our seasonal patterns to look more like a typical retailer. Both Butterfields and Kruse have significant quarter-to-quarter variations in their results of

operations depending on the timing of auctions and the availability of high quality items from large collections and estates. Butterfields typically has its best operating results in the traditional fall and spring auction seasons and has historically incurred operating losses in the first and third quarters. Kruse typically sees a seasonal peak in operations in the third quarter. Seasonal or cyclical variations in our business may become more pronounced over time and may harm our results of operations in the future.

Due to the inherent difficulty in forecasting net revenues, it is also difficult to forecast income statement expense categories as a percentage of net revenues. Quarterly and annual income statement expense categories as a percentage of net revenues may be significantly different from historical or projected rates. As a general note, we expect costs to increase in absolute dollars across all income statement categories.

To a large extent, the changes in the consolidated results of operations for the periods presented are due to the growth of the online business, which will be the primary focus of our year-over-year comparisons.

Net Revenues

We derive revenue from a variety of sources including: listing, success and featured item fees, end-to-end services, commercial alliances, sponsorships and other advertising. In addition, we derive commissions and rental income from our traditional offline auction operations. Our net revenues increased from \$86.1 million to \$224.7 million for the years ended December 31, 1998 and 1999 and further increased to \$431.4 million in the year ended December 31, 2000. The successive year-over-year growth from 1998 through 2000 was predominantly the result of increased use of our website, reflected in the growth in the number of registered users, listings and gross merchandise sales. We expect that future revenue growth will be largely driven by the growth of online services including end-to-end services, commercial alliance revenues and direct advertising.

The Securities and Exchange Commission issued Staff Accounting Bulletin (“SAB”) No. 101, “Revenue Recognition in Financial Statements.” As it relates to eBay, SAB 101 requires that listing and featured item fee revenue be recognized ratably over the estimated period of the auction. We implemented SAB 101 in the first quarter of 2000, and the effect was insignificant.

Cost of Net Revenues

Cost of net revenues for online operations consists primarily of costs associated with customer support and site operations. The costs included are compensation, employee and facilities costs for customer support and site operations personnel, ISP connectivity charges and depreciation on site equipment. Cost of net revenues in traditional auction operations primarily includes compensation for auction, appraisal, and customer support personnel and direct auction costs, such as event site rental. Cost of net revenues increased from \$16.1 million or 18.7% of net revenues to \$57.6 million or 25.6% of net revenues for the years ended December 31, 1998 and 1999 and further increased in absolute dollars but decreased as a percentage of sales to \$95.5 million or 22.1% of net revenues in the year ended December 31, 2000. The successive year-over-year growth from 1998 through 2000 was due almost entirely to our online business, including our international operations, as well as our acquisition of Billpoint in 1999 and Half.com in 2000. The increase in absolute dollars in expenditures for the online service resulted from the continued development and expansion of our customer support and site operations departments, depreciation of the equipment required for site operations, software licensing fees and ISP connectivity charges. The decrease in cost of net revenues as a percentage of net revenue from 1999 to 2000 resulted from cost management in customer support and site operations and increases in higher gross margin businesses such as autos and end-to-end trading solutions. As a result of these efficiencies, we expect the cost of net revenues to increase in absolute dollars but decrease as a percentage of net revenues in 2001.

Sales and Marketing

Our sales and marketing expenses for both the online and traditional auction businesses are comprised primarily of compensation for our sales and marketing personnel, advertising, tradeshow and other promotional costs, employee and facilities costs. Sales and marketing expenses increased from \$36.0 million or 41.8% of net revenues to \$96.2 million or 42.8% of net revenues for the years ended December 31, 1998 and 1999 and

further increased in absolute dollars but decreased as a percentage of sales to \$166.8 million or 38.7% of net revenues in the year ended December 31, 2000. The successive year-over-year growth from 1998 through 2000 was primarily the result of growth in online and traditional advertising, including expenses for various marketing agreements, personnel related costs, costs associated with the use of outside services and consultants and miscellaneous user and promotional costs.

Online sales and marketing expenses are expected to increase in absolute dollars for 2001 as we plan to build the eBay brand more broadly. We expect to build our brand further with continued advertising impressions delivered under the strategic alliances with America Online (“AOL”), Autotrader.com and GO.com (a wholly owned subsidiary of the Walt Disney Company) an increase in mass media advertising and the expansion of international advertising. Sales and marketing expenses in the traditional auction businesses are expected to remain comparable with historical levels.

Product Development

Product development expenses consist primarily of compensation for our product development staff, payments to outside contractors, depreciation on equipment used for development, employee and facilities costs. Our product development expenses increased from \$4.6 million or 5.4% of net revenues to \$24.8 million or 11.1% of net revenues for the years ended December 31, 1998 and 1999 and further increased to \$55.9 million or 12.9 % of net revenues in the year ended December 31, 2000. The successive year over year growth from 1998 through 2000 was primarily the result of an increase in personnel-related costs as we significantly increased the size of our product development staff, expenses related to contractors and consultants employed within product development departments, and maintenance and depreciation for equipment used in research and development. The year-over-year increase also resulted from the addition of product development operations at Billpoint in 1999 and Half.com in 2000 including a one-time, stock-based compensation expense at Half.com resulting from the acquisition. Product development expenses are expected to increase in absolute dollars during future periods primarily from personnel additions, the continued impact of Billpoint and Half.com product development, additional depreciation costs as we continue to purchase equipment to improve and expand operations both domestically and internationally and expected amortization costs associated with the phased rollout of our next generation three-tier architecture.

General and Administrative

General and administrative expenses consist primarily of compensation for personnel and, to a lesser extent, fees for external professional advisors, provisions for doubtful accounts, employee and facilities costs. Our general and administrative expenses increased from \$15.8 million or 18.4% of net revenues to \$43.9 million or 19.5% of net revenues for the years ended December 31, 1998 and 1999 and increased in absolute dollars but decreased as a percentage of sales to \$73.0 million or 16.9% of net revenues in the year ended December 31, 2000. The year-over-year increases resulted from growth in personnel-related expenses in order to meet the demands of our expanding business, including operations in new countries and the integration of new businesses, fees for professional services, employee and facilities costs. We expect that general and administrative expenses will increase in absolute dollars in future periods as we continue to invest in the infrastructure that is necessary for our business.

Payroll Expense on Employee Stock Options

We are subject to employer payroll taxes on employee exercises of non-qualified stock options. These employer payroll taxes are recorded as a charge to operations in the period such options are exercised and sold based on actual gains realized by employees. Our quarterly results of operations and cash flows could vary significantly depending on the actual period that the stock options are exercised by employees and, consequently, the amount of employer payroll taxes assessed.

Amortization of Acquired Intangible Assets

From time to time we have purchased, and expect to continue purchasing, assets or businesses in order to maintain our leadership role in online trading. These purchases may result in the creation of intangible assets and lead to a corresponding increase in the amortization in the related periods. Our amortization of acquired intangible assets increased in absolute dollars from \$805,000 or 0.9% of net revenues to \$1.1 million or 0.5% of net revenues for the years ended December 31, 1998 and 1999 and further increased in absolute dollars to \$1.4 million or 0.3% of net revenues in the year ended December 31, 2000. We expect the amortization of intangible assets to increase in 2001 due to our recent acquisition of Internet Auction in Korea and our agreement to acquire iBazar S.A. Both acquisitions will be accounted for as purchase business combinations.

Merger-related Costs

In 1999, eBay incurred direct merger related transaction costs of \$4.4 million which were primarily related to the acquisitions of Billpoint, Butterfields, Kruse and alando.de.ag. In 2000, eBay incurred direct merger transaction costs of \$1.6 million primarily associated with the acquisition of Half.com. There were no comparable expenses for the same period in 1998. As opportunities present themselves, eBay may continue to acquire new companies; such acquisitions could lead to additional direct and indirect expenses which could negatively affect eBay's results of operations.

Interest and Other Income, Net

Interest and other income, net consists of interest earned on cash, cash equivalents, and investments offset by foreign exchange gains or losses. Our interest and other income, net increased from \$1.8 million or 2.2% of net revenues to \$23.8 million or 10.6% of net revenues for the years ended December 31, 1998 and 1999 and increased to \$46.3 million or 10.7% of net revenues in the year ended December 31, 2000. The year-over-year increases resulted from interest earned on cash, cash equivalents and investments. We expect interest and other income will continue to exceed interest expense in 2001.

Provision for Income Taxes

Our effective federal and state income tax rates were 39.7%, 47.0%, and 40.4% in the years ended December 31, 1998, 1999 and 2000, respectively. The tax rates in 1998 and 1999 include the effects of our acquisitions. Additionally, we receive tax deductions for gains realized by employees on the exercise of non-qualified stock options for which the benefit is recognized as a component of paid-in capital. We have provided for a valuation allowance on the deferred tax assets relating to these stock option deductions.

Prior to the acquisition by eBay in 1999, Butterfields was taxed as an S Corporation. In connection with the acquisition, Butterfields' status as an S Corporation was terminated, and Butterfields became subject to federal and state income taxes. The supplemental pro forma financial information presented in the financial statements includes an increase to the provisions for income taxes based upon a combined federal and state tax rate. This rate approximates the statutory tax rate that would have been applied if Butterfields were taxed as a C Corporation prior to the acquisition.

Stock-Based Compensation

In connection with granting certain stock options from May 1997 through May 1999, we recorded aggregate unearned compensation totaling \$13.1 million, which is being amortized over the four-year vesting period of the options. In connection with certain stock options granted between July 1999 and March 2000 by companies that we subsequently acquired, we recorded unearned compensation totaling \$4.9 million. Of the total unearned stock compensation, approximately \$3.1 million, \$4.8 million and \$7.1 million was amortized in 1998, 1999 and 2000, respectively. Of the amortization in 2000, approximately \$4.8 was related to the acquisition of Half.com. We expect additional amortization of unearned stock compensation as a result of our acquisition of Internet Auction and potential acquisition of iBazar S.A.

Liquidity and Capital Resources

Since inception, eBay has financed operations primarily from net cash generated from operating activities. We obtained additional financing from the sale of preferred stock and warrants, proceeds from the exercise of those warrants, proceeds from the exercise of stock options, and proceeds from our initial and follow-on public offerings.

Net cash provided by operating activities was \$6.0 million in 1998, \$62.9 million in 1999 and \$100.1 million in 2000. Net cash provided by operating activities resulted primarily from our net income before non-cash charges for depreciation and amortization, and changes in accrued expenses offset by changes in accounts receivable and other assets.

Net cash used in investing activities was \$53.0 million in 1998, \$603.4 million in 1999, and \$206.1 million in 2000. The primary use for invested cash in the periods presented was purchases of investments, property, and equipment.

Net cash provided by financing activities was \$72.2 million in 1998, \$725.0 million in 1999, and \$86.0 million in 2000. We remained cash flow positive from financing activities primarily due to our public offering in 1998 and our subsequent follow-on offering in 1999. To a lesser extent, financing activities included the sale of common stock under employee benefit plans. In 2000, net cash provided by financing activities primarily resulted from the issuance of common stock to third parties by our subsidiaries.

We had no material commitments for capital expenditures at December 31, 2000, but expect such expenditures to approximate \$86.0 million during 2001 without taking into account any acquisitions. Of the \$86.0 million, approximately \$20.0 million has been committed for capital expenditures relating to hardware and software for the development of our new architecture. The remaining balance will be used primarily for computer equipment, furniture and fixtures and leasehold improvements. We also have total minimum lease obligations of \$43.9 million under certain noncancellable operating leases and notes payable obligations of \$26.7 million through August 2023. Under our agreement with AOL, we will pay AOL \$75 million over the four-year term of the contract. To date, we have paid \$37.5 million on the contract. In February 2000, we signed an agreement with GO.com. In consideration for this agreement, we will pay a minimum of \$30 million to GO.com over the four-year term. In 2001, Disney announced that it was dissolving GO.com; consequently, eBay is currently in the process of renegotiating new contract terms with Disney.

We believe that existing cash, cash equivalents and investments, and any cash generated from operations will be sufficient to fund our operating activities, capital expenditures and other obligations for the foreseeable future. However, if during that period or thereafter we are not successful in generating sufficient cash flow from operations or in raising additional capital when required in sufficient amounts and on terms acceptable to us, our business could suffer.

Recent accounting pronouncements

In June 1998, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 133, “Accounting for Derivatives and Hedging Activities.” SFAS No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. In June 1999, the FASB issued SFAS No. 137, “Accounting for Derivative Instruments and Hedging Activities — Deferral of the Effective Date of FASB Statement No. 133,” which deferred the effective date until the first fiscal year ending on or after June 30, 2000. In June 2000, the FASB issued SFAS Statement No. 138, “Accounting for Certain Derivative Instruments and Certain Hedging Activities—an Amendment of SFAS 133.” SFAS No. 138 amends certain terms and conditions of SFAS 133. SFAS 133 requires that all derivative instruments be recognized at fair value as either assets or liabilities in the statement of financial position. The accounting for changes in the fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. We will adopt SFAS No. 133, as amended, in our quarter ending March 31, 2001. Upon adoption, the cumulative effect to net income and other comprehensive income of this

change in accounting method is a gain of approximately \$650,000 and a loss of approximately \$2.6 million, respectively, net of tax.

In July 2000, the Emerging Issues Task Force (“EITF”) reached a consensus with respect to EITF Issue No. 99-19, “Reporting Revenue Gross as a Principal versus Net as an Agent.” EITF 99-19 addressed whether a company should report revenue based on the gross amount billed to a customer because it has earned revenue from the sale of the goods or services or the net amount retained (that is, the amount billed to the customer less the amount paid to a supplier) because it has earned a commission or fee. We adopted EITF 99-19, and such adoption did not have a material impact on its consolidated financial statements.

In March 2000, the EITF reached a consensus on EITF Issue No. 00-14, “Accounting for Certain Sales Incentives.” This consensus provides guidance on the recognition, measurement, and income statement classification of sales incentives which are offered voluntarily by a vendor without charge to customers that can be used in, or that are exercisable by a customer as a result of, a single exchange transaction. We evaluated the provisions of the guidance in conjunction with our policies and concluded that we are in compliance with this pronouncement.

In July 2000, the EITF issued EITF Issue No. 00-15, “Classification in the Statement of Cash Flows of the Income Tax Benefit Realized by a Company upon Employee Exercise of a Non-qualified Stock Option.” EITF 00-15 addresses the cash flow statement presentation of the tax benefit associated with the exercise of nonqualified stock options. We receive an income tax deduction for the difference between the exercise price and the market price of a nonqualified stock option upon exercise by the employee. EITF 00-15 concludes that the income tax benefit realized by us upon employee exercise should be classified in the operating section of the cash flow statement. The EITF is effective for all quarters ending after July 20, 2000. We adopted EITF 00-15, and such adoption did not have a material impact on our consolidated financial statements.

In July 2000, the EITF issued EITF Issue No. 00-16, “Recognition and Measurement of Employer Payroll Taxes on Employee Stock-Based Compensation.” This Issue addresses how an entity should account for employer payroll taxes on stock-based compensation under Accounting Principles Board Opinion No. 25, “Accounting for Stock Issued to Employees,” and SFAS No. 123, “Accounting for Stock-Based Compensation.” This Issue addresses our timing for recognizing our payroll tax liability and requires that this liability be recognized when the tax obligation is due and payable. We adopted EITF 00-16 effective July 31, 2000. Such adoption did not have a material impact on our consolidated financial statements.

Risk Factors that may Affect Results of Operations and Financial Condition

The risks and uncertainties described below are not the only ones facing eBay. Additional risks and uncertainties not presently known to us or that we currently deem immaterial also may impair our business operations. If any of the following risks or such other risks actually occur, our business could be harmed.

We have a limited operating history

Our company was formed as a sole proprietorship in September 1995 and was incorporated in May 1996. We have only a limited operating history on which you can base an evaluation of our business and prospects. As an online commerce company still relatively early in our development, we face substantial risks, uncertainties, expenses and difficulties. To address these risks and uncertainties, we and our subsidiaries must do the following:

- maintain and increase our number of registered users, items listed on our service and completed sales;
- expand into new areas;
- maintain and grow our website and customer support operations at a reasonable cost;
- continue to make trading through our service safer for users;
- maintain and enhance our brand;
- continue to develop and upgrade our technology and information processing systems;

- continue to enhance and expand our service to meet the changing requirements of our users;
- provide superior customer service;
- remain attractive to our commercial partners;
- respond to competitive developments; and
- attract, integrate, retain and motivate qualified personnel.

We may be unable to accomplish one or more of these goals, which could cause our business to suffer. In addition, accomplishing one or more of these goals might be very expensive, which could harm our financial results.

Our operating results may fluctuate

Our operating results have varied on a quarterly basis during our operating history. Our operating results may fluctuate significantly as a result of a variety of factors, many of which are outside our control. Factors that may affect our quarterly operating results include the following:

- our ability to retain an active user base, to attract new users who list items for sale and who purchase items through our service and to maintain customer satisfaction;
- our ability to keep our website operational and to manage the number of items listed on our service;
- the amount and timing of operating costs and capital expenditures relating to the maintenance and expansion of our business, operations and infrastructure;
- foreign, federal, state or local government regulation, including investigations prompted by items improperly listed or sold by our users;
- the introduction of new sites, services and products by us or our competitors;
- volume, size, timing and completion rate of trades on our websites;
- consumer confidence in the security of transactions on our websites;
- our ability to upgrade and develop our systems and infrastructure to accommodate growth;
- technical difficulties or service interruptions;
- our ability to attract new personnel in a timely and effective manner;
- our ability to retain key employees in both our online businesses and our acquisitions;
- our ability to successfully integrate and manage our acquisitions;
- our ability to successfully expand our product offerings involving fixed price trading;
- the ability of our land-based auction businesses to acquire high quality properties for auction;
- the timing, cost and availability of advertising in traditional media and on other websites and online services;
- the timing of payments to us and of marketing and other expenses under existing and future contracts;
- consumer trends and popularity of some categories of collectible items;
- the success of our brand building and marketing campaigns;
- the level of use of the Internet and online services;
- increasing consumer acceptance of the Internet and other online services for commerce and, in particular, the trading of products such as those listed on our websites; and

- general economic conditions and economic conditions specific to the Internet and e-commerce industries.

Our limited operating history and growing competition make it difficult for us to forecast the level or source of our revenues or earnings accurately. We believe that period-to-period comparisons of our operating results may not be meaningful, and you should not rely upon them as an indication of future performance. We do not have backlog, and almost all of our net revenues each quarter come from transactions for items that are listed and sold during that quarter. Our operating results in one or more future quarters may fall below the expectations of securities analysts and investors. In that event, the trading price of our common stock would almost certainly decline.

Our failure to manage growth could harm us

We currently are experiencing a period of expansion in our headcount, facilities and infrastructure, and we anticipate that further expansion will be required to address potential growth in our customer base and number of listings as well as our expansion into new geographic areas, types of goods and alternative methods of sale. This expansion has placed, and we expect it will continue to place, a significant strain on our management, operational and financial resources. The areas that are put under strain by our growth include the following:

- *The Websites.* We must constantly add new hardware, update software and add new engineering personnel to accommodate the increased use of our and our subsidiaries' websites and the new products and features we are regularly introducing. This is expensive and the increased complexity of our websites increases the cost of additional enhancements. If we are unable to increase the capacity of our systems at least as fast as the growth in demand for this capacity, our websites may become unstable and may cease to operate for periods of time. We have experienced periodic unscheduled downtime. Continued unscheduled downtime would harm our business and also could anger users of our website and reduce future revenues.
- *Customer Support.* We are expanding our customer support operations to accommodate the increased number of users and transactions on our websites. If we are unable to hire and successfully train sufficient employees or contractors in this area in a cost effective manner, users of our websites may have negative experiences, and current and future revenues could suffer or our margins may decrease.
- *Customer Accounts.* Our revenues are dependent on prompt and accurate billing processes. If we are unable to grow our transaction processing abilities to accommodate the increasing number of transactions that must be billed, our ability to collect revenue will be harmed.

We must continue to hire, train and manage new employees at a rapid rate. The majority of our employees today have been with us less than one year and we expect that our rate of hiring will continue at a very high pace. If our new hires perform poorly, or if we are unsuccessful in hiring, training and integrating these new employees, or if we are not successful in retaining our existing employees, our business may be harmed. To manage the expected growth of our operations and personnel, we will need to improve our transaction processing, operational and financial systems, procedures and controls. This is a special challenge when we acquire new operations with different systems. Our current and planned personnel, systems, procedures and controls may not be adequate to support our future operations. We may be unable to hire, train, retain and manage required personnel or to identify and take advantage of existing and potential strategic relationships and market opportunities.

We may not maintain profitability

We believe that our continued profitability will depend in large part on our ability to do the following:

- maintain sufficient transaction volume to attract buyers and sellers;
- manage the costs of our business, including the costs associated with maintaining and developing our websites, customer support and international and product expansion;

- increase our brand name awareness; and
- provide our customers with superior community and trading experiences.

We are investing heavily in marketing and promotion, customer support, further development of our websites, technology and operating infrastructure development. The costs of these investments are expected to remain significant into the future. In addition, we have significant ongoing commitments in some of these areas. As a result, we may be unable to adjust our spending rapidly enough to compensate for any unexpected revenue shortfall, which may harm our profitability. The existence of several larger and more established companies that are enabling online sales as well as new companies, many of whom do not charge for transactions on their sites and others who are facilitating trading through other pricing formats (e.g. fixed price, reverse auction, group buying, etc.) may limit our ability to raise user fees in response to declines in profitability. In addition, we are spending in advance of anticipated growth, which may also harm our profitability. In view of the rapidly evolving nature of our business and our limited operating history, we believe that period-to-period comparisons of our operating results are not necessarily meaningful. You should not rely upon our historical results as indications of our future performance.

Acquisitions could result in dilution, operating difficulties and other harmful consequences

We have acquired a number of businesses, including our recently completed acquisitions of Half.com and Internet Auction Company Ltd. in Korea and our announced acquisition of iBazar S.A., and may in the future acquire businesses, technologies, services or products that we believe are strategic. The process of integrating any acquisition may create unforeseen operating difficulties and expenditures and is itself risky. The areas where we may face difficulties include:

- diversion of management time (at both companies) during the period of negotiation through closing and further diversion of such time after closing from focus on operating the businesses to issues of integration and future products;
- decline in employee morale and retention issues resulting from changes in compensation, reporting relationships, future prospects or the direction of the business;
- the need to integrate each company's accounting, management information, human resource and other administrative systems to permit effective management, and the lack of control if such integration is delayed or not implemented; and
- the need to implement controls, procedures and policies appropriate for a larger public company at companies that prior to acquisition had been smaller, private companies.

Prior to the four large acquisitions we made in 1999, we had almost no experience in managing this integration process. Many of our acquisitions to date have involved either family-run companies or very early stage companies, which may worsen these integration issues. Foreign acquisitions involve special risks including those related to integration of operations across different cultures, currency risks and the particular economic and political risks associated with specific countries. Moreover, the anticipated benefits of any or all of our acquisitions may not be realized. Future acquisitions or mergers could result in potentially dilutive issuances of equity securities, the incurrence of debt, contingent liabilities or amortization expenses related to goodwill and other intangible assets, any of which could harm our business. Future acquisitions or mergers may require us to obtain additional equity or debt financing, which may not be available on favorable terms or at all. Even if available, this financing may be dilutive.

The inability to expand our systems may limit our growth

We seek to generate a high volume of traffic and transactions on our service. The satisfactory performance, reliability and availability of our websites, processing systems and network infrastructure are critical to our reputation and our ability to attract and retain large numbers of users. Our revenues depend primarily on the number of items listed by users, the volume of user transactions that are successfully completed and the final prices paid for the items listed. We need to expand and upgrade our technology,

transaction processing systems and network infrastructure both to meet increased traffic on our site and to implement new features and functions, including those required under our contracts with third parties. We may be unable to accurately project the rate or timing of increases, if any, in the use of our service or to expand and upgrade our systems and infrastructure to accommodate any increases in a timely fashion.

We use internally developed systems to operate our service for transaction processing, including billing and collections processing. We must continually improve these systems in order to accommodate the level of use of our website. In addition, we may add new features and functionality to our services that would result in the need to develop or license additional technologies. We capitalize hardware and software costs associated with this development in accordance with generally accepted accounting principles and include such amounts in property and equipment. Our inability to add additional software and hardware or to upgrade our technology, transaction processing systems or network infrastructure to accommodate increased traffic or transaction volume could have adverse consequences. These consequences include unanticipated system disruptions, slower response times, degradation in levels of customer support, impaired quality of the users' experience of our service and delays in reporting accurate financial information. Our failure to provide new features or functionality also could result in these consequences. We may be unable to effectively upgrade and expand our systems in a timely manner or to integrate smoothly any newly developed or purchased technologies with our existing systems. These difficulties could harm or limit our ability to expand our business.

Unauthorized break-ins or other assaults on our service could harm our business

Our servers are vulnerable to computer viruses, physical or electronic break-ins and similar disruptions, which could lead to interruptions, delays, loss of data, public release of confidential data or the inability to complete customer transactions. In addition, unauthorized persons may improperly access our data. We have experienced an unauthorized break-in by a "hacker" who has stated that he can in the future damage or change our system or take confidential information. We have also experienced "denial of service" type attacks on our system that have made all or portions of our website unavailable for periods of time. These and other types of attacks could harm us. Actions of this sort may be very expensive to remedy and could damage our reputation and discourage new and existing users from using our service.

There are many risks associated with our international operations

We are expanding internationally. In 1999, we acquired alando.de.ag, a leading online German personal trading platform, and began operations in the United Kingdom and, through a joint venture, in Australia. In the first quarter of 2000, we further expanded into Japan and formally launched our localized Canadian operations. In October 2000, we launched our French site. In January 2001, we launched our Italian site. In February 2001, we completed our acquisition of a majority interest in Internet Auction Company, Ltd. and announced our intended acquisition of iBazar S.A., a French company with online trading operations in eight countries, primarily in Europe. Expansion into international markets requires management attention and resources. We have limited experience in localizing our service to conform to local cultures, standards and policies. In most countries, we will have to compete with local companies who understand the local market better than we do. We may not be successful in expanding into international markets or in generating revenues from foreign operations. Even if we are successful, the costs of operating are expected to exceed our net revenues for at least 12 months in most countries. As we continue to expand internationally, we are subject to risks of doing business internationally, including the following:

- regulatory requirements, including regulation of "auctions," that may limit or prevent the offering of our services in local jurisdictions, may prevent enforceable agreements between sellers and buyers or may prohibit certain categories of goods;
- legal uncertainty regarding liability for the listings of our users, including less Internet-friendly legal systems, unique local laws and lack of clear precedent or applicable law;
- government-imposed limitations on the public's access to the Internet;

- difficulties in staffing and managing foreign operations;
- longer payment cycles, different accounting practices and problems in collecting accounts receivable;
- higher telecommunications and Internet service provider costs;
- more stringent consumer protection laws;
- cultural non-acceptance of online trading;
- stronger local competitors;
- seasonal reductions in business activity; and
- potentially adverse tax consequences.

Some of these factors may cause our international costs to exceed our domestic costs of doing business. To the extent we expand our international operations and have additional portions of our international revenues denominated in foreign currencies, we also could become subject to increased difficulties in collecting accounts receivable and risks relating to foreign currency exchange rate fluctuations.

Our revenue from end-to-end service providers, commercial partners and advertising is subject to factors beyond our control

We are receiving revenues from end-to-end service providers, commercial partnerships and direct advertising promotions. These revenues may be affected by the financial condition of the parties with whom we have these relationships and by the success of online promotions generally. The profitability of online advertisements has deteriorated markedly recently. Our direct advertising revenue is dependent in significant part on the performance of AOL's sales force, which we do not control. Reduction in these revenues, whether due to the softening of the demand for online advertising in general or particular problems facing parties with whom we have commercial relationships, could adversely affect our results.

Our business may be harmed by the listing or sale by our users of illegal items

The law relating to the liability of providers of online services for the activities of their users on their service is currently unsettled. We are aware that certain goods, such as firearms, other weapons, adult material, tobacco products, alcohol and other goods that may be subject to regulation by local, state or federal authorities, have been listed and traded on our service. We may be unable to prevent the sale of unlawful goods, or the sale of goods in an unlawful manner, by users of our service, and we may be subject to allegations of civil or criminal liability for unlawful activities carried out by users through our service. We have been subject to several lawsuits based upon such allegations. See “— We are subject to intellectual property and other litigation” and “Legal Proceedings.” In order to reduce our exposure to this liability, we have prohibited the listing of certain items and increased the number of personnel reviewing questionable items. We may in the future implement other protective measures that could require us to spend substantial resources and/or to reduce revenues by discontinuing certain service offerings. Any costs incurred as a result of liability or asserted liability relating to the sale of unlawful goods or the unlawful sale of goods, could harm our business. In addition, we have received significant and continuing media attention relating to the listing or sale of unlawful goods on our website. This negative publicity could damage our reputation and diminish the value of our brand name. It also could make users reluctant to continue to use our services.

Our business may be harmed by the listing or sale by our users of pirated items

We have received in the past, and we anticipate we will receive in the future, communications alleging that certain items listed or sold through our service by our users infringe third-party copyrights, trademarks and tradenames or other intellectual property rights. Although we have actively sought to work with the content community to eliminate infringing listings on our website, some content owners have expressed the view that our efforts are insufficient. Content owners have been active in defending their rights against online companies, including eBay. An allegation of infringement of third-party intellectual property rights may result

in litigation against us. Any such litigation could be costly for us, could result in increased costs of doing business through adverse judgment or settlement, could require us to change our business practices in expensive ways, or could otherwise harm our business. Litigation against other online companies could result in interpretations of the law that could also require us to change our business practices or otherwise increase our costs. See “Legal Proceedings” and “Risk Factors — We are subject to intellectual property and other litigation.”

Our business may be harmed by fraudulent activities on our website

Our future success will depend largely upon sellers reliably delivering and accurately representing their listed goods and buyers paying the agreed purchase price. We have received in the past, and anticipate that we will receive in the future, communications from users who did not receive the purchase price or the goods that were to have been exchanged. In some cases individuals have been arrested and convicted for fraudulent activities using our website. While we can suspend the accounts of users who fail to fulfill their delivery obligations to other users, we do not have the ability to require users to make payments or deliver goods or otherwise make users whole other than through our limited insurance program. Other than through this program, we do not compensate users who believe they have been defrauded by other users. We also periodically receive complaints from buyers as to the quality of the goods purchased. Negative publicity generated as a result of fraudulent or deceptive conduct by users of our service could damage our reputation and diminish the value of our brand name. We expect to continue to receive requests from users requesting reimbursement or threatening or commencing legal action against us if no reimbursement is made. This sort of litigation could be costly for us, divert management attention, result in increased costs of doing business, lead to adverse judgments or could otherwise harm our business.

Government inquiries may lead to charges or penalties

On January 29, 1999, we received initial requests to produce certain records and information to the federal government relating to an investigation of possible illegal transactions in connection with our website. We were informed that the inquiry includes an examination of our practices with respect to these transactions. We have provided further information in connection with this ongoing inquiry. In order to protect the investigation, the court has ordered that no further public disclosures be made with respect to the matter.

On March 24, 2000, Butterfields received a grand jury subpoena from the Antitrust Division of the Department of Justice requesting documents relating to, among other things, changes in Butterfields’ seller commissions and buyer premiums and discussions, agreements or understandings with other auction houses, in each case since 1992. We believe this request may be related to a publicly reported criminal investigation of auction houses for price fixing. We have provided the information requested in the subpoena.

Should these or any other investigations lead to civil or criminal charges against us, we would likely be harmed by negative publicity, the costs of litigation, the diversion of management time and other negative effects, even if we ultimately prevail. Our business would suffer if we were not to prevail in any actions like these. Even the process of providing records and information can be expensive, time consuming and result in the diversion of management attention.

A large number of transactions occur on our website. We believe that government regulators have received a substantial number of consumer complaints about us which, while small as a percentage of our total transactions, are large in aggregate numbers. As a result, we have from time to time been contacted by various federal, state and local regulatory agencies and been told that they have questions with respect to the adequacy of the steps we take to protect our users from fraud. We are likely to receive additional inquiries from regulatory agencies in the future, which may lead to action against us. We have responded to all inquiries from regulatory agencies by describing our current and planned antifraud efforts. If one or more of these agencies is not satisfied with our response to current or future inquiries, the resultant investigations and potential fines or other penalties could harm our business.

We have provided information to the antitrust division of the Department of Justice in connection with an inquiry into our conduct with respect to “auction aggregators” including our licensing program and our

recently settled lawsuit against Bidder's Edge. Should the division decide to take action against us, we would likely be harmed by negative publicity, the costs of the action, possible private antitrust lawsuits, the diversion of management time and effort and penalties we might suffer if we ultimately were not to prevail.

Some of our businesses are subject to regulation and others may be in the future

Both Butterfields and Kruse are subject to regulation in some jurisdictions governing the manner in which live auctions are conducted. Both are required to obtain licenses in these jurisdictions with respect to their business or to permit the sale of categories of items (e.g. wine, automobiles and real estate). These licenses generally must be renewed regularly and are subject to revocation for violation of law, violation of the regulations governing auctions in general or the sale of the particular item and other events. If either company was unable to renew a license or had a license revoked, its business would be harmed. In addition, changes to the regulations or the licensure requirements could increase the complexity and the cost of doing auctions, thereby harming us.

As our activities and the types of goods listed on our site expand, state regulatory agencies may claim that we are subject to licensure in their jurisdiction. These claims could result in costly litigation or could require us to change our manner of doing business in ways that increase our costs or reduce our revenues or force us to prohibit listings of certain items. We could also be subject to fines or other penalties. Any of these outcomes could harm our business.

As we have expanded internationally, we have become subject to new regulations, including regulations on the transmission of personal information. These laws may require costly changes to our business practices. If we are found to have violated any of these laws, we could be subject to fines or penalties, and our business could be harmed.

Companies that handle payments, including our subsidiaries Billpoint and Half.com may be subject to additional regulation

The Half.com business model involves the handling of payments by buyers for the items listed by Half.com's sellers. Internet Auction Company, Ltd. also has a business model involving the handling of payments by buyers. Billpoint handles its customer funds as a provider of Internet payment solutions. Businesses that handle consumers' funds are subject to numerous regulations, including those related to banking, credit cards, escrow, fair credit reporting and others. Billpoint is a new business with a relatively novel approach to facilitating payments. It is not yet known how regulatory agencies will treat Billpoint. The cost and complexity of Billpoint's business may increase if certain regulations are deemed to apply to its business. In addition to the need to comply with these regulations, Billpoint's business is also subject to risks of fraud, the need to grow systems and processes rapidly if its products are well received, a high level of competition, including larger and better financed competitors and the need to coordinate systems and policies among itself, us and Wells Fargo Bank, which is the provider of payment services. Similarly, Half.com may be subject to certain regulations regarding payments and the cost and complexity of its business may increase if these regulations are deemed to apply to its business.

We are subject to risks associated with information disseminated through our service

The law relating to the liability of online services companies for information carried on or disseminated through their services is currently unsettled. Claims could be made against online services companies under both United States and foreign law for defamation, libel, invasion of privacy, negligence, copyright or trademark infringement, or other theories based on the nature and content of the materials disseminated through their services. Several private lawsuits seeking to impose liability upon us have brought against us. In addition, federal, state and foreign legislation has been proposed that imposes liability for or prohibits the transmission over the Internet of certain types of information. Our service features a Feedback Forum, which includes information from users regarding other users. Although all such feedback is generated by users and not by us, it is possible that a claim of defamation or other injury could be made against us for content posted in the Feedback Forum. Claims like these become more likely and have a higher probability of success in

jurisdictions outside the U.S. If we become liable for information provided by our users and carried on our service in any jurisdiction in which we operate, we could be directly harmed and we may be forced to implement new measures to reduce our exposure to this liability. This may require us to expend substantial resources and/or to discontinue certain service offerings, which would negatively affect our financial results. In addition, the increased attention focused upon liability issues as a result of these lawsuits and legislative proposals could harm our reputation or otherwise impact the growth of our business. Any costs incurred as a result of this liability or asserted liability could harm our business.

We are subject to intellectual property and other litigation

On September 1, 1999, we were served with a lawsuit filed by Randall Stoner, on behalf of the general public, in San Francisco Superior Court (No. 305666). The lawsuit alleged that we violated Section 17200 of the California Business & Professions Code, a statute that relates to unfair competition, based upon the listing of “bootleg” or “pirate” recordings by eBay’s users, allegedly in violation of California penal statutes relating to the sale of unauthorized audio recordings. The lawsuit sought declaratory and injunctive relief, restitution and legal fees. We filed a general demurrer which was sustained by the court with leave to amend. The plaintiff subsequently filed an amended complaint. We filed a motion for summary judgement. On November 7, 2000, our motion for summary judgement was granted.

On December 10, 1999, we sued Bidder’s Edge, Inc. in the United States District Court for the Northern District of California alleging trespass, unfair competition, violation of the computer fraud and abuse act, misappropriation, false advertising, trademark dilution, injury to business reputation, interference with prospective economic advantage, and unjust enrichment. On February 7, 2000, Bidder’s Edge denied these claims and counterclaimed against us alleging that we violated the antitrust laws by monopolizing or attempting to monopolize a market, that we competed unfairly, and that we interfered with their contract with eBay magazine. Bidder’s Edge sought treble damages, an injunction and its fees and costs. On May 24, 2000, the court granted us a preliminary injunction against the use by Bidder’s Edge of robotic means to copy our site. In February 2001, the parties settled this lawsuit. All claims by both parties were dismissed, and Bidder’s Edge paid us an undisclosed amount.

On April 25, 2000, we were served with a lawsuit, *Gentry et.al. v. eBay, Inc. et.al.*, filed in Superior Court in San Diego, California. The lawsuit was filed on behalf of a purported class of eBay users who purchased allegedly forged autographed sports memorabilia on eBay. The lawsuit claims we were negligent in permitting certain named (and other unnamed) defendants to sell allegedly forged autographed sports memorabilia on eBay. In addition, the lawsuit claims we violated Section 17200 and a section of the California Civil Code which prohibits “dealers” from selling sports memorabilia without a “Certificate of Authenticity.” On January 26, 2001, the Court issued a ruling dismissing all claims against us in the lawsuit. The Court ruled that our business falls within the safe harbor provisions of 47 USC 230, which grants internet service providers such as eBay with immunity from state claims based on the conduct of third parties. The Court also noted that we were not a “dealer” under California law and thus not required to provide certificates of authenticity with autographs sold over our site by third parties. All counts of the plaintiffs’ suit were dismissed with prejudice as to eBay. Plaintiffs have filed an appeal of this ruling. We believe we have meritorious defenses and intend to defend ourselves vigorously.

Other third parties have from time to time claimed and may claim in the future that we have infringed their past, current or future intellectual property rights. We may become more vulnerable to such claims as laws such as the Digital Millennium Copyright Act are interpreted by the courts. We expect that we will increasingly be subject to infringement claims as the number of services and competitors in our segment grow. These claims whether meritorious or not, could be time-consuming, result in costly litigation, cause service upgrade delays require expensive changes in our methods of doing business or could require us to enter into costly royalty or licensing agreements, if available. As a result, these claims could harm our business.

From time to time, we are involved in disputes that have arisen in the ordinary course of business. Management believes that the ultimate resolution of these disputes will not have a material adverse impact on our financial position or results of operations.

System failures could harm our business

We have experienced system failures from time to time. Our website has been interrupted for periods of up to 22 hours. In addition to placing increased burdens on our engineering staff, these outages create a flood of user questions and complaints that need to be addressed by our customer support personnel. Any unscheduled interruption in our service results in an immediate loss of revenues that can be substantial and may cause some users to switch to our competitors. If we experience frequent or persistent system failures, our reputation and brand could be permanently harmed. We have been taking steps to increase the reliability and redundancy of our system. These steps are expensive, reduce our margins and may not be successful in reducing the frequency or duration of unscheduled downtime.

Substantially all of our computer hardware for operating our services (other than Half.com) currently is located at the facilities of Exodus Communications, Inc. in Santa Clara, California and AboveNet Communications in San Jose, California. The computer hardware for the Half.com service is located in the facilities of Level 3 Communications in Philadelphia, Pennsylvania. These systems and operations are vulnerable to damage or interruption from earthquakes, floods, fires, power loss, telecommunication failures and similar events. They are also subject to break-ins, sabotage, intentional acts of vandalism and similar misconduct. We do not maintain fully redundant systems or alternative providers of hosting services, and we do not carry business interruption insurance sufficient to compensate us for losses that may occur. Despite any precautions we may take, the occurrence of a natural disaster or other unanticipated problems at any of the Exodus, AboveNet or Level 3 facilities could result in interruptions in our services. In addition, the failure by Exodus, AboveNet or Level 3 to provide our required data communications capacity could result in interruptions in our service. Any damage to or failure of our systems could result in interruptions in our service. Interruptions in our service will reduce our revenues and profits, and our future revenues and profits will be harmed if our users believe that our system is unreliable.

Risks Relating to Possible California Power Outages

The State of California is currently experiencing a chronic shortage of power and, as a result, power outages may occur. Although we have emergency backup power capabilities at the facilities of Exodus, AboveNet, Level 3 Communications and limited backup power at our headquarters, repeated or lengthy power outages may adversely affect our business.

Our stock price has been and may continue to be extremely volatile

The trading price of our common stock has been and is likely to be extremely volatile. Our stock price could be subject to wide fluctuations in response to a variety of factors, including the following:

- actual or anticipated variations in our quarterly operating results;
- unscheduled system downtime;
- additions or departures of key personnel;
- announcements of technological innovations or new services by us or our competitors;
- changes in financial estimates by securities analysts;
- conditions or trends in the Internet and online commerce industries;
- changes in the market valuations of other Internet companies;
- developments in Internet regulation;
- announcements by us or our competitors of significant acquisitions, strategic partnerships, joint ventures or capital commitments;
- sales of our common stock or other securities in the open market; and
- other events or factors that may be beyond our control.

In addition, the trading price of Internet stocks in general, and ours in particular, have experienced extreme price and volume fluctuations in recent periods. These fluctuations often have been unrelated or disproportionate to the operating performance of these companies. The valuations of many Internet stocks, including ours, are extraordinarily high based on conventional valuation standards such as price-to-earnings and price-to-sales ratios. The trading price of our common stock has increased enormously from the initial public offering price. These trading prices and valuations may not be sustained. Any negative change in the public's perception of the prospects of Internet or e-commerce companies could depress our stock price regardless of our results. Other broad market and industry factors may decrease the market price of our common stock, regardless of our operating performance. Market fluctuations, as well as general political and economic conditions, such as recession or interest rate or currency rate fluctuations, also may decrease the market price of our common stock. In the past, following declines in the market price of a company's securities, securities class-action litigation often has been instituted. Litigation of this type, if instituted, could result in substantial costs and a diversion of management's attention and resources.

New and existing regulations could harm our business

We are subject to the same federal, state and local laws as other companies conducting business on the Internet. Today there are relatively few laws specifically directed towards online services. However, due to the increasing popularity and use of the Internet and online services, many laws relating to the Internet are being debated at the state and federal levels (both in the U.S. and abroad) and it is possible that laws and regulations will be adopted with respect to the Internet or online services. These laws and regulations could cover issues such as user privacy, freedom of expression, pricing, fraud, content and quality of products and services, taxation, advertising, intellectual property rights and information security. Applicability to the Internet of existing laws governing issues such as property ownership, copyrights and other intellectual property issues, taxation, libel, obscenity and personal privacy is uncertain. The vast majority of these laws were adopted prior to the advent of the Internet and related technologies and, as a result, do not contemplate or address the unique issues of the Internet and related technologies. Those laws that do reference the Internet, such as the Digital Millennium Copyright Act, are only beginning to be interpreted by the courts and their applicability and reach are therefore uncertain. In addition, numerous states, including the State of California, where our headquarters are located, have regulations regarding how "auctions" may be conducted and the liability of "auctioneers" in conducting such auctions. No final legal determination has been made with respect to the applicability of the California regulations to our business to date and little precedent exists in this area. Several states are considering imposing these regulations upon us or our users, which could harm our business. In addition, as the nature of the products listed by our users change, we may become subject to new regulatory restrictions.

Several states have proposed legislation that would limit the uses of personal user information gathered online or require online services to establish privacy policies. The Federal Trade Commission also has settled several proceedings regarding the manner in which personal information is collected from users and provided to third parties. Changes to existing laws or the passage of new laws intended to address these issues could directly affect the way we do business or could create uncertainty on the Internet. This could reduce demand for our services, increase the cost of doing business as a result of litigation costs or increased service delivery costs, or otherwise harm our business. In addition, because our services are accessible worldwide, and we facilitate sales of goods to users worldwide, foreign jurisdictions may claim that we are required to comply with their laws. For example, a French court has recently ruled that a U.S. website must comply with French laws regarding content. As we have expanded our international activities, we have become obligated to comply with the laws of the countries in which we operate. Laws regulating Internet companies outside of the United States may be less favorable than those in the United States, giving greater rights to consumers, content owners and users. Compliance may be more costly or may require us to change our business practices or restrict our service offerings relative to those in the United States. Our failure to comply with foreign laws could subject us to penalties ranging from fines to bans on our ability to offer our services.

Our business has been seasonal

Our results of operations historically have been somewhat seasonal in nature because many of our users reduce their activities on our website during the Thanksgiving and Christmas holidays and with the onset of good weather. We have historically experienced our strongest quarter of online growth in our first fiscal quarter, although our shift to more “practical” items may cause our seasonal patterns to look more like a typical retailer. Both Butterfields and Kruse have significant quarter-to-quarter variations in their results of operations depending on the timing of auctions and the availability of high quality items from large collections and estates. Butterfields typically has its best operating results in the traditional fall and spring auction seasons and has historically incurred operating losses in the first and third quarters. Kruse typically sees a seasonal peak in operations in the third quarter. Seasonal or cyclical variations in our business may become more pronounced over time and may harm our results of operations in the future.

We are dependent on the continued growth of online commerce

The business of selling goods over the Internet, particularly through personal trading, is new and dynamic. Our future net revenues and profits will be substantially dependent upon the widespread acceptance of the Internet and online services as a medium for commerce by consumers. Rapid growth in the use of and interest in the Internet and online services is a recent phenomenon. This acceptance and use may not continue. Even if the Internet is accepted, concerns about fraud, privacy and other problems may mean that a sufficiently broad base of consumers will not adopt the Internet as a medium of commerce. In particular, our website requires users to make publicly available their e-mail addresses and other personal information that some potential users may be unwilling to provide. These concerns may increase as additional publicity over privacy issues on eBay or generally over the Internet increase. Market acceptance for recently introduced services and products over the Internet is highly uncertain, and there are few proven services and products. In order to expand our user base, we must appeal to and acquire consumers who historically have used traditional means of commerce to purchase goods. If these consumers prove to be less active than our earlier users, and we are unable to gain efficiencies in our operating costs, including our cost of acquiring new customers, our business could be adversely impacted.

Our business may be subject to sales and other taxes

We do not collect sales or other similar taxes on goods sold by users through our service. One or more states may seek to impose sales tax collection obligations on companies such as ours that engage in or facilitate online commerce. Several proposals have been made at the state and local level that would impose additional taxes on the sale of goods and services through the Internet. These proposals, if adopted, could substantially impair the growth of e-commerce, and could diminish our opportunity to derive financial benefit from our activities. In 1998, the U.S. federal government enacted legislation prohibiting states or other local authorities from imposing new taxes on Internet commerce for a period of three years. This tax moratorium will last only for a limited period and does not prohibit states or the Internal Revenue Service from collecting taxes on our income, if any, or from collecting taxes that are due under existing tax rules. A successful assertion by one or more states or any foreign country that we should collect sales or other taxes on the exchange of merchandise on our system would harm our business.

We are dependent on key personnel

Our future performance will be substantially dependent on the continued services of our senior management and other key personnel. Our future performance also will depend on our ability to retain and motivate our other officers and key personnel. The loss of the services of any of our executive officers or other key employees could harm our business. We do not have long-term employment agreements with any of our key personnel, and we do not maintain any “key person” life insurance policies. Our new businesses are all dependent on attracting and retaining key personnel. The land-based auction businesses are particularly dependent on specialists and senior management because of the relationships these individuals have established with sellers who consign property for sale at auction. We have had some turnover of these personnel, and continued losses could result in the loss of significant future business and would harm us. In

addition, employee turnover frequently increases during the period following an acquisition as employees evaluate possible changes in compensation, culture, reporting relationships, and the direction of the business. Such increased turnover could increase our costs and reduce our future revenues. Our future success also will depend on our ability to attract, train, retain and motivate highly skilled technical, managerial, marketing and customer support personnel. Competition for these personnel is intense, especially for engineers and other professionals, especially in the San Francisco Bay Area, and we may be unable to successfully attract, integrate or retain sufficiently qualified personnel. In making employment decisions, particularly in the Internet and high-technology industries, job candidates often consider the value of the stock options they are to receive in connection with their employment. Fluctuations in our stock price may make it more difficult to retain and motivate employees whose stock option strike prices are substantially above current market prices.

Our offline auction businesses need to continue to acquire auction properties

The businesses of Butterfields and Kruse are dependent on the continued acquisition of high quality auction properties from sellers. Their future success will depend in part on their ability to maintain an adequate supply of high quality auction property, particularly fine and decorative arts and collectibles and collectible automobiles, respectively. There is intense competition for these pieces with other auction companies and dealers. In addition, a small number of key senior management and specialists maintain the relationships with the primary sources of auction property and the loss of any of these individuals could harm the business of Butterfields and Kruse.

Our offline auction businesses could suffer losses from price guarantees, advances or rescissions of sales

In order to secure high quality auction properties from sellers, Butterfields and Kruse may give a guaranteed minimum price or a cash advance to a seller, based on the estimated value of the property. If the auction proceeds are less than the amount guaranteed, or less than the amount advanced and the seller does not repay the difference, the company involved will suffer a loss. In addition, under certain circumstances a buyer who believes that an item purchased at auction does not have good title, provenance or authenticity may rescind the purchase. Under these circumstances, the company involved will lose its commissions and fees on the sale even if the seller, in accordance with the terms and conditions of sale, in turn accepts back the item and returns the funds he or she received from the sale.

We are subject to the risks of owning real property

In connection with the acquisitions of Kruse and Butterfields we acquired real property including land, buildings and interests in partnerships holding land and buildings. We have no experience in managing real property. Ownership of this property subjects us to new risks, including:

- the possibility of environmental contamination and the costs associated with fixing any environmental problems;
- adverse changes in the value of these properties, due to interest rate changes, changes in the neighborhoods in which the properties are located, or other factors;
- the possible need for structural improvements in order to comply with zoning, seismic, disability act or other requirements; and
- possible disputes with tenants, partners or others.

Our market is intensely competitive

Depending on the category of product, we currently or potentially compete with a number of companies serving particular categories of goods as well as those serving broader ranges of goods. The Internet is a new, rapidly evolving and intensely competitive area. We expect competition to intensify in the future as the barriers to entry are relatively low, and current and new competitors can launch new sites at a nominal cost using commercially available software. Our broad-based competitors include the vast majority of traditional department and general merchandise stores as well as emerging online retailers. These include most

prominently: Wal-Mart, Kmart, Target, Sears, Macy's, JC Penney, Costco, Sam's Club as well as Amazon.com, Buy.com, AOL.com, Yahoo! shopping and MSN.

In addition, we face competition from specialty retailers and exchanges in each of its categories of products. For example:

Antiques: Christie's, eHammer, Sotheby's/Sothebys.com

Coins & Stamps: Collectors Universe, Heritage, Numismatists Online, US Mint

Collectibles: Franklin Mint

Musical Instruments: Guitar Center, Harmony-Central.com, MARRS, MusicHotBid.com

Sports Memorabilia: Beckett's, Collectors Universe

Toys, Bean Bag Plush: Amazon.com, KB Toys, Toys.com

Premium Collectibles: Christies, DuPont Registry, Greg Manning Auctions, iCollector, Lycos/Skinner Auctions, Millionaire.com, Phillips (LVMH), Sotheby's, Sothebys.com

Automotive (used cars): Autobytel.com, AutoVantage.com, AutoWeb.com, Barrett-Jackson, CarOrder.com, CarPoint, Collectorcartraderonline.com, eClassics.com, Edmunds, CarsDirect.com, Hemmings, imotors.com, vehix.com, newspaper classifieds, used car dealers

Books, Movies, Music: Amazon.com, Barnes & Noble, Barnesandnoble.com, BigStar, Blockbuster, BMG Columbia House, CDNow, DVD Express, Warehouse, Alibris.com, Emusic.com, Bookfinders.com

Clothing: Bluefly.com, Dockers.com, FashionMall.com, The Gap, J. Crew, LandsEnd.com, The Limited, Macys, The Men's Wearhouse, Ross, 3Dshopping.com

Computers & Consumer Electronics: Best Buy, Buy.com, Circuit City, Compaq, CompUSA, Dell, Egghead, Fry's Electronics, Gateway, The Good Guys, IBM, MicroWarehouse, The Sharper Image, Shopping.com

Home & Garden: IKEA, Crate & Barrel, Home Depot, Garden.com, Pottery Barn, Ethan Allen, Frontgate

Jewelry: Ashford.com, Mondera.com

Sporting Goods/Equipment: dsports.com, FogDog.com, Footlocker, Gear.com, golfclubexchange, MVP.com, PlanetOutdoors.com, Play It Again Sports, REI, Sports Authority, Sportsline.com

Tool/Equipment/Hardware: Home Depot, HomeBase, Amazon.com, Ace Hardware, OSH

Business-to-Business: Ariba, BidFreight.com, BizBuyer.com, bLiquid.com, CloseOutNow.com, Commerce One, Concur Technologies, DoveBid, FreeMarkets, Oracle, PurchasePro.com, RicardoBiz.com, Sabre, SurplusBin.com, UnionStreet.com, Ventro, VerticalNet

Additionally, we face competition from various online auction sites including: Amazon.com, the Fairmarket Auction Network (an auction network including Microsoft's MSN, Excite@Home, Dell Computer, ZD Net, Lycos and more than 100 others), First Auction, Surplus Auction, uBid, Yahoo! Auctions and a large number of other companies using an auction format for consumer-to-consumer or business-to-consumer sales. Overseas, we face competition from Yahoo! Auctions in most countries and from a large number of regional and national competitors in each country.

The principal competitive factors for eBay include the following:

- ability to attract buyers;
- volume of transactions and selection of goods;
- customer service; and

- brand recognition.

With respect to our online competition, additional competitive factors are:

- community cohesion and interaction;
- system reliability;
- reliability of delivery and payment;
- website convenience and accessibility;
- level of service fees; and
- quality of search tools.

Some current and potential competitors have longer company operating histories, larger customer bases and greater brand recognition in other business and Internet spaces than we do. Some of these competitors also have significantly greater financial, marketing, technical and other resources. Other online trading services may be acquired by, receive investments from or enter into other commercial relationships with larger, well-established and well-financed companies. As a result, some of our competitors with other revenue sources may be able to devote more resources to marketing and promotional campaigns, adopt more aggressive pricing policies and devote substantially more resources to website and systems development than we are able to. Increased competition may result in reduced operating margins, loss of market share and diminished value of our brand. Some of our competitors have offered services for free, and others may do this as well. We may be unable to compete successfully against current and future competitors.

In order to respond to changes in the competitive environment, we may, from time to time, make pricing, service or marketing decisions or acquisitions that could harm our business. For example, we have implemented an insurance program that generally insures items up to a value of \$200, with a \$25 deductible, for users with a non-negative feedback rating at no cost to the user. New technologies may increase the competitive pressures by enabling our competitors to offer a lower cost service. Some Internet-based applications that direct Internet traffic to certain websites may channel users to trading services that compete with us.

Although we have established Internet traffic arrangements with several large online services and search engine companies, these arrangements may not be renewed on commercially reasonable terms. Even if these arrangements are renewed, they may not result in increased usage of our service. In addition, companies that control access to transactions through network access or Internet browsers could promote our competitors or charge us substantial fees for inclusion.

The off-line auction business is intensely competitive. Butterfields competes with two larger and better known auction companies, Sotheby's Holdings, Inc. and Christie's International plc, as well as numerous regional auction companies. To the extent that these companies increase their focus on the middle market properties that form the core of Butterfields' business or in the western United States, its business may suffer. Kruse is subject to competition from numerous regional competitors. In addition, competition with Internet-based auctions may harm the land-based auction business. Although Billpoint's business is new, several new companies have entered this space, including competitors who are offering free services and significant promotional incentives, and large companies, including banks and credit card companies, are also beginning to enter this space. Half.com competes directly with online retailers in its product categories such as Amazon.com which offers a directly competitive service, as well as with traditional sellers of used books, videos and CDs.

Our business is dependent on the development and maintenance of the Internet infrastructure

The success of our service will depend largely on the development and maintenance of the Internet infrastructure. This includes maintenance of a reliable network backbone with the necessary speed, data capacity and security, as well as timely development of complementary products, for providing reliable Internet access and services. The Internet has experienced, and is likely to continue to experience, significant

growth in the numbers of users and amount of traffic. If the Internet continues to experience increased numbers of users, increased frequency of use or increased bandwidth requirements, the Internet infrastructure may be unable to support the demands placed on it. In addition, the performance of the Internet may be harmed by increased number of users or bandwidth requirements. The Internet has experienced a variety of outages and other delays as a result of damage to portions of its infrastructure, and it could face outages and delays in the future. These outages and delays could reduce the level of Internet usage as well as the level of traffic and the processing transactions on our service.

Our business is subject to online commerce security risks

A significant barrier to online commerce and communications is the secure transmission of confidential information over public networks. Our security measures may not prevent security breaches. Our failure to prevent security breaches could harm our business. Currently, a significant number of our users authorize us to bill their credit card accounts directly for all transaction fees charged by us. Billpoint's users routinely provide credit card and other financial information. We rely on encryption and authentication technology licensed from third parties to provide the security and authentication technology to effect secure transmission of confidential information, including customer credit card numbers. Advances in computer capabilities, new discoveries in the field of cryptography, or other developments may result in a compromise or breach of the technology used by us to protect customer transaction data. A number of websites have reported breaches of their security. Any compromise of our security could harm our reputation and, therefore, our business. In addition, a party who is able to circumvent our security measures could misappropriate proprietary information or cause interruptions in our operations. An individual has claimed to have misappropriated some of our confidential information by breaking into our computer system. We may need to expend significant resources to protect against security breaches or to address problems caused by breaches. These issues are likely to become more difficult as we expand the number of places where we operate. Security breaches could damage our reputation and expose us to a risk of loss or litigation and possible liability. Our insurance policies carry low coverage limits, which may not be adequate to reimburse us for losses caused by security breaches.

We must keep pace with rapid technological change to remain competitive

The space in which we compete is characterized by rapidly changing technology, evolving industry standards, frequent new service and product introductions and enhancements and changing customer demands. These characteristics are worsened by the emerging and changing nature of the Internet. Our future success therefore will depend on our ability to adapt to rapidly changing technologies, to adapt our services to evolving industry standards and to continually improve the performance, features and reliability of our service. Our failure to adapt to such changes would harm our business. New technologies, such as the development of a peer to peer personal trading technology, could adversely affect us. In addition, the widespread adoption of new Internet, networking or telecommunications technologies or other technological changes could require substantial expenditures to modify or adapt our services or infrastructure.

We need to develop new services, features and functions in order to expand

We plan to expand our operations by developing new or complementary services, products or transaction formats or expanding the breadth and depth of services. We may be unable to expand our operations in a cost-effective or timely manner. Even if we do expand, we may not maintain or increase our overall acceptance. If we launch a new business or service that is not favorably received by consumers, it could damage our reputation and diminish the value of our brand. We anticipate that future services will include pre-and post-trade services.

We are pursuing strategic relationships with third parties to provide many of these services. Because we use third parties to deliver these services, we may be unable to control the quality of these services and our ability to address problems if any of these third parties fails to perform adequately will be reduced. Expanding our operations in this manner also will require significant additional expenses and development, operations and other resources and will strain our management, financial and operational resources. The lack of acceptance of any new services could harm our business.

Our growth will depend on our ability to develop our brand

We believe that our historical growth has been largely attributable to word of mouth. We have benefited from frequent and high visibility media exposure both nationally and locally. We believe that continuing to strengthen our brand will be critical to achieving widespread acceptance of our service. Promoting and positioning our brand will depend largely on the success of our marketing efforts and our ability to provide high quality services. In order to promote our brand, we will need to increase our marketing budget and otherwise increase our financial commitment to creating and maintaining brand loyalty among users. Brand promotion activities may not yield increased revenues, and even if they do, any increased revenues may not offset the expenses we incurred in building our brand. If we do attract new users to our service, they may not conduct transactions over our service on a regular basis. If we fail to promote and maintain our brand or incur substantial expenses in an unsuccessful attempt to promote and maintain our brand, our business would be harmed.

We may be unable to protect or enforce our own intellectual property rights adequately

We regard the protection of our URLs, copyrights, service marks, trademarks, trade dress and trade secrets as critical to our success. We rely on a combination of patent, copyright, trademark, service mark and trade secret laws and contractual restrictions to protect our proprietary rights in products and services. We have entered into confidentiality and invention assignment agreements with our employees and contractors, and nondisclosure agreements with parties with whom we conduct business in order to limit access to and disclosure of our proprietary information. These contractual arrangements and the other steps taken by us to protect our intellectual property may not prevent misappropriation of our technology or deter independent third-party development of similar technologies. We pursue the registration of our URLs, trademarks and service marks in the U.S. and internationally. Effective copyright, service mark, trademark, trade dress and trade secret protection is very expensive to maintain, and protection may not be available in every country in which our services are made available online. Furthermore, we must also protect our URLs in an increasing number of jurisdictions, a process that is expensive and may not be successful in every location. We have licensed in the past, and expect to license in the future, certain of our proprietary rights, such as trademarks or copyrighted material, to third parties. These licensees may take actions that might diminish the value of our proprietary rights or harm our reputation. We also rely on certain technologies that we license from third parties, such as Oracle Corporation, Microsoft Corporation and Sun Microsystems Inc., the suppliers of key database technologies, the operating system and specific hardware components for our service. These third-party technology licenses may not continue to be available to us on commercially reasonable terms. The loss of these technologies could require us to obtain substitute technologies of lower quality or performance standards or at greater cost.

Our business is subject to consumer trends and discretionary consumer spending

We derive most of our revenues from fees received from sellers for listing products for sale on our service and fees received from successfully completed transactions. Our future revenues will depend upon continued demand for the types of goods that are listed by users of our service. The popularity of certain categories of items, such as toys, dolls and memorabilia, among consumers may vary over time due to perceived scarcity, subjective value, and societal and consumer trends in general. A decline in the popularity of, or demand for, certain collectibles or other items sold through our service could reduce the overall volume of transactions on our service, resulting in reduced revenues. In addition, consumer “fads” may temporarily inflate the volume of certain types of items listed on our service, placing a significant strain upon our infrastructure and transaction capacity. These trends also may cause fluctuations in our operating results from one reporting period to the next. Any decline in demand for the goods offered through our service as a result of changes in consumer trends could harm our business. A decline in consumer spending would harm our land-based auction businesses. Sales of fine and decorative art, collectable cars and other collectibles would be adversely affected by a decline in discretionary consumer spending, especially for luxury items. Changes in buyers’ tastes, economic conditions or consumer trends could cause declines in the number or dollar volume of items sold and thereby harm the business of these companies.

Some anti-takeover provisions may affect the price of our common stock

The Board of Directors has the authority to issue up to 10,000,000 shares of preferred stock and to determine the preferences, rights and privileges of those shares without any further vote or action by the stockholders. The rights of the holders of common stock may be harmed by the rights of the holders of any preferred stock that may be issued in the future. Some provisions of our certificate of incorporation and bylaws could have the effect of making it more difficult for a third party to acquire a majority of our outstanding voting stock. These include provisions that provide for a classified board of directors, prohibit stockholders from taking action by written consent and restrict the ability of stockholders to call special meetings. We are also subject to provisions of Delaware law that prohibit us from engaging in any business combination with any interested stockholder for a period of three years from the date the person became an interested stockholder, unless certain conditions are met. This restriction could have the effect of delaying or preventing a change of control.

We are controlled by certain stockholders, executive officers and directors

Our executive officers and directors (and their affiliates) own approximately one-half of our outstanding common stock. As a result, they have the ability to control our company and direct our affairs and business, including the election of directors and approval of significant corporate transactions. This concentration of ownership may have the effect of delaying, deferring or preventing a change in control of our company and may make some transactions more difficult or impossible without the support of these stockholders. Any of these events could decrease the market price of our common stock.

Item 7A: *Quantitative and Qualitative Disclosures about Market Risk*

Interest Rate Risk

The primary objective of our investment activities is to preserve principal while at the same time maximizing yields without significantly increasing risk. To achieve this objective, we maintain our portfolio of cash equivalents, short-term and long-term investments in a variety of securities, including both government and corporate obligations and money market funds. These securities are generally classified as available for sale and consequently are recorded on the balance sheet at fair value with unrealized gains or losses reported as a separate component of accumulated other comprehensive income, net of estimated tax.

Investments in both fixed rate and floating rate interest earning instruments carry varying degrees of interest rate risk. Fixed rate securities may have their fair market value adversely impacted due to a rise in interest rates. In general, longer dated securities are subject to greater interest rate risk than shorter dated securities. While floating rate securities generally are subject to less interest rate risk than fixed rate securities, floating rate securities may produce less income than expected if interest rates decrease. Due in part to these factors, our investment income may fall short of expectations or we may suffer losses in principal if securities are sold that have declined in market value due to changes in interest rates. As of December 31, 2000, our fixed income investments earned a pretax yield of approximately 6.4% and had a weighted average maturity of 0.6 years. If interest rates were to instantaneously increase (decrease) by 100 basis points using a duration modeling technique, the fair market value of the total investment portfolio could decrease (increase) by approximately \$4.9 million. Assuming an average investment balance of \$750 million, if rates were to increase (decrease) by 100 basis points, this would translate to an increase (decrease) in interest income of \$7.5 million annually.

We entered into two interest rate swaps on June 19 and July 20, 2000 totaling \$95 million to reduce the impact of changes in interest rates on a portion of the floating rate operating lease for our facilities. The interest rate swaps allow for us to receive floating rate receipts based on LIBOR in exchange for making fixed rate payments which effectively changes our interest rate exposure on our operating lease from a floating rate to a fixed rate on \$95 million of the total \$126.4 million operating lease. Of the \$126.4 million operating lease, the interest rate is fixed on \$95 million with the balance of \$31.4 million remaining at a floating rate of interest based on the spread over 3-month LIBOR. If the 3-month LIBOR rates were to increase (decrease) by 100 basis points, then our lease payments would increase (decrease) by \$78,000 per quarter.

Equity Price Risk

We are exposed to equity price risk on the marketable portion of equity investments as such investments we hold, typically as the result of strategic investments in strategic partners are subject to considerable market risk due to their volatility. We typically do not attempt to reduce or eliminate our market exposure in these equity investments. As of December 31, 2000, the position in equity investments included a net unrealized loss of \$1.6 million, net of tax.

Foreign Currency Risk

International sales are made mostly from our sales in the respective countries by our foreign subsidiaries and are typically denominated in the local currency of each country. These subsidiaries also incur most of their expenses in the local currency. Accordingly, all foreign subsidiaries use the local currency as their functional currency. Our international business is subject to risks typical of an international business, including, but not limited to differing economic conditions, changes in political climate, differing tax structures, other regulations and restrictions, and foreign exchange rate volatility. Accordingly, our future results could be materially adversely impacted by changes in these or other factors. These financial statements are typically denominated in the functional currency of the foreign subsidiary in order to centralize foreign exchange risk with the parent company in the United States. We are also exposed to foreign exchange rate fluctuations as the financial results of foreign subsidiaries are translated into U.S. dollars in consolidation. As exchange rates vary, these results, when translated, may vary from expectations and adversely impact overall expected profitability. The effect of foreign exchange rate fluctuations on eBay as of December 31, 2000 was a translation gain of approximately \$745,000.

Item 8: *Financial Statements and Supplementary Data*

Annual Financial Statements: See Part IV, Item 14 of this Form 10-K.

Item 9: *Changes In and Disagreements with Accountants on Accounting and Financial Disclosure*

None.

PART III

Item 10: *Directors and Executive Officers of the Registrant*

Incorporated by reference to eBay's Proxy Statement to be filed on or before April 30, 2001.

Item 11: *Executive Compensation*

Incorporated by reference to eBay's Proxy Statement to be filed on or before April 30, 2001.

Item 12: *Security Ownership of Certain Beneficial Owners and Management*

Incorporated by reference to eBay's Proxy Statement to be filed on or before April 30, 2001.

Item 13: *Certain Relationships and Related Transactions*

Incorporated by reference to eBay's Proxy Statement to be filed on or before April 30, 2001.

PART IV

Item 14: Exhibits, Financial Statement Schedules and Reports on Form 8-K

Upon written request, eBay will provide, without charge, a copy of this Report on Form 10-K, including the consolidated financial statements, financial statement schedules and any exhibits for eBay's most recent fiscal year. All requests should be sent to:

eBay Inc.
Investor Relations
2145 Hamilton Ave.
San Jose, CA 95125
(408) 558-7400

In addition, the Securities and Exchange Commission maintains a website that provides access to all filings made electronically by eBay at www.sec.gov. eBay's website is located at www.ebay.com. Information contained on eBay's website is not a part of this Annual Report on Form 10-K.

(a) The following documents are filed as part of this report:

1. *Consolidated Financial Statements:*

	<u>Page Number</u>
Report of Independent Accountants	52
Consolidated Balance Sheet	53
Consolidated Statement of Income	54
Consolidated Statement of Comprehensive Income	55
Consolidated Statement of Stockholders' Equity	56
Consolidated Statement of Cash Flows	57
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2. *Financial Statement Schedules.*

All schedules have been omitted because the information required to be set forth therein is not applicable or is shown in the financial statements or notes thereto.

3. *Exhibits.*

The following exhibits are filed as part of, or incorporated by reference into, this Form 10-K:

<u>Exhibit Number</u>	<u>Exhibit Title</u>
2.01	Agreement and Plan of Merger and Reorganization among Registrant, Margarine Acquisition Sub Corp., Butterfield & Butterfield Auctioneers Corp, HBJ Partners, LLC and 111 Potrero LLC.(6)
2.04	Agreement and Plan of Merger and Reorganization among Registrant and Kruse, Inc.(5)
2.05	Agreement and Plan of Merger and Reorganization among Registrant and Billpoint, Inc.(6)
3.01	Registrant's Amended and Restated Certificate of Incorporation.(2)
3.02	Registrant's Certificate of Amendment of Certificate of Incorporation.
3.03	Registrant's Corrected Certificate of Certificate of Amendment of Certificate of Incorporation of Registrant.
3.04	Registrant's Amended and Restated Bylaws.(2)
4.01	Form of Specimen Certificate for Registrant's Common Stock.(1)
4.02	Investor Rights Agreement, dated June 20, 1997, between the Registrant and certain stockholders named therein.(1)
10.01	Form of Indemnity Agreement entered into by Registrant with each of its directors and executive officers.(1)
10.02	Registrant's 1996 Stock Option Plan and related documents.(1)

<u>Exhibit Number</u>	<u>Exhibit Title</u>
10.03	Registrant's 1997 Stock Option Plan and related documents.(1)
10.04	Registrant's 1998 Equity Incentive Plan and related documents.(1)
10.05	Registrant's 1998 Directors Stock Option Plan and related documents.(1)
10.06	Amendment No. 1 to Registrant's 1998 Directors Stock Option Plan.(3)
10.07	Registrant's 1998 Employee Stock Purchase Plan.(1)
10.08	Registrant's 1999 Global Equity Incentive Plan and related documents.(10)
10.09	Employment Letter Agreement dated October 16, 1996 between Jeff Skoll and Registrant.(1)
10.10	Employment Letter Agreement dated September 15, 1997 between Gary Bengier and Registrant.(1)
10.11	Employment Letter Agreement dated January 16, 1998 between Margaret C. Whitman and Registrant.(1)
10.12	Employment Letter Agreement dated August 14, 1998 between Brian T. Swette and Registrant.(1)
10.13	Employment Letter Agreement dated August 20, 1998 between Michael R. Jacobson and Registrant.(1)
10.14	Offer Letter to Maynard Webb.(8)
10.15	Retention Bonus Plan between Registrant and Maynard Webb, dated January 10, 2001.
10.16	Offer Letter to Jeffrey D. Jordan.(8)
10.17	Retention Bonus Plan between Registrant and Jeffrey D. Jordan, dated May 16, 2000.
10.18	Lease between eBay Realty Trust and Registrant, dated March 1, 2000.(9)
10.19	Cash Collateral Agreement between Registrant and Chase Manhattan Bank as Agent, Dated March 1, 2000.(9)
21.01	List of Subsidiaries.
23.01	PricewaterhouseCoopers LLP consent.

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- (1) Previously filed as an Exhibit to Registrant's Registration Statement on Form S-1 (No. 33-59097) filed in connection with eBay's initial public offering and incorporated by reference herein.
 - (2) Previously filed as an Exhibit to the Registrant's Form 10-Q filed on November 13, 1998 and incorporated by reference herein.
 - (3) Previously filed as an Exhibit to Registrant's Registration Statement on Form S-1 (No. 33-75009) filed on March 25, 1999 and incorporated by reference herein.
 - (4) Previously filed as an Exhibit to the Registrant's Form 10-K for the fiscal year ended December 31, 1998 and incorporated by reference herein.
 - (5) Previously filed as an Exhibit to the Registrant's Form 8-K filed on May 8, 1999 and incorporated by reference herein.
 - (6) Previously filed as an Exhibit to the Registrant's Form 8-K filed on June 7, 1999 and incorporated by reference herein.
 - (7) Previously filed as an Exhibit to the Registrant's Form 10-Q filed on November 15, 1999 and incorporated by reference herein.
 - (8) Previously filed as an Exhibit to the Registrant's Registration Statement on Form S-3 (No. 333-88205) filed on September 30, 1999 and incorporated by reference herein.
 - (9) Previously filed as an Exhibit to the Registrant's Form 10-K for the fiscal year ended December 31, 1999 and incorporated by reference herein.
 - (10) Previously filed as an Exhibit to the Registrant's Registration Statement on Form S-8 (No. 333-41944) filed on July 21, 2000 and incorporated by reference herein.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and
Stockholders of eBay Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, comprehensive income, stockholders' equity and of cash flows present fairly, in all material respects, the financial position of eBay Inc. and its subsidiaries ("the Company") at December 31, 1999 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

San Jose, California
January 18, 2001

eBay Inc.
CONSOLIDATED BALANCE SHEET
(in thousands, except per share amounts)

ASSETS

	December 31,	
	1999	2000
Current assets:		
Cash and cash equivalents	\$221,801	\$ 201,873
Short-term investments	181,086	354,166
Accounts receivable, net	36,538	67,163
Other current assets	25,882	52,262
Total current assets	465,307	675,464
Long-term investments	373,988	218,197
Property and equipment, net	112,202	125,161
Intangible and other assets, net	12,689	23,299
Restricted cash and investments	—	126,390
Deferred tax assets	5,639	13,892
	\$969,825	\$1,182,403

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Accounts payable	\$ 32,133	\$ 31,725
Accrued expenses	32,173	60,882
Deferred revenue and customer advances	5,997	12,656
Short-term debt	15,781	15,272
Income taxes payable	6,455	11,092
Other current liabilities	502	5,815
Total current liabilities	93,041	137,442
Long-term debt	15,018	11,404
Other liabilities	5,905	6,549
Minority interests	1,732	13,248
	115,696	168,643
Commitments and contingencies (Note 10)		
Stockholders' equity:		
Preferred Stock, \$0.001 par value; 10,000 shares authorized, no shares issued or outstanding	—	—
Common Stock, \$0.001 par value; 900,000 shares authorized; 262,087 and 269,250 shares issued and outstanding	262	269
Additional paid-in capital	831,121	941,285
Notes receivable from stockholders	(11)	—
Unearned stock-based compensation	(8,704)	(1,423)
Retained earnings	26,367	74,504
Accumulated other comprehensive income (loss)	5,094	(875)
Total stockholders' equity	854,129	1,013,760
	\$969,825	\$1,182,403

The accompanying notes are an integral part of these consolidated financial statements.

eBay Inc.

CONSOLIDATED STATEMENT OF INCOME
(in thousands, except per share amounts)

	Year Ended December 31,		
	1998	1999	2000
Net revenues	\$ 86,129	\$224,724	\$431,424
Cost of net revenues	16,094	57,588	95,453
Gross profit	<u>70,035</u>	<u>167,136</u>	<u>335,971</u>
Operating expenses:			
Sales and marketing	35,976	96,239	166,767
Product development	4,640	24,847	55,863
General and administrative	15,849	43,919	73,027
Payroll expense on employee stock options	—	—	2,337
Amortization of acquired intangibles	805	1,145	1,433
Merger related costs	—	4,359	1,550
Total operating expenses	<u>57,270</u>	<u>170,509</u>	<u>300,977</u>
Income (loss) from operations	12,765	(3,373)	34,994
Interest and other income, net	1,799	23,833	46,337
Interest expense	(2,191)	(2,319)	(3,374)
Income before income taxes, minority interest and equity interest in partnership income	12,373	18,141	77,957
Provision for income taxes	(4,789)	(8,472)	(32,725)
Minority interest in consolidated company	(381)	(256)	3,062
Equity interest in partnership income	70	154	—
Net income	<u>\$ 7,273</u>	<u>\$ 9,567</u>	<u>\$ 48,294</u>
Net income per share:			
Basic	<u>\$ 0.07</u>	<u>\$ 0.04</u>	<u>\$ 0.19</u>
Diluted	<u>\$ 0.03</u>	<u>\$ 0.04</u>	<u>\$ 0.17</u>
Weighted average shares:			
Basic	<u>104,128</u>	<u>217,674</u>	<u>251,776</u>
Diluted	<u>233,519</u>	<u>273,033</u>	<u>280,346</u>
Supplemental pro forma information:			
Income before income taxes, minority interest and equity interest in partnership income	\$ 12,373	\$ 18,141	\$ 77,957
Provision for income taxes as reported	(4,789)	(8,472)	(32,725)
Pro forma adjustment to provision for income taxes (Note 15)	(2,071)	1,118	—
Minority interest in consolidated company as reported	(381)	(256)	3,062
Equity interest in partnership income as reported	70	154	—
Pro forma net income	<u>\$ 5,202</u>	<u>\$ 10,685</u>	<u>\$ 48,294</u>
Pro forma net income per share:			
Basic	<u>\$ 0.05</u>	<u>\$ 0.05</u>	<u>\$ 0.19</u>
Diluted	<u>\$ 0.02</u>	<u>\$ 0.04</u>	<u>\$ 0.17</u>

The accompanying notes are an integral part of these consolidated financial statements.

eBay Inc.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
(in thousands)

	Year Ended December 31,		
	1998	1999	2000
Net income	\$7,273	\$ 9,567	\$ 48,294
Other comprehensive income (loss):			
Foreign currency translation adjustments	—	(58)	803
Unrealized gains (losses) on investments, net	—	8,883	(11,583)
Estimated tax benefit (provision) on other comprehensive income ...	—	(3,731)	4,811
Net change in other comprehensive income (loss)	—	5,094	(5,969)
Comprehensive income	<u>\$7,273</u>	<u>\$14,661</u>	<u>\$ 42,325</u>

The accompanying notes are an integral part of these consolidated financial statements.

eBay Inc.

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(in thousands)

	Year ended December 31,		
	1998	1999	2000
Convertible preferred stock:			
Balance, beginning of year	\$ 4	\$ —	\$ —
Conversion of preferred stock to common stock	(4)	—	—
Balance, end of year	—	—	—
Common stock:			
Balance, beginning of year	126	246	262
Conversion of preferred to common stock	56	—	—
Common stock issued	64	16	7
Balance, end of year	246	262	269
Additional Paid-in-capital:			
Balance, beginning of year	2,476	87,656	831,121
Conversion of preferred to common stock	5,105	—	—
Common stock issued	73,944	714,319	49,043
Common stock repurchased	—	(1,397)	(365)
Contributions from partners and minority interest	300	—	23,816
Unearned stock-based compensation	5,831	10,686	187
Tax benefit related to acquisitions	—	8,753	—
Stock option income tax benefit	—	11,104	37,483
Balance, end of year	87,656	831,121	941,285
Notes receivable from stockholders:			
Balance, beginning of year	(68)	(1,130)	(11)
Common stock issued for notes	(1,378)	—	—
Note repayments	316	1,066	11
Cancellation or repurchase of shares	—	53	—
Balance, end of year	(1,130)	(11)	—
Unearned stock-based compensation:			
Balance, beginning of year	(1,399)	(4,139)	(8,704)
Unearned stock-based compensation	(5,831)	(10,686)	(187)
Amortization of unearned stock-based compensation	3,091	4,781	7,141
Cancellation or repurchase of shares	—	1,340	327
Balance, end of year	(4,139)	(8,704)	(1,423)
Retained earnings:			
Balance, beginning of year	8,583	17,905	26,367
Accretion of mandatorily redeemable convertible preferred stock	(46)	—	—
Partnership contributions	5,323	—	—
Partnership distributions	(3,228)	(1,105)	(157)
Net income	7,273	9,567	48,294
Balance, end of year	17,905	26,367	74,504
Other comprehensive income:			
Balance, beginning of year	—	—	5,094
Unrealized gain (loss) on investments, net of tax	—	5,152	(6,772)
Foreign currency translation adjustment	—	(58)	803
Balance, end of year	—	5,094	(875)
Total stockholders' equity	\$100,538	\$854,129	\$1,013,760
		Number of shares	
Common stock:			
Balance, beginning of year	126,630	246,450	262,087
Conversion of preferred to common stock	55,654	—	—
Issuance of common stock for cash and notes	38,579	3,614	4,593
Issuance of common stock at public offering	24,086	8,500	—
Issuance of common stock for acquisition	857	3,523	2,570
Contribution of common stock for charitable foundation	644	—	—
Balance, end of year	246,450	262,087	269,250

The accompanying notes are an integral part of these consolidated financial statements.

eBay Inc.

CONSOLIDATED STATEMENT OF CASH FLOWS
(in thousands)

	Year Ended December 31,		
	1998	1999	2000
Cash flows from operating activities:			
Net income	\$ 7,273	\$ 9,567	\$ 48,294
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for doubtful accounts and authorized credits	3,939	9,271	18,237
Depreciation and amortization	4,526	20,742	38,050
Amortization of unearned stock-based compensation	2,661	4,781	7,141
Tax benefit on stock options	—	11,104	37,483
Other	(1,507)	1,751	(1,475)
Changes in assets and liabilities:			
Accounts receivable	(8,931)	(33,384)	(48,862)
Other current and non-current assets	(3,702)	(18,701)	(40,775)
Accounts payable	(3,112)	22,137	(408)
Accrued expenses	3,164	26,099	28,709
Income tax payable	(35)	6,143	4,637
Other liabilities	1,765	3,342	9,117
Net cash provided by operating activities	6,041	62,852	100,148
Cash flows from investing activities:			
Purchases of property and equipment	(12,758)	(86,907)	(49,753)
Purchases of investments	(40,401)	(620,733)	(398,998)
Maturities of investments	—	111,154	247,398
Sales of investments	—	—	1,149
Proceeds from sale of property and equipment	1,274	173	—
Purchases of intangible assets	(1,248)	(7,159)	(5,850)
Payments on notes receivable	109	109	—
Net cash used in investing activities	(53,024)	(603,363)	(206,054)
Cash flows from financing activities:			
Proceeds from issuance of preferred stock, net	2,110	—	—
Proceeds from issuance of common stock, net	69,305	713,252	45,556
Proceeds from issuance of common stock by subsidiaries	—	—	37,737
Repurchased shares	—	—	(38)
Repayments of stockholder loans	316	1,062	11
Proceeds (principal payments) on long-term debt	(1,967)	4,894	2,869
Proceeds from notes payable	—	3,507	—
Partnership contributions	5,623	6,204	—
Partnership distributions	(3,228)	(3,892)	(157)
Net cash provided by financing activities	72,159	725,027	85,978
Net increase (decrease) in cash and cash equivalents	25,176	184,516	(19,928)
Cash and cash equivalents at beginning of year	12,109	37,285	221,801
Cash and cash equivalents at end of year	\$ 37,285	\$ 221,801	\$ 201,873
Supplemental cash flow disclosures:			
Cash paid for interest	\$ 1,710	\$ 1,465	\$ 1,915
Cash paid for income taxes	\$ 4,932	\$ —	\$ —
Non-cash investing and financing activities:			
Common stock issued for notes receivable	\$ 1,378	\$ —	\$ —
Common stock issued for acquisition	\$ 2,000	\$ 9,744	\$ 17,341
Preferred stock issued for notes payable	\$ —	\$ —	\$ 3,494
Building and inventory obtained in connection with foreclosure	\$ 751	\$ —	\$ —
Receivables cancelled in connection with foreclosure	\$ 500	\$ —	\$ —
Land and building transferred for assumption of debt	\$ 835	\$ —	\$ —

The accompanying notes are an integral part of these consolidated financial statements.

eBay Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 — The Company and Summary of Significant Accounting Policies:

The Company

eBay Inc. (“eBay”) was incorporated in California in May 1996, and reincorporated in Delaware in March 1998 and by December 31, 2000 had operations in the United States, Switzerland, the United Kingdom, Germany, France, Austria, Australia, Canada, and Japan. eBay pioneered online personal trading by developing a Web-based community in which buyers and sellers are brought together to buy and sell almost anything. The eBay online service permits sellers to list items for sale, buyers to bid on items of interest and all eBay users to browse through listed items in a fully-automated, topically-arranged service that is available online seven days a week. eBay’s acquisition of Half.com, Inc. (“Half.com”) enables eBay to offer an online website to buy and sell using a fixed-price trading platform. eBay also engages in the traditional auction business through its subsidiaries, Butterfields Auctioneer Corporation (“Butterfields”) and Kruse International (“Kruse”) and in online payment processing through its Billpoint, Inc. (“Billpoint”) subsidiary.

Reincorporation

As a result of the reincorporation in April 1998, eBay was authorized to issue 180,000,000 shares of \$0.001 par value common stock and 6,000,000 shares of \$0.001 par value Preferred Stock. The Board of Directors and the stockholders subsequently amended the number of authorized shares such that eBay was authorized to issue 900,000,000 shares of common stock and 10,000,000 shares of Preferred Stock. The Board of Directors has the authority to issue the undesignated Preferred Stock in one or more series and to fix the rights, preferences, privileges and restrictions thereof.

Stock split

During January 1999 and April 2000, eBay’s Board of Directors approved a three-for-one and two-for-one common stock split, respectively. Stockholders of record on February 9, 1999, received two additional shares on March 1, 1999. Stockholders of record on May 9, 2000, received one additional share for each share owned on May 24, 2000. All share and per share amounts in these consolidated financial statements and notes thereto for all periods presented reflect the stock splits in all periods presented.

Public offerings

On September 24, 1998, eBay completed its initial public offering of 24,150,000 shares of its common stock which were sold at a price of \$3.00 per share. Of the 24,150,000 shares, 64,000 shares were sold on behalf of a charitable foundation established by eBay. The proceeds resulted in net proceeds to eBay of approximately \$66.1 million. At the closing of the offering, all issued and outstanding shares of eBay’s Convertible Preferred Stock and Mandatorily Redeemable Convertible Preferred Stock were converted into an aggregate of 55,654,038 shares of common stock.

On April 16, 1999, eBay completed a follow-on public offering of common stock. A total of 8,500,000 shares were sold by eBay at a price of \$85.00 per share. The offering resulted in net proceeds to eBay of approximately \$696.2 million.

Sale of subsidiary stock

WELLS FARGO BANK

On February 24, 2000, Billpoint and Wells Fargo Bank (“Wells Fargo”) entered into an agreement whereby Wells Fargo became the exclusive provider of Internet payment services of domestic transactions for Billpoint’s customers. The service agreement expires February 28, 2007.

eBay Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Billpoint was reincorporated in Delaware and sold 350 shares of common stock and 1,399,965 shares of Series A preferred stock to Wells Fargo which represented approximately 35% ownership in Billpoint. Simultaneously, eBay exchanged 25,999,350 of Billpoint's common shares for 2,599,935 shares of Series A preferred stock. eBay continues to consolidate the financial statements of Billpoint and reflects a minority interest for the equity interest of Wells Fargo.

NEC

On February 17, 2000, eBay Japan Inc., a wholly owned subsidiary of eBay, entered into a shareholder and marketing services agreement with NEC Corporation. In accordance with the shareholder agreement, NEC acquired 30% of eBay Japan and eBay retained the remaining 70% interest of eBay Japan. eBay will continue to consolidate the financial statements of eBay Japan due to a majority ownership interest and will reflect a minority interest for the equity interest of NEC.

In accordance with the marketing agreement, NEC provided marketing and services to eBay Japan in an effort to deliver a minimum level of confirmed registered users. As compensation for the marketing and other services performed by NEC, eBay Japan paid NEC an annual up-front fee of approximately \$1.5 million. The first payment was made in April, 2000, and additional payments will be payable on the anniversary of such date in each of the subsequent three years as long as the contract is in effect. If NEC is unable to deliver the minimum level of confirmed registered users, then eBay will have the right to repurchase shares of eBay Japan from NEC.

Use of estimates

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Principles of consolidation and basis of presentation

The financial statements as of December 31, 1999 and 2000 and for the three years ended December 31, 2000 are consolidated and include eBay and its majority owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. Certain prior period balances have been reclassified to conform to the current period presentation.

Investments in subsidiaries and general partnerships

Subsidiaries and general partnerships in which eBay holds more than 50 percent ownership are consolidated. The consolidated accounts include 100 percent of the assets and liabilities of these subsidiaries and general partnerships and the ownership interests of minority investors are recorded as minority interests. Investments in entities and general partnerships where eBay holds more than 20 percent ownership but less than 50 percent ownership and has the ability to significantly influence the operations of the investee are accounted for using the equity method of accounting, are recorded as investments in partnerships or equity investees and are included within other assets.

Investments by third parties in the stock of eBay subsidiaries are evaluated for their impact on the carrying amount of eBay's interest at the date such investments are made. To the extent the proceeds from these investments differ from the carrying amount of the third party's ownership interest in the net equity of the subsidiary, such differences are recognized as a component of stockholders' equity.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Fair value of financial instruments

eBay's financial instruments, including cash, cash equivalents, accounts receivable, and accounts payable are carried at cost, which approximates their fair value because of the short-term maturity of these instruments. Cash and cash equivalents are short-term, highly liquid investments with original maturities of three months or less when purchased. Short and long-term investments, which include marketable equity securities, municipal, government and corporate bonds are classified as available-for-sale and reported at fair value using the specific identification method. Realized gains and losses are included in earnings. Unrealized gains and losses are excluded from earnings and reported as other comprehensive income, net of estimated tax provisions or benefits.

Concentrations of credit risk

Financial instruments that potentially subject eBay to a concentration of credit risk consist of cash, cash equivalents, investments and accounts receivable. Cash, cash equivalents and investments are deposited with high credit, quality financial institutions. eBay's accounts receivable are derived from revenue earned from customers located in the U.S. and internationally. The revenues earned from the U.S. site are denominated in U.S. dollars and revenue earned from eBay's international sites are denominated in the country's functional currency. Accounts receivable balances are typically settled through customer credit cards and, as a result, the majority of accounts receivable are collected upon processing of credit card transactions. eBay maintains an allowance for doubtful accounts receivable based upon the expected collectibility of accounts receivable. Generally, due to the relative small amount of individual outstanding accounts receivable balances, eBay does not require collateral on these balances. eBay also entered into two interest rate swaps with two separate financial institutions in order to reduce its interest rate exposure on its lease payments. If either of these financial institutions should fail to deliver under these contracts, eBay may be subject to variable interest rate payments. During the years ended December 31, 1998, 1999 and 2000 no customers accounted for more than 10% of net revenues or net accounts receivable.

Foreign currency

All of eBay's foreign subsidiaries use the local currency of their respective countries as their functional currency. Assets and liabilities are translated at exchange rates prevailing at the balance sheet dates. Revenues, costs and expenses are translated into United States dollars at average exchange rates for the period. Gains and losses resulting from translation are accumulated as a component of other comprehensive income.

Realized gains and losses from foreign currency transactions are recognized as a component of net income as incurred.

Property and equipment

Property and equipment are stated at historical cost less accumulated depreciation. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the assets, generally 5 years or less for equipment and furniture, and up to 40 years for buildings and building improvements.

Impairment of long-lived assets

eBay evaluates the recoverability of long-lived assets in accordance with Statement of Financial Accounting Standards ("SFAS") No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of." SFAS No. 121 requires recognition of impairment of long-lived assets

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

in the event the net book value of such assets exceeds the future undiscounted cash flows attributable to such assets.

Intangible assets

Intangible assets resulting from the acquisitions of entities accounted for using the purchase method of accounting are estimated by management based on the fair value of assets received. These include acquired customer lists, workforce, technological know how, covenants not to compete and goodwill. During the year ended December 31, 2000, a subsidiary of eBay purchased the technology and related workforce from the Precision Buying Service, a division of Deja.com, in which eBay recorded an intangible asset of approximately \$5.9 million. Intangible assets are amortized from eight months to ten years on a straight-line basis which represents the estimated periods of benefit.

Environmental expenditures

eBay owns or controls real estate properties that are either used in the auction business or leased to unrelated parties for various commercial applications. Certain environmental and structural deficiencies have been identified in the past for which eBay has remediation responsibility. The amounts accrued to correct these matters are based upon estimates developed in preliminary studies by external consultants. Due to uncertainties inherent in the estimation process, the amounts accrued for these matters may be revised in future periods as additional information is obtained.

Environmental expenditures that relate to an existing condition caused by past operations, and that do not contribute to current or future revenue generation, are charged to expense. Liabilities are recorded when environmental assessments are made, remediation obligations are probable and the costs can be reasonably estimated. The timing of these accruals is generally upon the completion of feasibility studies. As of December 31, 1999 and 2000, estimated liabilities of approximately \$5.8 million are included within other liabilities.

Comprehensive income

eBay accounts for comprehensive income in accordance with SFAS No. 130, "Reporting Comprehensive Income." SFAS No. 130 establishes standards for reporting comprehensive income and its components in financial statements. Comprehensive income, as defined, includes all changes in equity (net assets) during a period from non-owner sources. The change in comprehensive income for all periods presented resulted from foreign currency translation gains and losses and unrealized gains and losses on securities.

Revenue recognition

Online transaction revenues are derived primarily from placement fees charged for the listing of items on the eBay website, success fees calculated as a percentage of the final sales transaction value for both eBay and Half.com, and to a lesser extent, online advertising.

Listing and featured item fee revenue is recognized ratably over the estimated period of the auction while revenues related to success fees are recognized at the time that the transaction is successfully concluded. A transaction is considered successfully concluded when at least one buyer has bid above the seller's specified minimum price or reserve price, whichever is higher, at the end of the transaction term. Advertising revenues, which are principally derived from the sale of banners or sponsorship on the eBay site, are recognized as the impressions are delivered, or ratably over the term of the agreement where such agreements provide for minimum monthly or quarterly advertising commitments or such commitments are fixed throughout the term. Provisions for doubtful accounts and authorized credits to sellers are made at the time of revenue recognition based upon our historical experience.

eBay Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Kruse auction revenues are derived primarily from entry fees on auction items, bidder registration fees and commission fees calculated as a percentage of the final auction sales transaction value. Revenues related to these fees are recognized upon the completion of an auction. Revenues are also derived from sponsorship fees paid by various corporations. Sponsorship fee revenues are recognized over the term of the sponsorship agreement. Advertising revenues and auctioneer tuition fees do not represent a significant source of revenues and are recognized as advertising and auctioneer training services are provided.

Butterfields auction revenues are derived primarily from auction commissions and fees from the sale of property through the auction process. Revenues from these sources are recognized at the date the related auction is concluded. Service revenues are derived from financial, appraisal and other related services and are recognized as such services are rendered. Rental revenues are derived from property rentals to third parties.

To date, barter advertising has accounted for less than 1% of eBay's revenue. eBay records barter revenue in accordance with Emerging Issues Task Force ("EITF") Issue No. 99-17, "Accounting for Advertising Barter Transactions" which requires that barter transactions be recognized at the fair value of the advertising surrendered when an entity has a historical practice of receiving cash or marketable securities for similar advertising transactions. A period not to exceed six months prior to the date of the barter transaction has been used to determine whether eBay has a historical practice of receiving cash or marketable securities for similar advertising. In addition, the recognition of revenue on barter advertising is limited by the dollar amount of the cash received for similar transactions during the same period.

Website development costs

eBay recognizes website development costs in accordance with EITF Issue No. 00-02, "Accounting for Website Development Costs." As such, eBay expenses all costs incurred that relate to the planning and post implementation phases of development of its website. Direct costs incurred in the development phase are capitalized and recognized over the product's estimated useful life. Costs associated with repair or maintenance for the website are included in cost of net revenues in the accompanying consolidated statement of income.

Advertising expense

eBay recognizes advertising expenses in accordance with SOP 93-7 "Reporting on Advertising Costs." As such, eBay expenses the costs of producing advertisements at the time production occurs, and expenses the cost of communicating advertising in the period during which the advertising space or airtime is used. Internet advertising expenses are recognized based on the terms of the individual agreements, which is generally over the greater of the ratio of the number of impressions delivered over the total number of contracted impressions, or a straight-line basis over the term of the contract. Advertising expenses totaled \$15.4 million, \$46.1 million, and \$85.4 million during the years ended December 31, 1998, 1999 and 2000, respectively.

Stock-based compensation

eBay accounts for stock-based employee compensation arrangements in accordance with provisions of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," FASB Interpretation No. 44 ("FIN 44") "Accounting for Certain Transactions Involving Stock Compensation — an Interpretation of APB 25," and complies with the disclosure provisions of SFAS No. 123, "Accounting for Stock-Based Compensation." Under APB No. 25, compensation expense is based on the difference, if any, on the date of the grant, between the fair value of eBay's stock and the exercise price. eBay accounts for stock issued to non-employees in accordance with the provisions of SFAS No. 123 and the EITF Issue No. 96-18, "Accounting for Equity Instruments that are Issued to other than Employees for Acquiring, or in Conjunction with Selling Goods or Services."

eBay Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Income taxes

Income taxes are accounted for using an asset and liability approach which requires the recognition of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in eBay's financial statements or tax returns. The measurement of current and deferred tax assets and liabilities are based on provisions of the enacted tax law; the effects of future changes in tax laws or rates are not anticipated. The measurement of deferred tax assets is reduced, if necessary, by the amount of any tax benefits that, based on available evidence, are not expected to be realized.

Recent accounting pronouncements

In June 1998, the Financial Accounting Standards Board ("FASB") issued SFAS No. 133, "Accounting for Derivatives and Hedging Activities." SFAS No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. In June 1999, the FASB issued SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities — Deferral of the Effective Date of FASB Statement No. 133," which deferred the effective date until the first fiscal year ending on or after June 30, 2000. In June 2000, the FASB issued SFAS Statement No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities — an Amendment of SFAS 133." SFAS No. 138 amends certain terms and conditions of SFAS 133. SFAS 133 requires that all derivative instruments be recognized at fair value as either assets or liabilities in the statement of financial position. The accounting for changes in the fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. eBay will adopt SFAS No. 133, as amended, in its quarter ending March 31, 2001. Upon adoption, the cumulative effect to net income and other comprehensive income of this change in accounting method is a gain of approximately \$650,000 and a loss of approximately \$2.6 million, respectively, net of tax.

In July 2000, the EITF reached a consensus with respect to EITF Issue No. 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent." EITF 99-19 addressed whether a company should report revenue based on the gross amount billed to a customer because it has earned revenue from the sale of the goods or services or the net amount retained (that is, the amount billed to the customer less the amount paid to a supplier) because it has earned a commission or fee. eBay adopted EITF 99-19, and such adoption did not have a material impact on its consolidated financial statements.

In March 2000, the EITF reached a consensus on EITF Issue No. 00-14, "Accounting for Certain Sales Incentives." This consensus provides guidance on the recognition, measurement, and income statement classification of sales incentives which are offered voluntarily by a vendor without charge to customers that can be used in, or that are exercisable by a customer as a result of, a single exchange transaction. eBay evaluated the provisions of the guidance in conjunction with its policies and concluded that eBay is in compliance with this pronouncement.

In July 2000, the EITF issued EITF Issue No. 00-15, "Classification in the Statement of Cash Flows of the Income Tax Benefit Realized by a Company upon Employee Exercise of a Non-qualified Stock Option." EITF 00-15 addresses the cash flow statement presentation of the tax benefit associated with nonqualified stock options. eBay receives an income tax deduction for the difference between the exercise price and the market price of a nonqualified stock option upon exercise by the employee. EITF 00-15 concludes that the income tax benefit realized by eBay upon an employee exercise of stock options should be classified in the operating section of the cash flow statement. The EITF is effective for all quarters ending after July 20, 2000. eBay adopted EITF 00-15, and such adoption did not have a material impact on its consolidated financial statements.

In July 2000, the EITF issued EITF Issue No. 00-16, "Recognition and Measurement of Employer Payroll Taxes on Employee Stock-Based Compensation." This Issue addresses how an entity should account

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

for employer payroll taxes on stock-based compensation under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and SFAS No. 123, "Accounting for Stock-Based Compensation." This Issue addresses eBay's timing for recognizing the payroll tax liability and requires that this liability be recognized when the tax obligation becomes due and payable. eBay adopted EITF 00-16 effective July 31, 2000 and such adoption did not have a material impact on its consolidated financial statements.

Note 2 — Net Income per Share:

eBay computes net income per share in accordance with SFAS No. 128, "Earnings per Share." Under the provisions of SFAS No. 128, basic net income per share is computed by dividing the net income available to common stockholders for the period by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing the net income for the period by the weighted average number of common and common equivalent shares outstanding during the period. Common equivalent shares, composed of unvested, restricted common stock and incremental common shares issuable upon the exercise of stock options and warrants and upon conversion of Series A and Series B Convertible Preferred Stock, are included in diluted net income per share to the extent such shares are dilutive.

The following table sets forth the computation of basic and diluted net income per share for the periods indicated (in thousands, except per share amounts):

	Year Ended December 31,		
	1998	1999	2000
Numerator:			
Net income	\$ 7,273	\$ 9,567	\$ 48,294
Accretion of Series B Mandatorily Redeemable Convertible Preferred Stock to redemption value	(46)	—	—
Net income available to common stockholders	<u>\$ 7,227</u>	<u>\$ 9,567</u>	<u>\$ 48,294</u>
Denominator:			
Weighted average shares	183,284	255,806	266,826
Weighted average unvested common shares subject to repurchase agreements	(79,156)	(38,132)	(15,050)
Denominator for basic calculation	104,128	217,674	251,776
Weighted average effect of dilutive securities:			
Series A Preferred Stock	22,074	—	—
Series B Preferred Stock	16,108	—	—
Warrants	2,197	7	93
Weighted average common shares subject to repurchase agreements	79,156	38,132	15,050
Employee stock options	9,856	17,220	13,427
Denominator for diluted calculation	<u>233,519</u>	<u>273,033</u>	<u>280,346</u>
Net income per share:			
Basic	<u>\$ 0.07</u>	<u>\$ 0.04</u>	<u>\$ 0.19</u>
Diluted	<u>\$ 0.03</u>	<u>\$ 0.04</u>	<u>\$ 0.17</u>

Note 3 — Acquisitions:

Jump Incorporated

Effective June 30, 1998, eBay acquired all the outstanding shares of Jump Incorporated ("Jump"), an online personal trading community. The total purchase price of approximately \$2.3 million consisted of

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

857,088 shares of eBay's common stock with an estimated fair value of approximately \$2.0 million and other acquisition related expenses of approximately \$335,000, consisting primarily of payments for non-compete agreements totaling approximately \$208,000 and legal and other professional fees. Of the total purchase price, approximately \$150,000 was allocated to in-process technology and was immediately charged to operations because such in-process technology had not reached the stage of technological feasibility at the acquisition date and had no alternative future use. The remainder of the purchase price was allocated to net tangible liabilities assumed (\$31,000) and intangible assets, including completed technology (\$500,000), customer list (\$1.5 million), covenants not to compete (\$208,000) and goodwill (\$24,000). The intangible assets are being amortized over their estimated useful lives of 8 to 24 months.

Kruse International

On May 18, 1999, eBay acquired Kruse, Inc. (d/b/a Kruse International) and all affiliated entities under common control including: Auburn Cordage, Inc., ACD Auto Sales, Inc., Reppert School of Auctioneering, Inc. and Classic Advertising & Promotions, Inc., each an Indiana corporation, and Kruse Montana, Inc., a Montana corporation (collectively, "Kruse" or the "Kruse Companies").

Kruse International was founded in 1971 and operated as a sole proprietorship until it was incorporated in the state of Indiana in August 1986. The Kruse Companies conduct auctions, perform appraisal services and auctioneer training for classic car auctions in various locations in the United States, England, Germany and the Netherlands.

The aggregate consideration exchanged for the acquisition was 1,574,624 shares of eBay common stock for all shares of capital stock of the Kruse Companies. The acquisition has been accounted for as a pooling of interests.

Billpoint

On May 25, 1999, eBay acquired Billpoint, Inc. ("Billpoint"). Billpoint has developed a centralized, turnkey authorization, billing and payment fulfillment solution that permits individuals and small merchants to accept credit cards as payment for Internet-based sales transactions. Billpoint's service is now being made available to eBay's users, providing the ability to accept credit cards for payment.

In connection with the acquisition, eBay issued 1,048,264 shares of eBay common stock to the existing Billpoint shareholders as consideration for all shares of capital stock, and all options and warrants to purchase shares of common stock of Billpoint outstanding immediately prior to the consummation of the merger were converted into options and warrants to purchase shares of eBay common stock. The acquisition has been accounted for as a pooling of interests.

Butterfields

On May 28, 1999, eBay acquired Butterfields Auctioneers Corporation, a Delaware corporation and all affiliated entities under common control including Butterfield Credit Corporation Inc., 111 Potrero Partners, LLC and HBJ Partners, LLC (collectively "Butterfields").

Butterfields was established in 1865, incorporated in California in July 1970 and reincorporated in the state of Delaware in March 1999. Butterfields conducts auctions and performs appraisal services of fine art, jewelry, antiques and other collectibles primarily in San Francisco, Los Angeles and Chicago.

Butterfield Credit Corporation Inc. ("BCCI") is a wholly-owned subsidiary of Butterfields and is incorporated in California. BCCI operates as a financing corporation whose sole purpose is serving Butterfield's clients.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

111 Potrero Partners, LLC (“111 Potrero”) is a limited liability corporation organized in May 1996. 111 Potrero owns several commercial properties located in San Francisco and Los Angeles, which are currently occupied by Butterfields and third parties.

HBJ Partners, LLC (“HBJ”) is a limited liability corporation organized in California in September 1996. HBJ owns several commercial properties located in San Francisco, which are currently occupied by Butterfields and third parties. HBJ also has general partnership interests in 17600 Santa Fe Avenue Partners and 2959 Victoria Street. As of December 31, 2000, ownership interests in the above partnerships were 94% and 85%, respectively.

The aggregate consideration exchanged for the acquisition was 2,654,740 shares of eBay common stock. The acquisition has been accounted for as a pooling of interests. In April 1999, Butterfields withdrew its registration statement for its initial public offering. Accordingly, in the second quarter of 1999, eBay recorded a charge of approximately \$2.6 million related to the costs of the withdrawn offering.

alando.de.ag

On June 15, 1999, eBay acquired all of the outstanding stock of alando.de.ag (“alando”). alando began operations on February 19, 1999 and is Germany’s leading online personal trading community. The aggregate consideration exchanged for the acquisition was 632,000 shares of eBay common stock. The acquisition has been accounted for as a pooling of interests.

Half.com

On July 11, 2000, eBay acquired Half.com. Half.com was incorporated in Pennsylvania in June 1999 and provides a fixed-price, person-to-person e-commerce site that allows people to buy and sell previously owned goods at discounted prices.

In connection with the merger, eBay issued, or reserved for issuance, a total of approximately 5,484,000 shares of eBay common stock to Half.com’s existing shareholders, option holders and warrant holders as consideration for all shares of capital stock, options and warrants of Half.com held immediately prior to consummation of the merger. The merger has been accounted for as a pooling-of-interests.

The results of operations previously reported by eBay and Half.com are summarized as follows (in thousands):

	<u>Six Months Ended</u> <u>June 30,</u>		<u>Year Ended</u> <u>December 31,</u>
	<u>1999</u>	<u>2000</u>	<u>1999</u>
Net revenues:			
eBay	\$92,280	\$183,152	\$224,724
Half.com.....	—	887	—
	<u>\$92,280</u>	<u>\$184,039</u>	<u>\$224,724</u>
Net income (loss):			
eBay	\$ 4,581	\$ 17,878	\$ 10,828
Half.com.....	—	(8,661)	(1,261)
	<u>\$ 4,581</u>	<u>\$ 9,217</u>	<u>\$ 9,567</u>

There were no adjustments required to conform the accounting policies of Half.com to those of eBay.

See Subsequent Events — Note 16.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 4 — Segment Information:

Effective January 1, 1998, eBay adopted the provisions of SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." SFAS No. 131 establishes the standards for reporting information about operating segments in annual financial statements and requires that certain selected information about operating segments be reported in interim financial reports. It also establishes standards for related disclosures about products and services and geographic areas. Operating segments are defined as components of an enterprise about which separate financial information is evaluated regularly by the chief operating decisionmaker in order to allocate resources and in assessing performance.

eBay has identified two primary reporting segments: online trading services and offline, traditional auction services. The online trading services segment consists of the operations of eBay, Billpoint, alando.de.ag and Half.com. The offline, traditional auction segment consists of the current operations of Butterfields and Kruse.

Segment selection is based upon the internal organization structure, the manner in which these operations are managed and their performance evaluated by management, the availability of separate financial information, and overall materiality considerations. Segment performance measurement is based on operating income before income taxes, amortization of intangibles, stock-based compensation, payroll expense on employee stock options and merger related costs. The operating information for the two segments identified are as follows (in thousands):

	Year Ended December 31, 1998		
	Online	Offline	Consolidated
Net revenues from external customers	<u>\$47,352</u>	<u>\$38,777</u>	<u>\$ 86,129</u>
Operating income before amortization of intangibles, stock-based compensation, payroll expense on employee stock options and merger related costs	\$11,573	\$ 6,678	\$ 18,251
Interest and other income, net	908	891	1,799
Interest expense	(39)	(2,152)	(2,191)
Amortization of intangibles, stock-based compensation, payroll expense on employee stock options and merger related costs	<u>(5,486)</u>	<u>—</u>	<u>(5,486)</u>
Income before income taxes, minority interest and equity interest in partnership income	<u>\$ 6,956</u>	<u>\$ 5,417</u>	<u>\$ 12,373</u>
Total assets	<u>\$92,545</u>	<u>\$56,991</u>	<u>\$149,536</u>

	Year Ended December 31, 1999		
	Online	Offline	Consolidated
Net revenues from external customers	<u>\$182,533</u>	<u>\$42,191</u>	<u>\$224,724</u>
Operating income before amortization of intangibles, stock-based compensation, payroll expense on employee stock options and merger related costs	\$ 3,970	\$ 3,188	\$ 7,158
Interest and other income, net	23,624	209	23,833
Interest expense	(504)	(1,815)	(2,319)
Amortization of intangibles, stock-based compensation, payroll expense on employee stock options and merger related costs	<u>(8,697)</u>	<u>(1,834)</u>	<u>(10,531)</u>
Income (loss) before income taxes, minority interest and equity interest in partnership income	<u>\$ 18,393</u>	<u>\$ (252)</u>	<u>\$ 18,141</u>
Total assets	<u>\$873,122</u>	<u>\$96,703</u>	<u>\$969,825</u>

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Year Ended December 31, 2000		
	Online	Offline	Consolidated
Net revenues from external customers	\$ 391,952	\$39,472	\$ 431,424
Operating income (loss) before amortization of intangibles, stock-based compensation, payroll expense on employee stock options and merger related costs . .	\$ 49,767	\$(2,312)	\$ 47,455
Interest and other income, net	45,642	695	46,337
Interest expense	(1,071)	(2,303)	(3,374)
Amortization of intangibles, stock-based compensation, payroll expense on employee stock options and merger related costs	(11,464)	(997)	(12,461)
Income (loss) before income taxes, minority interest and equity interest in partnership income	\$ 82,874	\$(4,917)	\$ 77,957
Total assets	\$1,084,909	\$97,494	\$1,182,403

Note 5 — Investments:

At December 31, 1999 and 2000, short and long-term investments were classified as available-for-sale securities and are reported at fair value as follows (in thousands):

	December 31, 1999			
	Gross Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Short-term investments:				
Municipal bonds and notes	\$ 75,442	\$ —	\$ (55)	\$ 75,387
Corporate bonds	44,356	—	(5)	44,351
Government securities	59,820	—	(492)	59,328
Other	2,034	—	(14)	2,020
Total	\$181,652	\$ —	\$ (566)	\$181,086
Long-term investments:				
Municipal bonds and notes	\$322,144	\$ —	\$(3,425)	\$318,719
Corporate bonds	2,353	—	(26)	2,327
Government securities	28,112	—	(392)	27,720
Equity instruments	12,012	13,210	—	25,222
Total	\$364,621	\$13,210	\$(3,843)	\$373,988

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	December 31, 2000			Estimated Fair Value
	Gross Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
Short-term investments:				
Municipal bonds and notes	\$112,488	\$ 15	\$ (116)	\$112,387
Corporate bonds	21,193	70	—	21,263
Government securities	219,674	842	—	220,516
Total	<u>\$353,355</u>	<u>\$927</u>	<u>\$ (116)</u>	<u>\$354,166</u>
Long-term investments:				
Municipal bonds and notes	\$141,861	\$ 69	\$ (269)	\$141,661
Government securities	151,732	694	(81)	152,345
Equity instruments and other	54,505	—	(3,924)	50,581
Total	<u>\$348,098</u>	<u>\$763</u>	<u>\$(4,274)</u>	<u>\$344,587</u>

In 2000, restricted cash of \$126,390 is included within long-term investments.

The estimated fair value of short and long-term investments classified by date of contractual maturity are as follows (in thousands):

	December 31, 2000
Due within one year or less	\$354,166
Due after one year through two years	191,873
Due after two years through three years	5,028
Restricted cash and investments expiring in less than five years	126,390
Equity investments	21,296
	<u>\$698,753</u>

Note 6 — Balance Sheet Components:

	December 31,	
	1999	2000
	(in thousands)	
Cash and cash equivalents:		
Cash and money market funds	\$ 57,536	\$ 75,338
Securities and cash equivalents	164,265	126,535
Total	<u>\$221,801</u>	<u>\$201,873</u>
Accounts receivable, net:		
Accounts receivable	\$ 44,940	\$ 81,293
Allowance for doubtful accounts	(6,722)	(12,122)
Allowance for authorized credits	(1,680)	(2,008)
Total	<u>\$ 36,538</u>	<u>\$ 67,163</u>

eBay Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Write-offs against the allowance for doubtful accounts were \$562,000, \$4.5 million and \$12.5 million in the years ended December 31, 1998, 1999 and 2000, respectively.

	December 31,	
	1999	2000
	(in thousands)	
Property and equipment, net:		
Land and buildings	\$ 61,274	\$ 60,575
Computer equipment and software	65,268	113,917
Leasehold improvements	6,510	7,193
Furniture and fixtures	8,844	12,114
Vehicles and other	2,529	379
Total	<u>144,425</u>	<u>194,178</u>
Accumulated depreciation and amortization	<u>(32,223)</u>	<u>(69,017)</u>
Total	<u>\$112,202</u>	<u>\$125,161</u>

Within computer equipment and software, eBay capitalized \$5.8 million and \$9.4 million and recorded amortization expense of \$2.4 million and \$6.6 million for site related software during the years ended December 31, 1999 and 2000, respectively.

Total depreciation expense for years ended December 31, 1998, 1999 and 2000 totaled \$1.7 million, \$18.6 million and \$36.7 million, respectively.

	December 31,	
	1999	2000
	(in thousands)	
Intangible assets and other assets, net:		
Intangible assets	\$12,601	\$18,234
Accumulated amortization	<u>(3,789)</u>	<u>(5,171)</u>
Subtotal	8,812	13,063
Other assets	3,877	10,236
Total	<u>\$12,689</u>	<u>\$23,299</u>
Accrued expenses:		
Accrued compensation and related benefits	\$ 5,826	\$10,320
Advertising accruals	4,918	13,258
Professional fees	3,990	5,853
Other accruals	<u>17,439</u>	<u>31,451</u>
Total	<u>\$32,173</u>	<u>\$60,882</u>

	December 31,	
	1999	2000
	(in thousands)	
Other comprehensive income		
Unrealized gain/(loss) on investments	\$ 8,883	\$(2,700)
Foreign currency translation adjustment	(58)	745
Deferred tax asset/(liability) on unrealized gains and losses ...	<u>(3,731)</u>	<u>1,080</u>
Total	<u>\$ 5,094</u>	<u>\$ (875)</u>

eBay Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 7 — Debt:

Notes payable

Notes payable consists of amounts payable to various financial institutions, which are collateralized by specific properties and are detailed as follows:

	December 31,	
	1999	2000
	(in thousands)	
Mortgage notes, prime plus 1%, due September 30, 2002	\$ 1,797	\$ 1,689
Mortgage notes, LIBOR plus 1.75%, due July 15, 2001	3,501	3,351
Mortgage notes, 8.25%, due November 15, 2001	11,980	11,812
Mortgage notes, 8.175% variable, due August 1, 2023	9,300	9,300
Convertible note, prime plus 1%, due April 3, 2000	3,496	—
Loan on foreclosed property, prime plus 2%, due August 9, 2015	549	524
6% – 10.5% notes, due October 2000 through January 2003	176	—
Subtotal	<u>30,799</u>	<u>26,676</u>
Less: Current portion	<u>(15,781)</u>	<u>(15,272)</u>
Long-term portion	<u>\$ 15,018</u>	<u>\$ 11,404</u>

Mortgage notes outstanding are on property owned by Butterfields. The notes have variable interest rates, payment terms and are collateralized by certain land, buildings and improvements. Generally, the principal and interest are paid on a monthly basis.

The mortgage notes bearing an interest rate of 8.25% were originally due on May 15, 2000. The maturity was extended to November 15, 2001.

The convertible note was related to Half.com and was used as a bridge loan until funding was received from their preferred stock issuance. The convertible note was converted to Half.com’s preferred stock in January 2000.

Minimum annual repayments on these notes at December 31, 2000 are as follows (in thousands):

<u>Year ending December 31,</u>	<u>Total</u>
2001	\$15,272
2002	1,612
2003	35
2004	40
2005	44
Thereafter	<u>9,673</u>
	<u>\$26,676</u>

Note 8 — Leasing Arrangements:

eBay, through its Butterfields subsidiary, leases certain land and buildings. These leases are classified as operating leases that expire at various intervals between 2001 and 2013. Certain of these leases contain renewal options and have escalation clauses tied to changes in the Consumer Price Index. Under the terms of the leases, the tenants are generally responsible for the payment of property taxes, insurance and maintenance costs related to the leased property.

eBay Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Property under operating leases and property held for lease

The following schedule provides a summary of eBay's investment in property held for lease by major classes, in thousands:

	December 31,	
	1999	2000
Land and building	\$33,500	\$ 44,095
Building improvements.....	9,801	11,990
	43,301	56,085
Less: Accumulated depreciation	(6,986)	(12,029)
	\$36,315	\$ 44,056

The following is a schedule by year of minimum future rental income on noncancellable operating leases as of December 31, 2000 (in thousands):

Year ending December 31,	Total
2001	\$ 5,342
2002	5,226
2003	5,245
2004	5,201
2005	5,187
Thereafter	25,768
Total minimum future rentals	\$51,969

Note 9 — Purchase and Sale of Properties or Property Interests:

From time to time and in the ordinary course of business, eBay elects to sell properties previously held for lease, or purchase properties or property interests for future rental. eBay views its rental properties as sources of income, which may be derived either from property rental, or potentially the sale of the property. In November 1999, eBay sold its Curson property for \$350,000 in cash and recognized a gain of \$182,000.

During 1999 and 2000 eBay increased its ownership percentage in various property partnerships acquired in the merger with Butterfields. eBay became a majority owner in some properties in which it had previously held a minority interest.

See Subsequent Events — Note 16

Note 10 — Commitments and Contingencies:

Litigation

On September 1, 1999, eBay was served with a lawsuit filed by Randall Stoner, on behalf of the general public, in San Francisco Superior Court (No. 305666). The lawsuit alleged that eBay violated Section 17200 of the California Business & Professions Code, a statute that relates to unfair competition, based upon the listing of "bootleg" or "pirate" recordings by eBay's users, allegedly in violation of California penal statutes relating to the sale of unauthorized audio recordings. The lawsuit sought declaratory and injunctive relief, restitution and legal fees. eBay filed a general demurrer which was sustained by the court with leave to amend. The plaintiff subsequently filed an amended complaint. eBay filed a motion for summary judgement. On November 7, 2000, eBay's motion for summary judgement was granted.

eBay Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

On December 10, 1999, eBay sued Bidder's Edge, Inc. in the United States District Court for the Northern District of California alleging trespass, unfair competition, violation of the computer fraud and abuse act, misappropriation, false advertising, trademark dilution, injury to business reputation, interference with prospective economic advantage, and unjust enrichment. On February 7, 2000, Bidder's Edge denied these claims and counterclaimed against eBay alleging that eBay violated the antitrust laws by monopolizing or attempting to monopolize a market, that competed unfairly, and interfered with Bidder's Edge's contract with eBay magazine. Bidder's Edge sought treble damages, an injunction and its fees and costs. On May 24, 2000, the court granted us a preliminary injunction against the use by Bidder's Edge of robotic means to copy eBay's site. See Subsequent Events — Note 16.

On April 25, 2000, eBay was served with a lawsuit, *Gentry et. al. v. eBay, Inc. et. al.*, filed in Superior Court in San Diego, California. The lawsuit was filed on behalf of a purported class of eBay users who purchased allegedly forged autographed sports memorabilia on eBay. The lawsuit claims eBay was negligent in permitting certain named (and other unnamed) defendants to sell allegedly forged autographed sports memorabilia on eBay. In addition, the lawsuit claims eBay violated Section 17200 and a section of the California Civil Code which prohibits "dealers" from selling sports memorabilia without a "Certificate of Authenticity." See Subsequent Events — Note 16.

From time to time, eBay is involved in disputes which have arisen in the ordinary course of business. Management believes that the ultimate resolution of these disputes will not have a material adverse impact on eBay's consolidated financial positions, results of operations or cash flows.

Lease arrangement

On March 1, 2000, eBay entered into a five-year lease for general office facilities located in San Jose, California. Payments under this lease are based on a spread over the London Interbank Offering Rate ("LIBOR") applied to the \$126.4 million cost of the facility funded by the lessor. eBay has an option to renew the lease for up to two five-year extensions subject to specific conditions. Under the terms of the lease agreement, eBay was required to place \$126.4 million of cash and investment securities as collateral for the term of the lease. The cash and investment securities are restricted as to their withdrawal from the third party trustee and are classified as long-term restricted cash and investments in the accompanying balance sheet.

eBay entered into two interest rate swaps on June 19 and July 20, 2000 totaling \$95 million to reduce the impact of changes in interest rates on a portion of the floating rate operating lease for our facilities. The interest rate swaps allow eBay to receive floating rate receipts based on LIBOR in exchange for making fixed rate payments which effectively amends the interest rate exposure on our operating lease from a floating rate to a fixed rate on \$95 million of the total \$126.4 million operating lease. The interest rate swaps have been accounted for under the accrual method of accounting. The fair value of the interest rate swaps on December 31, 2000 was a \$4.4 million loss based on discounted cash flows.

eBay Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

eBay leases property and equipment under non-cancelable operating leases that expire at various dates. Future minimum rental payments under non-cancelable operating leases subsequent to December 31, 2000, are as follows (in thousands):

<u>Year ending December 31,</u>	<u>Operating Leases</u>
2001	\$10,383
2002	10,356
2003	10,351
2004	10,473
2005	2,269
Thereafter	<u>52</u>
Total minimum lease payments	<u><u>\$43,884</u></u>

Rent expense in the years ended December 31, 1998, 1999 and 2000 totaled \$672,000, \$3.9 million and \$4.8 million, respectively.

Advertising

GO.com

On February 6, 2000, eBay entered into a four-year marketing agreement with GO.com. In accordance with the agreement, GO.com provided eBay with online and offline promotion, eBay and GO.com developed a co-branded version of the eBay service and both companies developed a site featuring merchandise from GO.com affiliates. These affiliates include but are not limited to The Walt Disney Company, ESPN and ABC. In consideration for this agreement, eBay will pay a minimum of \$30 million to GO.com over the four-year term. See Subsequent Events — Note 16.

NEC

On February 17, 2000, eBay Japan Inc., a wholly owned subsidiary of eBay, entered into a shareholder and marketing services agreement with NEC Corporation. In accordance with the shareholder agreement, NEC acquired 30% of eBay Japan and eBay retained the remaining 70% interest in eBay Japan. eBay will continue to consolidate eBay Japan due to a majority ownership interest and will reflect a minority interest for the equity interest of NEC.

In accordance with the marketing agreement, NEC provided marketing and services to eBay Japan in an effort to deliver a minimum level of confirmed registered users. As compensation for the marketing and other services performed by NEC, eBay Japan paid NEC an annual up-front fee of approximately \$1.5 million. The first payment was made in April, 2000, and additional payments will be payable on the anniversary of such date in each of the subsequent three years as long as the contract is in effect. If NEC is unable to deliver the minimum level of confirmed registered users, then eBay will have the right to repurchase shares of eBay Japan from NEC.

AutoTrader.com

On March 6, 2000, eBay and Autotrader.com LLC (“Autotrader”) entered into a marketing and services agreement whereby eBay and Autotrader developed a co-branded site, and Autotrader will refer customers desiring an auction pricing format to eBay for a referral fee. Under the terms of the agreement, eBay has committed to provide certain marketing expenditures for the promotion of the eBay service and additional automobile related services offered by Autotrader. In consideration for these expenditures, eBay is committed to pay \$29 million over the 3.5-year term.

eBay Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Under the agreement, eBay acquired 1,439,040, approximately 3.3% of the equity of Autotrader for approximately \$11.0 million in cash or \$7.63 per unit.

AOL

In March 1999, eBay expanded the scope of its strategic relationship with AOL. Under the amended agreement, eBay was granted a prominent presence featuring it as the preferred provider of person-to-person trading services on AOL's proprietary services (both domestic and international), AOL.com, Digital Cities, ICQ, CompuServe (both domestic and international) and Netscape. In addition, eBay has developed or will develop a co-branded version of its service for each AOL property which will prominently feature each party's brand. AOL will be entitled to all advertising revenue from the co-branded site. eBay will pay \$75 million over the four-year term of the contract. eBay is recognizing these fees as sales and marketing expense over the greater of: i) the ratio of the number of impressions delivered over the total number of contracted impressions, or ii) a straight-line basis beginning with the initial delivery of impressions and extending over the term of the contract. At December 31, 2000, eBay had advanced \$37.5 million under the amended agreement, and had recognized \$28.5 million as advertising expense commencing with the launch of the co-branded program and delivery of advertising impressions.

In conjunction with the expanded strategic relationship, AOL terminated its original contract with eBay in August 1999. As a result, the remaining \$8.0 million commitment associated with the original agreement was waived. AOL continued to deliver impressions under the original agreement through August 1999.

Minimum auction guarantees

From time to time eBay, through its Butterfields subsidiary, guarantees the minimum net proceeds with respect to the sale of properties at future auctions. Such guaranteed proceeds are often advanced to the consignor prior to the completion of the auction. eBay is responsible for the shortfall, if any, between the guaranteed minimum proceeds and the actual net proceeds upon the completion of the auction. Losses, if any, are recognized at the conclusion of the auction. In 2000, Butterfields had entered into two such agreements with guaranteed net proceeds of \$1.25 million and \$2.0 million. The \$2.0 million agreement is shared with another auction service, half of which is guaranteed by each party. In June and October 2000, the minimum guarantee auctions took place, and at the conclusion of the auctions, the minimum net proceed amounts were not obtained. Butterfields recognized an insignificant loss for the shortfall between the minimum proceeds it guaranteed and the actual net proceeds received.

Note 11 — Related Party Transactions:

In February 2000, a subsidiary of eBay entered into a service contract with a related party whereby the subsidiary agreed to provide services with respect to the design of the related party's system. The related party remitted payment totaling \$1.5 million to the subsidiary of which \$35,000 was treated as a cost reimbursement for product development expenses, and the remainder was accounted for as revenue. Both amounts are included in the accompanying consolidated statement of income.

In February 2000, a subsidiary of eBay entered in to a marketing agreement with a related party. Total payments under this agreement were approximately \$1.5 million.

In July 2000, eBay purchased shares representing beneficial interest of less than five percent of a company affiliated with a director of eBay. In connection with the transaction, eBay received a warrant that would, if exercised, increase eBay's beneficial interest to less than ten percent. eBay recorded the investment at cost. Separately, eBay entered into a commercial agreement whereby eBay provided approximately \$1.3 million of advertising services to the related party. The amount is included in the accompanying consolidated statements of income.

eBay Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In July 2000, eBay had also entered into an agreement whereby eBay purchased shares representing beneficial interest of less than five percent of a company affiliated with a director of eBay. Additionally, eBay received a warrant that, if exercised, eBay's beneficial interest would remain at less than five percent. eBay recorded the investment at cost. Separately, eBay entered into a commercial agreement whereby eBay provided approximately \$1.3 million of advertising services to the related party. The amount is included in the accompanying consolidated statements of income.

In April 2000, eBay entered into an agreement with a company that is affiliated with a director of eBay, eBay recorded approximately \$4.1 million in income relating to advertising services. eBay also entered into an agreement whereby eBay purchased shares representing less than one percent of the related party's total shares outstanding. Additionally, eBay received a warrant that, if exercised, eBay's beneficial interest would remain at less than one percent.

All contracts with related parties are at rates and terms that management believes are comparable with those entered into with independent third parties.

Note receivable from stockholders

At December 31, 1999, eBay held a note receivable from an employee totaling \$11,000 which was fully paid at December 31, 2000. Note receivable from stockholders represented amounts owed to eBay from the exercise of stock options. These full recourse notes were collateralized by common stock and interest was at a rate of 8% per annum.

Notes receivable from eBay executive officers

At December 31, 2000, eBay held notes receivable from two executive officers of eBay totaling \$3.2 million. The promissory note held by one officer of eBay as of December 31, 1999 was amended in 2000. The amended note bears interest at a rate of 6.37% per annum as compared to the previous rate of 5.43% and remains collateralized by a Deed of Trust, held by eBay. The other note bears interest at a rate of 6.40% per annum and is collateralized by a Deed of Trust, held by eBay. Both notes' outstanding principal and interest are due and payable by 2004.

Note 12 — Preferred Stock:

Preferred Stock

eBay is authorized, subject to limitations prescribed by Delaware law, to provide for the issuance of Preferred Stock in one or more series, to establish from time to time the number of shares included within each series, to fix the rights, preferences and privileges of the shares of each wholly unissued series and any qualifications, limitations or restrictions thereon, and to increase or decrease the number of shares of any such series (but not below the number of shares of such series then outstanding) without any further vote or action by the stockholders. At December 31, 1999 and 2000 there were 10,000,000 shares of Preferred Stock authorized for issuance, and no shares issued or outstanding.

Note 13 — Common Stock:

eBay's Certificate of Incorporation, as amended, authorizes eBay to issue 900,000,000 shares of common stock. A portion of the shares outstanding are subject to repurchase by eBay over a four-year period from the earlier of the issuance date or employee hire date, as applicable. At December 31, 1999 and 2000, there were 25,356,000 and 7,509,000 shares, respectively, subject to repurchase rights at an average price of \$0.06 and \$0.12, respectively, per share.

eBay Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In June 1998, in connection with the appointment of two outside directors, eBay sold an aggregate of 1,287,000 shares of common stock to two directors and realized net proceeds of \$2.0 million. eBay recognized the \$429,000 excess of the estimated fair value of the stock over the price paid by the two directors as general and administrative expense in 1998.

At December 31, 2000, eBay had reserved 18,114,107 and 1,005,652 shares of common stock for future issuance for the exercise of options under the stock option plans and issuance of shares under the employee stock purchase plan, respectively.

Note 14 — Employee Benefit Plans:

401(k) Savings Plan

eBay has a savings plan that qualifies as a deferred salary arrangement under Section 401(k) of the Internal Revenue Code (the “401(k) Plan”). Under the 401(k) Plan, participating employees may defer a percentage (not to exceed 25%) of their eligible pretax earnings up to the Internal Revenue Service’s annual contribution limit. All employees on the United States payroll of eBay age 21 years or older are eligible to participate in the 401(k) Plan. eBay had not been required to contribute to the 401(k) Plan but in 1998 elected to match contributions up to a maximum of \$1,500 per employee, and committed to matching contributions to a maximum of \$1,500 per employee per year in future periods. As a result, eBay contributed and expensed \$97,000, \$856,000 and \$1.8 million in the years ended December 31, 1998, 1999 and 2000, respectively.

As a result of the mergers with eBay in 1999 and 2000, Butterfields, Kruse, Billpoint, and Half.com terminated any existing defined savings contribution plans and adopted eBay’s 401(k) Plan.

Stock option plans

In December 1996, eBay’s Board of Directors adopted the 1996 Stock Option Plan (the “1996 Plan”), in June 1997, adopted the 1997 Stock Option Plan (the “1997 Plan”), in August 1998, adopted the 1998 Stock Option Plan (the “1998 Plan”), and in 1999 the 1999 Global Equity Incentive Plan (the “1999 Plan”) (collectively, the “Plans”). The Plans provide for the granting of stock options to employees and consultants of eBay. Options granted under the Plans may generally be either incentive stock options (“ISOs”) or nonqualified stock options (“NSOs”). ISOs may be granted only to eBay’s employees (including officers and directors who are also employees). NSOs may be granted to eBay’s employees and consultants.

In July 1998, the Board adopted, and in August 1998 eBay’s stockholders approved, the 1998 Equity Incentive Plan (the “1998 Plan”) and reserved 27,000,000 shares of common stock for issuance thereunder. The 1998 Plan authorized the award of options, restricted stock awards and stock bonuses (each an “Award”). No person will be eligible to receive more than 6,000,000 shares in any calendar year pursuant to Awards under the 1998 Plan other than a new employee of eBay who will be eligible to receive no more than 12,000,000 shares in the calendar year in which such employee commences employment. Options granted under the 1998 Plan may be either ISOs or NSOs. ISOs may be granted only to eBay’s employees (including officers and directors who are also employees). NSOs may be granted to eBay’s employees, officers, directors, consultants, independent contractors and advisors of eBay.

In October 1999, the Board of Directors adopted the 1999 Global Equity Incentive Plan (the “1999 Plan”) and reserved 5,000,000 shares of common stock for issuance thereunder. Options may be granted to eBay’s employees, directors, and consultants and in particular to eBay’s employees, directors, and consultants who are neither citizens nor residents of the United States of America. The 1999 plan was approved by the stockholders at the Annual Stockholders Meeting in May 2000.

eBay Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In May 1999, in connection with eBay's acquisition of Billpoint, eBay assumed Billpoint's 1999 Stock Plan, and all options outstanding under the plan. At the time of the acquisition, the outstanding options became options to purchase approximately 200,000 shares of eBay common stock. eBay will make no further option grants under this plan.

Options under the Plans may be granted for periods of up to ten years and at prices no less than 85% of the estimated fair value of the shares on the date of grant as determined by the Board of Directors, provided, however, that (i) the exercise price of an ISO may not be less than 100% of the estimated fair value of the shares on the date of grant, and (ii) the exercise price of an ISO granted to a 10% shareholder may not be less than 110% of the estimated fair value of the shares on the date of grant. Options under the 1996 and 1997 Plans were exercisable immediately through June 30, 1998, subject to repurchase rights held by eBay, which lapse over the vesting period, which is generally four years. Options under the 1998 Plan are not immediately exercisable and generally vest over a period of four years.

The following table summarizes activity under eBay's stock option plans for the years ended December 31, 1998, 1999 and 2000 (shares in thousands):

	Year Ended December 31,					
	1998		1999		2000	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of period ..	23,580	\$0.01	18,493	\$ 1.84	26,236	\$ 29.73
Granted	34,574	1.07	12,210	64.59	9,037	62.69
Exercised	(38,954)	0.07	(3,551)	1.95	(4,499)	6.23
Cancelled	(707)	0.83	(916)	38.96	(4,525)	65.41
Outstanding at end of period	<u>18,493</u>	1.84	<u>26,236</u>	29.73	<u>26,249</u>	38.99
Options exercisable at end of period ..	<u>740</u>	<u>0.02</u>	<u>3,654</u>	<u>5.03</u>	<u>7,006</u>	<u>27.73</u>
Weighted average grant date fair value of options granted during period		<u>\$1.40</u>		<u>\$105.03</u>		<u>\$103.79</u>

The following table summarizes information about fixed stock options outstanding at December 31, 2000, (shares in thousands):

Range of Exercise Prices	Options Outstanding at December 31, 2000			Options Exercisable at December 31, 2000	
	Number of Shares Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number of Shares Exercisable	Weighted Average Exercise Price
\$ 0.01 - \$ 2.33	4,865	7.4 years	\$ 1.43	1,968	\$ 1.33
2.50 - 2.50	5,900	7.7	2.50	2,228	2.50
3.83 - 53.83	4,368	9.2	43.96	667	44.02
53.88 - 66.63	3,444	9.2	60.56	521	62.13
66.91 - 75.19	4,070	8.9	71.07	944	70.38
75.25 - 116.31	<u>3,602</u>	8.9	86.57	<u>678</u>	85.44
	<u>26,249</u>	8.4	\$38.99	<u>7,006</u>	\$27.73

eBay Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Fair value disclosures

eBay calculated the fair value of each option grant on the date of grant using the Black-Scholes option pricing model as prescribed by SFAS No. 123 using the following assumptions:

	Year Ended December 31,		
	1998	1999	2000
Risk-free interest rates	4.9%	5.5%	4.9%
Expected lives (in years)	3.0	3.0	3.0
Dividend yield	0%	0%	0%
Expected volatility	80%	100%	115%

Prior to eBay's initial public offering, the fair value of each option grant to employees of eBay was determined using the minimum value method. Subsequent to the offering, the fair value was determined using the Black-Scholes model. The effect of compensation cost on net income and earnings per share are as follows (in thousands, except per share amounts):

	Year ended December 31,		
	1998	1999	2000
Net income (loss):			
As reported	\$7,273	\$ 9,567	\$ 48,294
Pro forma	\$6,497	\$(41,357)	\$(90,677)
Net income (loss) per share—basic:			
As reported	\$ 0.07	\$ 0.04	\$ 0.19
Pro forma	\$ 0.06	\$ (0.19)	\$ (0.36)
Net income (loss) per share—diluted:			
As reported	\$ 0.03	\$ 0.04	\$ 0.17
Pro forma	\$ 0.03	\$ (0.19)	\$ (0.36)

1998 Employee Stock Purchase Plan

In July 1998, the Board adopted, and in August 1998 eBay's stockholders approved, the 1998 Employee Stock Purchase Plan (the "Purchase Plan") and reserved 1,800,000 shares of common stock for issuance thereunder. On each January 1, the aggregate number of shares reserved for issuance under the Purchase Plan will be increased automatically by the number of shares purchased under the Purchase Plan in the preceding calendar year. The aggregate number of shares reserved for issuance under the Purchase Plan shall not exceed 9,000,000 shares. The Purchase Plan became effective on September 24, 1998, the first business day on which price quotations for eBay's common stock were available on the Nasdaq National Market. Employees are generally eligible to participate in the Purchase Plan if they are customarily employed by eBay for more than 20 hours per week and more than five months in a calendar year and are not (and would not become as a result of being granted an option under the Purchase Plan) 5% stockholders of eBay. Under the Purchase Plan, eligible employees may select a rate of payroll deduction between 2% and 10% of their W-2 cash compensation subject to certain maximum purchase limitations. Each Offering Period has a maximum duration of two years (the "Offering Period") and consists of four six-month Purchase Periods (each, a "Purchase Period"), with the exception of the first Purchasing Period, which began on September 24, 1998 and ended on April 30, 1999 and two supplemental purchasing period to accommodate merged employees which began on July 1, 1999 and August 1, 2000 ended on October 31, 1999 and October 31, 2000, respectively. Offering Periods and Purchase Periods generally begin on May 1 and November 1. The price at which the common stock is purchased under the Purchase Plan is 85% of the lesser of the fair market value of eBay's common stock on the first day of the applicable offering period or on the last day of that purchase

eBay Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

period. The Purchase Plan will terminate after a period of ten years unless terminated earlier as permitted by the Purchase Plan.

In July 2000, the Board of Directors of Billpoint, eBay's majority-owned subsidiary, adopted Billpoint's 2000 Stock Option and Incentive Plan (the "Billpoint Plan") and reserved 4,444,444 shares of Billpoint's common stock for issuance thereunder. The Billpoint Plan authorized the award of options, restricted stock, and other stock-based awards. Options granted under the Billpoint Plan may be either be ISOs or NSOs and may be granted to Billpoint's employees, directors and consultants.

1998 Directors Stock Option Plan

In July 1998, the Board adopted, and in August 1998 eBay's stockholders approved, the 1998 Directors Stock Option Plan ("Directors Plan") and reserved a total of 1,200,000 shares of eBay's common stock for issuance thereunder. Members of the Board who are not employees of eBay, or any parent, subsidiary or affiliate of eBay, are eligible to participate in the Directors Plan. The option grants under the Directors Plan are automatic and nondiscretionary, and the exercise price of the options must be 100% of the fair market value of the common stock on the date of grant. Each eligible director who first becomes a member of the Board on or after September 24, 1998 will initially be granted an option to purchase 180,000 shares (an "Initial Grant") on the date such director first becomes a director. Immediately following each Annual Meeting of eBay, each eligible director will automatically be granted an additional option to purchase 30,000 shares if such director has served continuously as a member of the Board since the date of such director's Initial Grant or, if such director was ineligible to receive an Initial Grant, since the Effective Date. In 1999, the Board amended the Directors Plan to provide that no such grants would be made to eligible directors at the 1999 Annual Meeting. The term of such options is ten years, provided that they will terminate seven months following the date the director ceases to be a director or a consultant of eBay (twelve months if the termination is due to death or disability). All options granted under the Directors Plan will vest as to 25% of the shares on the first anniversary of the date of grant and as to 2.08% of the shares each month thereafter, provided the optionee continues as a member of the Board or as a consultant to eBay.

Unearned stock-based compensation

In connection with certain stock option and stock warrant grants during the years ended December 31, 1998, 1999 and 2000, eBay recognized unearned compensation totaling \$5.8 million, \$10.7 million, and \$187,000, respectively. The unearned compensation for 1998 and 1999 is being amortized over the four-year vesting periods of the options and the one year vesting period of the warrant as applicable. The unearned compensation for 2000 is related to the Half.com acquisition and was amortized fully in 2000. Amortization expense recognized during the years ended December 31, 1998, 1999 and 2000 totaled approximately \$3.1 million, \$4.8 million and \$7.1 million, respectively.

Note 15 — Income Taxes:

The components of income (loss) including minority interest and equity interest in partnership income before income taxes, for the years ended December 31, 1998, 1999 and 2000 are as follows (in thousands):

	Year Ended December 31,		
	1998	1999	2000
United States	\$12,062	\$23,013	\$80,872
Foreign	—	(4,974)	147
	\$12,062	\$18,039	\$81,019

eBay Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The provision for income taxes is composed of the following (in thousands):

	<u>Year Ended December 31,</u>		
	<u>1998</u>	<u>1999</u>	<u>2000</u>
Current:			
Federal	\$2,419	\$10,951	\$31,420
State and local	963	2,683	8,498
Foreign	—	—	280
	<u>3,382</u>	<u>13,634</u>	<u>40,198</u>
Deferred:			
Federal	1,211	(4,108)	(5,887)
State and local	196	(1,054)	(1,586)
	<u>1,407</u>	<u>(5,162)</u>	<u>(7,473)</u>
	<u>\$4,789</u>	<u>\$ 8,472</u>	<u>\$32,725</u>

The following is a reconciliation of the difference between the actual provision for income taxes and the provision computed by applying the federal statutory rate of 34% for 1998 and 35% for 1999 and 2000 to income before income taxes (in thousands):

	<u>Year Ended December 31,</u>		
	<u>1998</u>	<u>1999</u>	<u>2000</u>
Provision at statutory rate	\$ 4,255	\$ 6,314	\$28,357
Permanent differences:			
Foreign income	—	1,741	229
S Corporation (income) loss	(1,848)	978	—
Merger related expenses	384	329	175
Stock-based compensation	1,051	(379)	125
Nonconsolidated subsidiary loss	—	—	665
Tax-exempt interest income	(175)	(4,223)	(4,241)
Other	328	2,706	2,922
State taxes, net of federal benefit	794	1,006	4,493
	<u>\$ 4,789</u>	<u>\$ 8,472</u>	<u>\$32,725</u>

eBay Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Under SFAS No. 109, deferred tax assets and liabilities are recognized for the future tax consequences of differences between the carrying amounts of assets and liabilities and their respective tax bases using enacted tax rates in effect for the year in which the differences are expected to reverse. Significant deferred tax assets and liabilities consist of the following (in thousands):

	December 31,	
	1999	2000
Deferred tax assets:		
Net operating loss	\$ 84,807	\$ 103,628
Accruals and reserves	4,990	9,819
Depreciation and amortization	8,798	10,313
Net unrealized loss on marketable securities	—	1,080
Net deferred tax assets	98,595	124,840
Valuation allowance	(83,894)	(101,586)
	14,701	23,254
Deferred tax liabilities:		
Net unrealized gains on marketable securities	(3,731)	—
	\$ 10,970	\$ 23,254

As of December 31, 2000, eBay's federal and state net operating loss carryforwards for income tax purposes were approximately \$274.9 million and \$128.0 million, respectively. If not utilized, the federal net operating loss carryforwards will begin to expire in 2019, and the state net operating loss carryforwards will begin to expire in 2004. Deferred tax assets of approximately \$101.6 million at December 31, 2000 pertain to certain net operating loss carryforwards resulting from the exercise of employee stock options. When recognized, the tax benefit of these losses are accounted for as a credit to additional paid-in capital rather than a reduction of the income tax provision.

In connection with the acquisition of Butterfields by eBay, Butterfields' status as an S Corporation was terminated and became subject to federal and state income taxes. The supplemental pro forma information below includes an increase to the provisions for income taxes based upon a combined federal and state tax rate of 42%. This amount approximates the statutory tax rates that would have been applied if Butterfields had been taxed as a C Corporation during the periods prior to its acquisition. Because the acquisition of the Butterfields companies has been accounted for as a pooling of interests, there has been no adjustment to the historical carrying values of the real estate holdings. However, these properties are subject to increases in tax basis which will result in a higher depreciable basis for income and property tax purposes. As a result, a deferred tax asset and a corresponding increase to stockholder's equity of approximately \$8.8 million was recorded in the second quarter of 1999 for the difference between the financial statement carrying amounts and the tax basis of the related net assets upon the closing of the transaction.

eBay Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The pro forma provision for income taxes is composed of the following (in thousands):

	Year Ended December 31,		
	1998	1999	2000
Current:			
Federal	\$4,303	\$10,267	\$31,420
State and local	1,243	2,505	8,498
Foreign	—	—	280
	<u>5,546</u>	<u>12,772</u>	<u>40,198</u>
Deferred:			
Federal	1,138	(4,327)	(5,887)
State and local	176	(1,091)	(1,586)
	<u>1,314</u>	<u>(5,418)</u>	<u>(7,473)</u>
	<u>\$6,860</u>	<u>\$ 7,354</u>	<u>\$32,725</u>

The following is a reconciliation of the difference between the proforma provision for income taxes and the provision computed by applying the federal statutory rate of 34% 1998 and 35% for 1999 and 2000 to income before income taxes (in thousands):

	Year Ended December 31,		
	1998	1999	2000
Provision at statutory rate	\$4,255	\$ 6,314	\$28,357
Permanent differences:			
Foreign income	—	1,741	229
Merger related expenses	384	329	175
Nonconsolidated subsidiary loss	—	—	665
Stock based compensation	1,051	(379)	125
Tax exempt interest income	(175)	(4,223)	(4,241)
Other	316	2,706	2,922
State taxes, net of federal benefit	1,029	866	4,493
	<u>\$6,860</u>	<u>\$ 7,354</u>	<u>\$32,725</u>

Note 16 — Subsequent Events-Unaudited:

Litigation

On January 26, 2001, the Court issued a ruling dismissing all claims against eBay in the Gentry et.al lawsuit. The Court ruled that eBay's business falls within the safe harbor provisions of 47 USC 230, which grants internet service providers such as eBay with immunity from state claims based on the conduct of third parties. The Court also noted that eBay was not a "dealer" under California law and thus not required to provide certificates of authenticity with autographs sold over its site by third parties. All counts of the plaintiffs' suit were dismissed with prejudice as to eBay. Plaintiffs appealed this ruling. eBay believes it has meritorious defenses and intends to defend itself vigorously.

In February 2001, the parties settled the Bidder's Edge lawsuit. All claims by both parties were dismissed, and Bidder's Edge paid eBay an undisclosed amount.

GO.com

In January 2001, Disney announced that it was dissolving GO.com; consequently, eBay is currently in the process of renegotiating new contract terms with Disney.

eBay Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Internet Auction

On February 15, 2001, eBay acquired a majority interest in Internet Auction Co., Ltd., a South Korean company ("Internet Auction"). Internet Auction introduced person-to-person trading in Korea when it launched in April 1998. Internet Auction is listed on the KOSDAQ and is expected to continue to trade on KOSDAQ.

In connection with the acquisition of the majority interest in Internet Auction, eBay acquired 6,274,795 of the outstanding shares, slightly more than 50%, at a fixed price of 24,000 Korean won per share or approximately \$120 million in the aggregate. The transaction will be accounted for using the purchase method of accounting and accordingly, the purchase price will be allocated to the tangible and intangible assets acquired and the liabilities assumed on the basis of their respective fair values on the acquisition date.

iBazar S.A.

On February 21, 2001, eBay signed an agreement to acquire iBazar S.A. (iBazar). iBazar is based in Paris and introduced online, person-to-person trading in France when it launched in October 1998. Currently, iBazar has websites in Belgium, Brazil, France, Italy, the Netherlands, Portugal, Spain, and Sweden.

As consideration for 100% of the outstanding shares of iBazar, eBay will issue approximately 2,250,000 shares of eBay's common stock, subject to a minimum valuation of approximately \$66 million and a maximum valuation of approximately \$112 million, based on the value of eBay's stock at closing. The acquisition will be accounted for as a purchase business combination and is subject to various regulatory approvals.

Sale of property

In March 2001, Butterfields sold its Chicago property for approximately \$4.5 million in cash.

Note 17 — Quarterly Financial Data-Unaudited

The following tables present certain unaudited consolidated quarterly financial information for each of the eight quarters ended December 31, 2000. In the opinion of eBay's management, this quarterly information has been prepared on the same basis as the consolidated financial statements and includes all adjustments necessary to present fairly the information for the periods presented. The results of operations for any quarter are not necessarily indicative of results for the full year or for any future period. The quarterly financial data

eBay Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

for the quarters presented below have been restated to reflect the acquisitions of Billpoint, Butterfields, Kruse, alando.de.ag and Half.com which were accounted for as poolings of interest.

Quarterly Financial Data
(unaudited, in thousands, except per share amounts)

	Quarter Ended			
	March 31	June 30	September 30	December 31
2000				
Net revenues as previously reported	\$ 85,753	\$ 97,399	\$113,377	\$134,008
Adjustment as a result of pooled entities	134	753	—	—
Net revenues	<u>\$ 85,887</u>	<u>\$ 98,152</u>	<u>\$113,377</u>	<u>\$134,008</u>
Gross profit as previously reported	\$ 62,481	\$ 73,756	\$ 89,465	\$110,054
Adjustment as a result of pooled entities	23	192	—	—
Gross profit	<u>\$ 62,504</u>	<u>\$ 73,948</u>	<u>\$ 89,465</u>	<u>\$110,054</u>
Net income as previously reported	\$ 6,288	\$ 11,590	\$ 15,211	\$ 23,865
Adjustment as a result of pooled entities	(4,530)	(4,131)	—	—
Net income	<u>\$ 1,758</u>	<u>\$ 7,459</u>	<u>\$ 15,211</u>	<u>\$ 23,865</u>
Net income per share-basic as previously reported . .	\$ 0.02	\$ 0.05	\$ 0.06	\$ 0.09
Adjustment as a result of pooled entities	(0.01)	(0.02)	—	—
Net income per share-basic*	<u>\$ 0.01</u>	<u>\$ 0.03</u>	<u>\$ 0.06</u>	<u>\$ 0.09</u>
Net income per share-diluted as previously reported . .	\$ 0.02	\$ 0.04	\$ 0.05	\$ 0.09
Adjustment as a result of pooled entities	(0.01)	(0.01)	—	—
Net income per share-diluted*	<u>\$ 0.01</u>	<u>\$ 0.03</u>	<u>\$ 0.05</u>	<u>\$ 0.09</u>
Shares used in per share calculation-basic*	242,658	249,828	255,741	259,789
Shares used in per share calculation-diluted*	281,344	280,483	280,297	279,822

eBay Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Quarter Ended			
	March 31	June 30	September 30	December 31
1999				
Net revenues as previously reported	\$ 34,010	\$ 49,479	\$ 58,525	\$ 73,919
Adjustment as a result of pooled entities	8,791	—	—	—
Net revenues	<u>\$ 42,801</u>	<u>\$ 49,479</u>	<u>\$ 58,525</u>	<u>\$ 73,919</u>
Gross profit as previously reported	\$ 28,889	\$ 38,534	\$ 41,444	\$ 52,334
Adjustment as a result of pooled entities	5,935	—	—	—
Gross profit	<u>\$ 34,824</u>	<u>\$ 38,534</u>	<u>\$ 41,444</u>	<u>\$ 52,334</u>
Net income as previously reported	\$ 5,896	\$ 816	\$ 1,352	\$ 4,895
Adjustment as a result of pooled entities	(2,131)	—	(166)	(1,095)
Net income	<u>\$ 3,765</u>	<u>\$ 816</u>	<u>\$ 1,186</u>	<u>\$ 3,800</u>
Net income per share-basic as previously reported . .	\$ 0.03	\$ 0.00	\$ 0.01	\$ 0.02
Adjustment as a result of pooled entities	(0.01)	—	—	—
Net income per share-basic*	<u>\$ 0.02</u>	<u>\$ 0.00</u>	<u>\$ 0.01</u>	<u>\$ 0.02</u>
Net income per share-diluted as previously reported	\$ 0.02	\$ 0.00	\$ 0.00	\$ 0.02
Adjustment as a result of pooled entities	(0.01)	—	—	(0.01)
Net income per share-diluted*	<u>\$ 0.01</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ 0.01</u>
Shares used in per share calculation-basic*	195,363	214,062	227,975	233,125
Shares used in per share calculation-diluted*	264,654	273,580	276,179	277,844

SIGNATURES

In accordance with the requirements of the Securities Exchange Act, the Registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

eBay Inc.

Date: March 28, 2001

Principal Executive Officer:

Principal Financial Officer and Principal Accounting Officer:

By: /s/ MARGARET C. WHITMAN
Margaret C. Whitman
President and Chief Executive Officer

By: /s/ RAJIV DUTTA
Rajiv Dutta
Senior Vice President, Chief Financial Officer

Additional Directors:

By: /s/ PIERRE M. OMIKYAR
Pierre M. Omidyar
Founder, Chairman of the Board and Director

By: /s/ PHILIPPE BOURGUIGNON
Philippe Bourguignon
Director

By: /s/ SCOTT D. COOK
Scott D. Cook
Director

By: /s/ ROBERT C. KAGLE
Robert C. Kagle
Director

By: /s/ DAWN G. LEPORE
Dawn G. Lepore
Director

By: /s/ HOWARD D. SCHULTZ
Howard D. Schultz
Director