

YAHOO INC  
Form 10-Q  
August 01, 2003

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended June 30, 2003

OR

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**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 0-28018

**YAHOO! INC.**

(Exact name of registrant as specified in its charter)

<b>Delaware</b>		<b>77-0398689</b>
(State or other jurisdiction of incorporation or organization)		(I.R.S. Employer Identification No.)
<b>701 First Avenue</b>		
<b>Sunnyvale, California 94089</b>		
(Address of principal executive offices)		
Registrant's telephone number, including area code: <b>(408) 349-3300</b>		

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Indicate by check mark whether the Registrant (1) has filed all reports required by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 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 whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at July 30, 2003
Common stock, \$0.001 par value	610,116,199

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YAHOO! INC.

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## PART I FINANCIAL INFORMATION

## Item 1. Condensed Consolidated Financial Statements (unaudited)

## YAHOO! INC.

## Condensed Consolidated Statements of Operations

(unaudited, in thousands except per share amounts)

	Three Months Ended		Six Months Ended	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
Net revenues	\$ 321,406	\$ 225,792	\$ 604,354	\$ 418,457
Costs and expenses:				
Cost of revenues	46,842	41,708	89,974	79,529
Sales and marketing	122,218	110,015	235,906	206,161
Product development	45,687	35,162	82,371	67,944
General and administrative	34,125	25,437	62,845	52,106
Amortization of intangibles	9,762	5,952	15,509	9,374
Total costs and expenses	258,634	218,274	486,605	415,114
Income from operations	62,772	7,518	117,749	3,343
Other income, net	20,335	29,228	42,594	51,897
Minority interests in operations of consolidated subsidiaries	(1,126)	139	(3,034)	351
Income before income taxes and cumulative effect of accounting change	81,981	36,885	157,309	55,591
Provision for income taxes	31,153	15,491	59,778	23,722
Income before cumulative effect of accounting change	50,828	21,394	97,531	31,869
Cumulative effect of accounting change				(64,120)
Net income (loss)	\$ 50,828	\$ 21,394	\$ 97,531	\$ (32,251)
Net income (loss) per share basic:				
Income before cumulative effect of accounting change	\$ 0.08	\$ 0.04	\$ 0.16	\$ 0.05
Cumulative effect of accounting change				(0.10)
Net income (loss) per share basic	\$ 0.08	\$ 0.04	\$ 0.16	\$ (0.05)
Net income (loss) per share diluted:				
Income before cumulative effect of accounting change	\$ 0.08	\$ 0.03	\$ 0.16	\$ 0.05

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Cumulative effect of accounting change					(0.10)	
Net income (loss) per share diluted	\$	0.08	\$	0.03	\$ 0.16	\$(0.05)
Shares used in per share calculation basic		604,018		598,740	600,330	592,809
Shares used in per share calculation diluted		628,577		615,542	622,183	612,781

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

## YAHOO! INC.

## Condensed Consolidated Balance Sheets

(unaudited, in thousands)

	June 30, 2003	December 31, 2002
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 1,075,582	\$ 310,972
Short-term investments in marketable securities	497,400	463,204
Accounts receivable, net	142,372	113,612
Prepaid expenses and other current assets	103,407	82,216
Total current assets	1,818,761	970,004
Long-term investments in marketable securities	744,237	763,408
Property and equipment, net	371,794	371,272
Goodwill	636,434	415,225
Intangible assets, net	130,939	96,252
Other assets	219,356	174,020
Total assets	\$ 3,921,521	\$ 2,790,181
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 19,086	\$ 18,738
Accrued expenses and other current liabilities	302,640	257,575
Deferred revenue	155,997	135,501
Total current liabilities	477,723	411,814
Long-term debt	750,000	
Other liabilities	102,374	84,540
Minority interests in consolidated subsidiaries	34,591	31,557
Stockholders' equity:		
Common stock	624	611
Additional paid-in capital	2,621,560	2,430,222
Treasury stock	(159,988)	(159,988)
Retained earnings (accumulated deficit)	90,038	(7,493)
Accumulated other comprehensive income (loss)	4,599	(1,082)
Total stockholders' equity	2,556,833	2,262,270
Total liabilities and stockholders' equity	\$ 3,921,521	\$ 2,790,181

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



**YAHOO! INC.**

**Condensed Consolidated Statements of Cash Flows**

**(unaudited, in thousands)**

**Six Months Ended**



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	June 30, 2003	June 30, 2002
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income (loss)	\$ 97,531	\$ (32,251)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	63,576	50,431
Tax benefits from stock options	49,645	20,756
Cumulative effect of accounting change		64,120
Earnings in equity interests	(19,730)	(9,800)
Minority interests in operations of consolidated subsidiaries	3,034	(351)
Non-cash (gains) losses and impairments from investments	5,968	(3,101)
Other non-cash charges	3,045	6,776
Changes in assets and liabilities, net of effects of acquisitions:		
Accounts receivable, net	(23,529)	(3,526)
Prepaid expenses and other assets	(3,965)	23,874
Accounts payable	(405)	(67)
Accrued expenses and other liabilities	(933)	(10,613)
Current deferred revenue	16,514	14,577
Long-term deferred revenue		30,000
Net cash provided by operating activities	190,751	150,825
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Acquisition of property and equipment	(41,273)	(21,588)
Purchases of marketable securities	(666,178)	(543,037)
Proceeds from sales and maturities of marketable securities	650,499	495,745
Acquisitions, net of cash acquired	(228,318)	(189,168)
Purchases of other investments	(6,274)	
Proceeds from the sales of other investments		687
Net cash used in investing activities	(291,544)	(257,361)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from issuance of debt, net	733,125	
Proceeds from issuance of common stock, net	128,611	35,699
Net cash provided by financing activities	861,736	35,699
Effect of exchange rate changes on cash and cash equivalents	3,667	1,796
Net change in cash and cash equivalents	764,610	(69,041)
Cash and cash equivalents at beginning of period	310,972	372,632
Cash and cash equivalents at end of period	\$ 1,075,582	\$ 303,591

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

## YAHOO! INC.

## Condensed Consolidated Statements of Stockholders Equity

(unaudited, in thousands)

	Three Months Ended		Six Months Ended	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
<b>Common stock</b>				
Balance, beginning of period	\$ 614	\$ 601	\$ 611	\$ 581
Common stock issued	10	5	13	25
Balance, end of period	624	606	624	606
<b>Additional paid-in capital</b>				
Balance, beginning of period	2,485,343	2,309,215	2,430,222	2,067,410
Common stock issued	105,034	19,999	131,931	261,202
Compensation expense on option grants	891	1,120	1,465	6,741
Tax benefit on stock options	30,292	13,592	49,369	12,501
Other			8,573	(3,928)
Balance, end of period	2,621,560	2,343,926	2,621,560	2,343,926
<b>Treasury stock</b>				
Balance, beginning of period	(159,988)	(59,988)	(159,988)	(59,988)
Balance, end of period	(159,988)	(59,988)	(159,988)	(59,988)
<b>Retained earnings (accumulated deficit)</b>				
Balance, beginning of period	39,210	(103,953)	(7,493)	(50,308)
Net income (loss)	50,828	21,394	97,531	(32,251)
Balance, end of period	90,038	(82,559)	90,038	(82,559)
<b>Accumulated other comprehensive income (loss)</b>				
Balance, beginning of period	(4,285)	(6,061)	(1,082)	9,322
Net unrealized gains (losses) on securities	2,593	(529)	(377)	(12,380)
Foreign currency translation adjustments	6,291	3,468	6,058	(64)
Balance, end of period	4,599	(3,122)	4,599	(3,122)
<b>Total stockholders equity</b>	<b>\$ 2,556,833</b>	<b>\$ 2,198,863</b>	<b>\$ 2,556,833</b>	<b>\$ 2,198,863</b>
<b>Other comprehensive income (loss)</b>				
Net income (loss)	\$ 50,828	\$ 21,394	\$ 97,531	\$ (32,251)
Other comprehensive loss:				
Net unrealized gains (losses) on securities	2,593	(529)	(377)	(12,380)
Foreign currency translation adjustment	6,291	3,468	6,058	(64)
Comprehensive income (loss)	\$ 59,712	\$ 24,333	\$ 103,212	\$ (44,695)

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	Number of Shares			
<b>Common stock</b>				
Balance, beginning of period	597,817	596,015	594,860	575,520
Common stock issued	9,533	4,488	12,490	24,983
Balance, end of period	607,350	600,503	607,350	600,503

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

**YAHOO! INC.**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited)**

**Note 1 The Company and Basis of Presentation**

Yahoo! Inc. ( Yahoo! or the Company ) is a leading provider of comprehensive online products and services to consumers and businesses worldwide. The Company, a Delaware corporation, commenced operations in 1995.

The accompanying unaudited condensed consolidated interim financial statements reflect all adjustments, consisting of only normal and recurring items, which in the opinion of management, are necessary for a fair presentation of the results of operations for the periods shown. The results of operations for such periods are not necessarily indicative of the results expected for the full year or for any future period.

These financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2002. Certain prior period balances have been reclassified to conform to current period presentation.

**Note 2 Summary of Significant Accounting Policies**

**Revenue Recognition.** The Company's revenues are derived principally from services, which include marketing services, fees, and listings.

Marketing services revenues are primarily generated from the sale of banner, sponsorship, text-link advertisements, including sponsored search advertisements, and transaction revenues. Banner advertising agreements typically range from one week to three years. The Company recognizes marketing services revenues related to banner advertisements as impressions are delivered on pages on the Yahoo! network by the Company. Impressions are defined as the number of times that an advertisement appears in pages viewed by users of the Yahoo! network. Sponsorship advertising agreements have longer terms than banner advertising agreements, typically ranging from three months to three years, and can involve multiple element arrangements that may include placement on specific properties, exclusivity and content integration. Sponsorship advertisement revenues are recognized as impressions are delivered or ratably over the contract period, where applicable, and when collection of the resulting receivable is reasonably assured. Text-link advertisements, including sponsored searches, are generally recognized as the net amount earned in the period in which the click-throughs occur. Click-throughs are defined as the number of times a user clicks on an advertisement or search result. Transactions revenues include service fees for facilitating transactions through the Yahoo! network, principally from the Company's commerce properties. Transactions revenues are recognized when there is evidence that the qualifying transactions have occurred. The Company recognizes revenue on these arrangements in accordance with Securities and Exchange Commission Staff Accounting Bulletin No. 101 ( SAB 101 ), Revenue Recognition in Financial Statements. In all cases, revenue is recognized only when the price is fixed or determinable, persuasive evidence of an arrangement exists, the service is performed, and collectibility of the resulting receivable is reasonably assured.

Periodically, the Company engages in barter transactions for marketing services. Barter revenue is recognized over the periods in which the Company completes its obligations under the arrangement. Barter revenues represented less than 1% of total revenues each for the three and six months ended June 30, 2003, compared to approximately 2% of total revenues each for the three and six months ended June 30, 2002. During the three and six months ended June 30, 2003, the Company delivered approximately 1.3 billion and 1.5 billion impressions, respectively, under barter arrangements where fair value was not determinable under EITF 99-17 and, accordingly, revenue was not recognized, compared to approximately 1.4 billion and 2.8 billion impressions for the three and six months ended June 30, 2002, respectively.

Fees revenues consist of revenues generated from a variety of consumer and business fee-based services, including SBC Yahoo! DSL and SBC Yahoo! Dial, Yahoo! Personals, Small Business Services, Yahoo! Mail and Yahoo! Enterprise Solutions. With the exception of Yahoo! Portal Solutions, which is part of Yahoo! Enterprise Solutions, revenues are recognized in the month in which the services are performed, provided that no significant Company obligations remain and collection of the resulting receivable is reasonably assured. Revenues from Yahoo! Portal Solutions consist of software license and platform service revenues, which are principally platform and maintenance services. Yahoo! Portal Solutions revenue is recognized in accordance with Statement of Position No. 97-2, Software Revenue Recognition and Statement of Position 98-9, Modification of SOP No. 97-2 with Respect to Certain Transactions. License revenues are recognized when persuasive evidence of an arrangement exists, delivery of the license has occurred, the fee is fixed or determinable, and collection is probable. License revenues from Portal Solutions were not material to the Company as they represented less than 1% of total net revenue for all periods presented. Platform services are sold as a subscription and are recognized ratably over the subscription period. Platform services are priced based on the specific content or service purchased by the customer. These services are optional and renewable annually at fixed renewal rates. Maintenance is generally sold under annual contracts with fixed renewal rates. Maintenance revenue is recognized ratably over the contract period. Yahoo! Portal Solutions revenues have represented less than 10% of total net revenues in all periods presented.

Listings revenues consist of revenues generated from a variety of consumer and business listings-based services, including access to the HotJobs database and classifieds such as Yahoo! Autos, Yahoo! Real Estate and other Search and Directory services. Revenues are recognized in the month in which the services are performed, provided that no significant Company obligations remain and collection of the resulting receivable is reasonably assured.

Deferred revenue primarily consists of contractual billings in excess of recognized revenue and payments received in advance of revenue recognition.

**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, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reported period. On an on-going basis, the Company evaluates its estimates, including those related to uncollectible receivables, investment values, goodwill and intangible assets, income taxes, restructuring costs and contingencies. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

**Basic and Diluted Net Income (Loss) per Share.** Basic net income (loss) per share is computed using the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share is computed using the weighted average number of common and, if dilutive, potential common shares outstanding during the period. Potential common shares consist of shares issuable upon the exercise of stock options and warrants (using the treasury stock method). For the three and six month period ended June 30, 2003, potential common shares of 24.6 million and 21.9 million, respectively, were included in the computation and were related to shares issuable upon the exercise of stock options. For the three month period ended June 30, 2003, the 18.3 million common shares issuable under the terms of the zero coupon senior convertible notes that the Company issued in April 2003 have not been included in potential common shares as the conversion of the notes is subject to certain contingencies that have not yet been met. For the three month period ended June 30, 2002, potential common shares of 16.8 million were included in the computation and were related to shares issuable upon the exercise of stock options. For the six month period ended

June 30, 2002, potential common shares related to shares issuable upon the exercise of stock options of 20.0 million were not included in the computation because they were anti-dilutive.

**Stock-Based Compensation.** The Company measures compensation expense for its stock-based employee compensation plans using the intrinsic value method. If the fair value based method had been applied in measuring stock compensation expense, the pro forma effect on net income (loss) and net income (loss) per share would have been as follows (in thousands, except per share amounts):

	Three Months Ended		Six Months Ended	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
Net income (loss)				
As reported	\$ 50,828	\$ 21,394	\$ 97,531	\$ (32,251)
Stock compensation expense, net of tax	(77,864)	(106,660)	(143,097)	(254,590)
Pro forma	\$ (27,036)	\$ (85,266)	\$ (45,566)	\$ (286,841)
Net income (loss) per share:				
As reported - basic	\$ 0.08	\$ 0.04	\$ 0.16	\$ (0.05)
Pro forma - basic	\$ (0.04)	\$ (0.14)	\$ (0.08)	\$ (0.48)
As reported - diluted	\$ 0.08	\$ 0.03	\$ 0.16	\$ (0.05)
Pro forma - diluted	\$ (0.04)	\$ (0.14)	\$ (0.08)	\$ (0.48)

Pro forma diluted net loss per share for the three and six months ended June 30, 2003 is computed excluding potential common shares of 24.6 million and 21.9 million, respectively, as the effect is anti-dilutive. Pro forma diluted net loss per share for the three months ended June 30, 2002 is computed excluding potential common shares of 16.8 million, as the effect is anti-dilutive. Diluted net loss per share and pro forma diluted net loss per share for the six months ended June 30, 2002 are computed excluding potential common shares of 20.0 million, as the effect is anti-dilutive.

The Company recorded compensation expense in the amount of \$0.9 million, and \$1.1 million in the three months ended June 30, 2003 and 2002, respectively. The Company recorded compensation expense in the amount of \$1.5 million, and \$6.7 million in the six months ended June 30, 2003 and 2002, respectively. As of June 30, 2003, approximately \$2.0 million remains to be amortized over the remaining vesting periods of the options.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. Because the Company's options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in the opinion of management, the existing models do not necessarily provide a reliable single measure of the fair value of its options.

### Note 3 Recent Accounting Pronouncements



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In November 2002, the Emerging Issues Task Force ( EITF ) reached a consensus on Issue 00-21, addressing how to account for arrangements that involve the delivery or performance of multiple products, services, and/or rights to use assets. Revenue arrangements with multiple deliverables are divided into separate units of accounting if the deliverables in the arrangement meet the following criteria: (1) the delivered item has value to the customer on a standalone basis; (2) there is objective and reliable evidence of the fair value of undelivered items; and (3) delivery of any undelivered item is probable. Arrangement consideration should be allocated among the separate units of accounting based on their relative fair values, with the amount allocated to the delivered item being limited to the amount that is not contingent on the delivery of additional items or meeting other specified performance conditions. The final consensus is applicable to agreements entered into in fiscal periods beginning after June 15, 2003. The provisions of this consensus are not expected to have a significant effect on the Company's results of operations or financial position.

In January 2003, the Financial Accounting Standards Board ( FASB ) issued Interpretation No. 46 ( FIN 46 ) Consolidation of Variable Interest Entities. Until this interpretation, a company generally included another entity in its consolidated financial statements only if it controlled the entity through voting interests. FIN 46 requires a variable interest entity, as defined, to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns. The Company is currently evaluating the effect of adopting FIN 46 on its results of operations and financial position.

In April 2003, the FASB issued SFAS 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities, which amends SFAS 133 for certain decisions made by the FASB Derivatives Implementation Group. In particular, SFAS 149: (1) clarifies under what circumstances a contract with an initial net investment meets the characteristic of a derivative, (2) clarifies when a derivative contains a financing component, (3) amends the definition of an underlying to conform it to language used in FASB Interpretation No. 45 Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, and (4) amends certain other existing pronouncements. This Statement is effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003. In addition, most provisions of SFAS 149 are to be applied prospectively. The Company does not expect the adoption of SFAS 149 to have a material impact on its financial position, cash flows or results of operations.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity ( SFAS 150 ). SFAS 150 changes the accounting for certain financial instruments that under previous guidance issuers could account for as equity. It requires that those instruments be classified as liabilities in balance sheets. The guidance in SFAS 150 is generally effective for all financial instruments entered into or modified after May 31, 2003, and otherwise is effective on July 1, 2003. The Company does not anticipate that the adoption of SFAS 150 will have a material impact on its financial position, cash flows or results of operations.

#### Note 4 Goodwill

The changes in the carrying amount of goodwill for the six months ended June 30, 2003 are as follows (in thousands):

	United States	International	Total
Balance at December 31, 2002	\$ 327,082	\$ 88,143	\$ 415,225
Acquisitions and other (1)	217,100	4,109	221,209
Balance at June 30, 2003	\$ 544,182	\$ 92,252	\$ 636,434

(1) Other primarily includes certain purchase price adjustments that effect existing goodwill. See also Note 9 Acquisition.

The Company performed a transitional impairment test of its goodwill and intangible assets as of January 1, 2002. Due to, among other things, the overall softening of the global economy and the related decline in international advertising, the Company recorded a transitional goodwill impairment loss of \$64.1 million, which was recorded during the first quarter of 2002 as a cumulative effect of an accounting change in the Company's Condensed Consolidated Statements of Operations. The fair value of the reporting unit giving rise to the transitional impairment loss was estimated using the expected present value of future cash flows and market valuation approach.



**Note 5 Intangible Assets, Net**

(in thousands)

	Gross carrying amount	June 30, 2003 Accumulated amortization	Net	December 31, 2002 Net
Trademarks	\$ 57,100	\$ (12,488)	\$ 44,612	\$ 48,894
Customer-related intangible assets	76,230	(21,540)	54,690	38,605
Developed technology	34,600	(3,757)	30,843	7,161
Content and other	4,956	(4,162)	794	1,592
<b>Total</b>	<b>\$ 172,886</b>	<b>\$ (41,947)</b>	<b>\$ 130,939</b>	<b>\$ 96,252</b>

The intangible assets are all amortizable and have original estimated useful lives as follows: Trademarks four to seven years; Customer-related intangible assets one to seven years; Developed technology three to five years; Content and other two to three years. Based on the current amount of intangibles subject to amortization, the estimated amortization expense for each of the succeeding five years is as follows: Six months ending December 31, 2003: \$18.4 million; Years ending December 31, 2004: \$28.6 million; 2005: \$23.6 million; 2006: \$22.8 million; and 2007: \$21.0 million.

**Note 6 Restructuring Costs**

During 2001, the Company announced restructuring programs to balance its investment in growth areas with the desire to modify its near-term business plan to reflect an economic and capital market slowdown. These restructuring programs included a charge for worldwide workforce reductions of approximately \$15.1 million and consolidation of excess facilities and other charges of approximately \$42.3 million, which were classified as operating expenses in 2001. If facilities rental rates continue to decrease in these markets or if it takes longer than expected to sublease these facilities, the maximum amount the actual loss could exceed the original estimate is approximately \$5.0 million.

A summary of the restructuring accrual during the six months ended June 30, 2003 is as follows (in thousands):

	Restructuring Accrual at December 31, 2002	Cash Payments	Restructuring Accrual at June 30, 2003
Consolidation of excess facilities and other charges	\$ 11,745	\$ (2,481)	\$ 9,264

The restructuring accrual is included on the balance sheet in accrued expenses and other liabilities. The accrual related to the workforce reduction was paid by December 31, 2002. Amounts related to the net lease expense due to the consolidation of facilities will be paid over the

respective lease terms through December 2012.

#### **Note 7 Long-Term Debt**

In April 2003, the Company issued \$750 million of zero coupon senior convertible notes (the Notes) due April 2008, which resulted in net proceeds to the Company of approximately \$733 million after transaction fees of approximately \$17 million, which have been deferred and are included on the balance sheet in other assets. The Notes were issued at par and bear no interest. The Notes are convertible into Yahoo! common stock at a conversion price of \$41.00 per share, which would result in an aggregate of 18.3 million shares, subject to adjustment upon the occurrence of specified events. Each \$1,000 principal amount of the Notes will initially be convertible into 24.3902 shares of Yahoo! common stock prior to April 1, 2008 if the sale price of our common stock issuable upon conversion of the Notes reaches a specified threshold for a defined period of time or specified corporate transactions have occurred. The specified thresholds for conversion prior to the maturity date are (1) the closing sale price of the Company's common stock for at least 20 trading days in the 30 trading-day period ending on the last trading day of the immediately preceding fiscal quarter exceeds 110% of the conversion price on that 30<sup>th</sup> trading day, and (2) during the period beginning January 1, 2008 through the maturity date, the closing sale price of the Company's common stock on the previous trading day was 110% or more of the then current conversion price. Upon conversion, Yahoo! has the right to deliver cash in lieu of common stock. The Company may be required to repurchase all of the notes following a fundamental change of the Company, such as a change of control, prior to maturity. Yahoo! may not redeem the Notes prior to their maturity.

#### **Note 8 Stockholders' Equity**

**Stock Repurchase Program.** In March 2001, the Company announced that its Board of Directors had authorized the Company to repurchase up to \$500 million of its outstanding shares of common stock from time to time over the next two years, depending on market conditions, share price and other factors. In March 2003, the Company's Board of Directors authorized a two-year extension of the stock repurchase program, which extension authorizes the Company to repurchase up to approximately \$340 million (representing the balance of the \$500 million originally authorized in March 2001) of its outstanding shares of common stock from time to time over the next two years, depending on market conditions, share price and other factors. The Company may utilize equity instrument contracts to facilitate the repurchase of common stock. From March 2001 through June 30, 2003, the Company had repurchased 16,458,620 shares of common stock at an average of \$9.72 per share for a total amount of approximately \$160 million. Of the shares repurchased, 16,033,620 shares were purchased from SOFTBANK at an average of \$9.67 per share. No shares were repurchased during the six months ended June 30, 2003. Treasury stock is accounted for under the cost method.

#### **Note 9 Acquisition**

On March 19, 2003, the Company completed the acquisition of Inktomi Corporation, ( Inktomi ), a provider of original equipment manufacturer Web search and paid inclusion services. The acquisition combined Yahoo!'s global audience and Inktomi's search technology to allow the Company to create a more relevant, comprehensive and higher quality search offering on the Web. These factors contributed to a purchase price in excess of the fair value of the Inktomi net tangible and intangible assets acquired, and as a result, the Company has recorded goodwill in connection with this transaction.

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The total estimated purchase price of approximately \$289.6 million consisted of \$272.9 million in cash consideration, approximately \$13.4 million of stock options exchanged, and direct transaction costs of approximately \$3.3 million. The value of the stock options was determined based on the average market price of the Company's common stock over the 5-day period prior to and including the date of the acquisition.

The preliminary allocation of the purchase price to the assets acquired and liabilities assumed based on the estimated fair values was as follows (in thousands):

Cash acquired	\$	44,610
Other tangible assets acquired		26,990
Amortizable intangible assets		49,400
Goodwill		216,921
Liabilities assumed		(49,602)
Deferred stock-based compensation		1,287
Total	\$	289,606

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Amortizable intangible assets consist of customer-related intangible assets and developed technology with useful lives not exceeding five years. A preliminary estimate of \$216.9 million has been allocated to goodwill. Goodwill represents the excess of the purchase price over the fair value of the net tangible and intangible assets acquired, and is not deductible for tax purposes. Goodwill will not be amortized and will be tested for impairment, at least annually. The preliminary purchase price allocation for Inktomi is subject to revision as more detailed analysis is completed and additional information on the fair value of assets and liabilities becomes available. Any change in the fair value of the net assets of Inktomi will change the amount of the purchase price allocable to goodwill. Liabilities assumed includes approximately \$12.7 million of restructuring costs associated with the acquisition.

The results of operations of Inktomi have been included in the Company's condensed consolidated statements of operations since the completion of the acquisition on March 19, 2003. The following unaudited pro forma information presents a summary of the results of operations of the Company assuming the acquisitions of Inktomi and HotJobs (acquired in February 2002) occurred on January 1, 2002 (in thousands, except per share amounts):

	Six Months Ended	
	June 30, 2003	June 30, 2002
Net revenues	\$ 619,285	\$ 470,921
Income (loss) before cumulative effect of accounting change	\$ 96,507	\$ (83,255)
Net income (loss)	\$ 96,507	\$ (147,375)
Net income (loss) per share basic:		
Income (loss) per share before cumulative effect of accounting change	\$ 0.16	\$ (0.14)
Net income (loss) per share	\$ 0.16	\$ (0.25)
Net income (loss) per share diluted:		
Income (loss) per share before cumulative effect of accounting change	\$ 0.16	\$ (0.14)
Net income (loss) per share	\$ 0.16	\$ (0.25)

### Note 10 Segment Information

The Company manages its business geographically. The Company's primary areas of measurement and decision-making are the United States and International. The Company's management relies on an internal management reporting process that provides revenue and segment information for making financial decisions and allocating resources. Segment operating income before depreciation and amortization includes income (loss) from operations before amortization of intangibles and depreciation. Segment operating income before depreciation and amortization (previously referred to as Segment EBITDA) for prior years has been reclassified to include stock compensation expense, consistent with the current year presentation. Management believes that segment operating income before depreciation and amortization is an appropriate measure of evaluating the operating performance of the Company's segments. However, segment operating income before depreciation and amortization should be considered only in addition to, not as a substitute for or superior to, operating income, cash flows or other measures of financial performance prepared in accordance with generally accepted accounting principles.

Revenue is attributed to individual countries according to the international online property that generated the revenue. No single foreign country accounted for more than 10% of net revenues during the three and six months ended June 30, 2003 and 2002.



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Summarized information by segment is as follows (in thousands):

	Three Months Ended,		Six Months Ended	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
Net revenues by segment:				
United States	\$ 271,345	\$ 187,465	\$ 509,891	\$ 354,077
International	50,061	38,327	94,463	64,380
Total net revenues	\$ 321,406	\$ 225,792	\$ 604,354	\$ 418,457

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	Three Months Ended,		Six Months Ended	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
Segment operating income (loss) before depreciation and amortization:				
United States	\$ 90,555	\$ 38,554	\$ 167,503	\$ 65,383
International	6,720	(3,560)	13,822	(11,609)
Total segment operating income before depreciation and amortization	\$ 97,275	\$ 34,994	\$ 181,325	\$ 53,774
Segment operating income before depreciation and amortization reconciliation:				
Income from operations	\$ 62,772	\$ 7,518	\$ 117,749	\$ 3,343
Depreciation and amortization	34,503	27,476	63,576	50,431
Segment operating income before depreciation and amortization	\$ 97,275	\$ 34,994	\$ 181,325	\$ 53,774
Operating income (loss) before depreciation and amortization by segment reconciliations:				
United States				
Income from operations	\$ 60,472	\$ 13,874	\$ 111,472	\$ 20,603
Depreciation and amortization	30,083	24,680	56,031	44,780
Segment operating income before depreciation and amortization United States	\$ 90,555	\$ 38,554	\$ 167,503	\$ 65,383
International				
Income (loss) from operations	\$ 2,300	\$ (6,356)	\$ 6,277	\$ (17,260)
Depreciation and amortization	4,420	2,796	7,545	5,651
Segment operating income (loss) before depreciation and amortization International	\$ 6,720	\$ (3,560)	\$ 13,822	\$ (11,609)
Capital expenditures, net:				
United States	\$ 16,372	\$ 13,279	\$ 32,370	\$ 19,792
International	4,398	1,022	8,903	1,796
Total consolidated capital expenditures, net	\$ 20,770	\$ 14,301	\$ 41,273	\$ 21,588
Long-lived assets:				
United States		\$ 1,224,455	\$ 919,667	
International		134,068	137,102	
Total consolidated long-lived assets		\$ 1,358,523	\$ 1,056,769	

The amounts above include property and equipment information, which is based on the physical location of the assets.



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The following table presents net revenues for groups of similar services (in thousands):

	Three Months Ended,		Six Months Ended	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
Marketing services	\$ 219,198	\$ 151,710	\$ 409,163	\$ 289,385
Fees	69,926	49,063	133,655	88,609
Listings	32,282	25,019	61,536	40,463
Total net revenues	\$ 321,406	\$ 225,792	\$ 604,354	\$ 418,457

Revenues from the Company's agreement with Overture Services, Inc. ( Overture ) are included in marketing services, and amounted to approximately 20% and 11% of total net revenues for the three months ended June 30, 2003 and 2002, respectively, and approximately 20% and 11% of total net revenues for the six months ended June 30, 2003 and 2002, respectively (See Note 12 Subsequent Event).

**Note 11 Commitments and Contingencies**

**Operating Leases.** The Company has entered into various non-cancelable operating lease agreements for its offices throughout the U.S. and for its international subsidiaries with original lease periods up to 13 years and expiring between 2003 and 2012.

In addition, the Company has entered into various sublease arrangements associated with its excess facilities under the 2001 Restructuring programs. Such subleases have terms extending through 2006 and amounts estimated to be received have been included in determining the restructuring accrual.

Net lease commitments as of June 30, 2003 can be summarized as follows (in millions):

	Gross lease commitments	Sublease income	Net lease commitments
Six months ending December 31, 2003	\$ 16.3	\$ (4.6)	\$ 11.7
Years ending December 31,			
2004	28.8	(6.2)	22.6
2005	24.3	(4.0)	20.3
2006	22.3	(3.2)	19.1
2007	18.4		18.4
2008	14.5		14.5

Thereafter		96.7		96.7
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The Company also has an agreement committing to lease two additional buildings adjacent to the headquarters in Sunnyvale, California. The buildings are expected to be ready for occupancy in the third quarter of 2003. Upon completion of the building construction, the Company is committed to a 15 year lease obligation, with annual lease payments under the lease of approximately \$5.1 million in year one, approximately \$6.7 million in year two, and with incremental increases of 3.5% in each of the following years. These amounts are included in the table above. After year one of the lease, the Company has the right to purchase the buildings for approximately \$68.9 million, plus fees, or continue leasing the buildings under the original agreement for the remaining fourteen years.

**Investment in Privately-Held Company.** During 2002, the Company acquired an equity interest of approximately 16% in Sonera zed OY ( Zed ), a Finnish company and previously wholly-owned subsidiary of a publicly-held telecommunications company. Under the terms of the investment agreement, the Company has call options to acquire the remaining interests not owned by the Company and a put option to sell back its shares. In addition, Zed has a put option enabling Zed to require the Company to acquire the remaining interests not owned by the Company if the Company exercises its option to buy a majority of Zed's outstanding shares. The amount of the purchase price for the remaining equity interests in Zed not held by the Company under these options is not determinable at this time but will be based on an operating performance based valuation of Zed. The Company is not obligated to purchase additional equity in Zed unless it chooses to exercise the option described above. As part of the transaction, the Company has agreed to provide up to 4.8 million Euro in additional funding to Zed. Other than this amount, the Company is not obligated to guarantee any obligations of Zed or to provide any funding to Zed. The Company's investment in Zed was immaterial to its condensed consolidated balance sheet as of June 30, 2003.

**Other Commitments.** In the ordinary course of business the Company enters into various arrangements with vendors and other business partners, principally for marketing, technology, bandwidth and content arrangements. There are no material commitments for these arrangements extending beyond June 30, 2004.

In connection with Company's commercial agreements, Yahoo! provides indemnifications of varying scope and terms to customers, business partners and other parties with respect to certain matters, including, but not limited to, losses arising out of the Company's breach of such agreements and out of intellectual property infringement claims made by third parties. In addition, the Company has entered into indemnification agreements with its directors and certain of its officers that will require the Company, among other things, to indemnify them against certain liabilities that may arise by reason of their status or service as directors or officers. The Company maintains directors and officers insurance which may cover certain liabilities arising from directors and officers indemnifications. Many of these indemnifications provided by the Company do not have stipulated maximum liabilities, therefore the Company is not able to develop a reasonable estimate of the maximum liabilities. To date, the Company has not incurred material costs as a result of such obligations and has not accrued any liabilities related to such indemnifications in its financial statements.

**Contingencies.** From time to time, third parties assert patent infringement claims against the Company in the form of letters, lawsuits, and other forms of communication. Currently, the Company or its acquired subsidiaries are engaged in several lawsuits regarding patent issues and have been notified of a number of other potential patent disputes.

In addition, from time to time the Company is subject to other legal proceedings and claims in the ordinary course of business, including claims of alleged infringement of trademarks, copyrights and other intellectual property rights, and a variety of claims arising in connection with its email, message boards, auction sites, shopping services, and other communications and community features, such as claims alleging defamation or invasion of privacy.

The Company does not believe, based on current knowledge, that any of the foregoing legal proceedings or claims are likely to have a material adverse effect on its financial position, results of operations or cash flows. However, the Company may incur substantial expenses in defending against third party claims. In the event of a determination adverse to Yahoo! or its subsidiaries, the Company may incur substantial monetary liability, and be required to change its business practices. Either of these could have a material adverse effect on the Company's financial position, results of operations or cash flows.

On May 24, 2001, Arista Records, Inc., Bad Boy Records, BMG Music d/b/a The RCA Records Label, Capitol Records, Inc., Virgin Records America, Inc., Sony Music Entertainment Inc., UMG Recordings, Inc., Interscope Records, Motown Record Company, L.P., and Zomba Recording Corporation filed a lawsuit alleging copyright infringement against LAUNCH Media, Inc. ( LAUNCH ) in the United States District Court for the Southern District of New York. After the lawsuit was commenced, the Company entered into an agreement to acquire LAUNCH. In June 2001, LAUNCH settled the LAUNCH litigation as to UMG Recordings, Inc. The Company's acquisition of LAUNCH closed in August 2001, and since that time LAUNCH has been a wholly owned subsidiary of the Company. The plaintiffs allege, among other things, that the consumer-influenced portion of LAUNCH's LAUNCHcast service is "interactive" within the meaning of Section 114 of the Copyright Act and therefore does not qualify for the compulsory license provided for by the Copyright Act. The Complaint seeks declaratory and injunctive relief and damages for the alleged infringement. The Company and LAUNCH do not believe that LAUNCH has infringed any rights of plaintiffs and intend to vigorously contest the lawsuit. The lawsuit is still in the preliminary, discovery phase and the Company does not believe it is feasible to predict or determine the outcome or resolution of the LAUNCH litigation. The range of possible resolutions of the LAUNCH litigation could include judgments against the Company or settlements that could require substantial payments by the Company, which could have a material adverse impact on the Company's financial position, results of operations or cash flows. An estimate of the potential loss, if any, or range of loss that could arise from the LAUNCH litigation cannot be made at this time. In January 2003, LAUNCH settled the LAUNCH litigation as to Sony Music Entertainment, Inc.

**Note 12 Subsequent Event**

On July 14, 2003, Yahoo! announced the signing of a definitive agreement to acquire Overture, a provider of commercial search services on the Internet. Under the terms of the agreement, each outstanding share of Overture will be exchanged for 0.6108 shares of Yahoo! common stock and \$4.75 in cash, which amounts to approximately \$0.3 billion in aggregate cash on the date of the announcement, and together with stock options exchanged and direct transaction costs will result in an aggregate purchase price of approximately \$1.6 billion. The transaction is subject to customary closing conditions, including regulatory approval and the approval of Overture's stockholders, and is expected to be completed in the fourth quarter of 2003.



## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

*This Report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including, without limitation, statements regarding the Company's expectations, beliefs, intentions or future strategies that are signified by the words expects, anticipates, intends, believes, or similar language. These forward-looking statements, including those with respect to our operating results for 2003, are based upon current expectations and beliefs of the Company's management and are subject to risks and uncertainties that could cause results to differ materially from those indicated in the forward-looking statements. Some, but not all, of the factors, which could cause actual results to differ materially include those set forth in the risks discussed below under the subheading Risk Factors and elsewhere in this report. The Company undertakes no obligation to revise or publicly release the results of any revision to these forward-looking statements, or to explain why actual results differ. Readers should carefully review the risk factors described in this section below and in any reports subsequently filed with the Securities and Exchange Commission (SEC).*

### Overview

Yahoo! Inc. (Yahoo!) is a global Internet company that offers a comprehensive branded network of properties and services to consumers and businesses worldwide. As the first online navigational guide to the Web, www.yahoo.com is a leading guide in terms of traffic, advertising, household and business user reach. Yahoo!'s global brand reaches the largest audience worldwide. Our global Web network includes 25 world properties. Headquartered in Sunnyvale, California, we have offices in the United States, Europe, Asia, Latin America, Australia and Canada.

We manage our business geographically. We rely on an internal management reporting process that provides revenue and certain operating cost information for making financial decisions and allocating resources. Our principal areas of measurement and decision-making are the United States and International.

### Results of Operations

#### Net Revenues

Net revenues by groups of similar service were as follows (dollars in thousands):

**Three Months Ended**

**Six Months Ended**

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	June 30, 2003	(1)	June 30, 2002	(1)	June 30, 2003	(1)	June 30, 2002	(1)
Marketing services	\$ 219,198	68%	\$ 151,710	67%	\$ 409,163	68%	\$ 289,385	69%
Fees	69,926	22%	49,063	22%	133,655	22%	88,609	21%
Listings	32,282	10%	25,019	11%	61,536	10%	40,463	10%
Total net revenues	\$ 321,406	100%	\$ 225,792	100%	\$ 604,354	100%	\$ 418,457	100%

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(1) Percent of net revenues

**Marketing Services Revenues.** Marketing services revenues are primarily generated from the sale of banner, sponsorship, and text-link advertisements, including sponsored search services primarily provided through our agreement with Overture Services, Inc. ( Overture ), and transactions revenues. Marketing services revenues for the second quarter of 2003 increased by \$67 million, or 44%, as compared to the same period in 2002. This increase resulted primarily from our global sponsored search services, which increased approximately \$45 million for the three months ended June 30, 2003, as well as increases in overall growth in the balance of Yahoo! s global marketing services revenues of approximately \$14 million, and incremental revenue from Inktomi of approximately \$8 million, which was acquired in the first quarter of 2003. Marketing services revenues for the six months ended June 30, 2003 increased by \$120 million, or 41%, as compared to the same period in 2002. This increase resulted primarily from our global sponsored search services, which increased approximately \$81 million for the six months ended June 30, 2003, as well as increases in overall growth in the balance of Yahoo! s global marketing services revenues of approximately \$30 million, and incremental revenue from Inktomi of approximately \$9 million.

The total number of impressions and click-throughs delivered under advertising arrangements, excluding barter arrangements, in the three months ended June 30, 2003 increased by approximately 59% on a combined basis as compared to the three months ended June 30, 2002, while the average price yield per impression and click-through delivered, also on a combined basis, declined approximately 2% for the same period. The total number of impressions and click-throughs delivered under advertising arrangements, excluding barter arrangements, in the six months ended June 30, 2003 increased by approximately 67% on a combined basis as compared to the six months ended June 30, 2002, while the average price yield per impression and click-through delivered, also on a combined basis, declined approximately 11% for the same period. The increase in volume and decrease in average price per unit primarily resulted from the addition of smaller-sized, lower-priced advertising units to certain of the Company's properties, which increased available inventory for sale and also resulted in a lower average price per unit. During the period, the Company's focus remained on obtaining overall advertising dollars rather than maximizing price per unit or impression. During the three months ended June 30, 2003 and 2002, revenues from our agreement with Overture accounted for approximately 20% and 11% of total net revenues, respectively. During the six months ended June 30, 2003 and 2002, revenues from our agreement with Overture accounted for approximately 20% and 11% of total net revenues, respectively.

**Fees Revenues.** Fees revenues consist of revenues generated from a variety of consumer and business fee-based services we provide. These services primarily include SBC Yahoo! DSL and SBC Yahoo! Dial, Yahoo! Personals, Small Business Services, Yahoo! Mail and Yahoo! Enterprise Solutions. Fees revenues for the second quarter of 2003 increased \$21 million, or 43% as compared to the same period in 2002. Of this increase, approximately \$13 million is attributable to our consumer services offerings and approximately \$9 million is attributable to our network services offerings. Fees revenues for the six months ended June 30, 2003 increased \$45 million, or 51% as compared to the same period in 2002. The increase was primarily driven by the growth in our paying relationships for Yahoo!'s premium services. Of this increase, approximately \$22 million is attributable to our consumer services offerings and approximately \$22 million is attributable to our network services offerings.

**Listings Revenues.** Listings revenues consist of revenues generated from a variety of consumer and business listings-based services we provide. These services primarily include access to the HotJobs database and classifieds such as Yahoo! Autos, Yahoo! Real Estate and other Search and Directory services. Listings revenues for the second quarter of 2003 increased approximately \$7 million, or 29% compared to the same period in 2002 primarily due to an increase in our search and marketplace services revenues. Listings revenues for the six months ended June 30, 2003 increased approximately \$21 million, or 52% compared to the same period in 2002. This increase was primarily driven by the incremental contribution in revenue of approximately \$12 million from HotJobs (excluding Resumix, which is included in fees revenues), as well as approximately \$8 million in increases in our search and marketplace services revenues.

Overall, we currently expect total combined revenues for marketing services, fees, and listings for 2003 to increase in absolute dollars as compared to 2002.

**Costs and Expenses:**

Primary operating costs and expenses were as follows (dollars in thousands):

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**Three Months Ended**

**Six Months Ended**

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	June 30, 2003		June 30, 2002		June 30, 2003		June 30, 2002	
		(1)		(1)		(1)		(1)
Cost of revenues	\$ 46,842	15%	\$ 41,708	18%	\$ 89,974	15%	\$ 79,529	19%
Sales and marketing	122,218	38%	110,015	49%	235,906	39%	206,161	49%
Product development	45,687	14%	35,162	16%	82,371	14%	67,944	16%
General and administrative	34,125	11%	25,437	11%	62,845	10%	52,106	12%

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(1) Percent of net revenues

**Cost of Revenues.** Cost of revenues consists of the expenses associated with the production and usage of the Yahoo! network. These costs primarily consist of fees paid to third parties for content included on our online media properties, Internet connection charges, equipment depreciation, technology license fees and compensation related expenses.

Cost of revenues in the second quarter of 2003 increased by approximately \$5 million, or 12%, as compared to the same period of 2002. Cost of revenues for the six months ended June 30, 2003 increased by approximately \$10 million, or 13%, as compared to the same period of 2002. The increases for both the three and six month periods were due to increased costs associated with greater network usage, premium services and content.

**Sales and Marketing.** Sales and marketing expenses consist primarily of advertising and other marketing related expenses, compensation related expenses, sales commissions and travel costs.

Sales and marketing expenses in the second quarter of 2003 increased approximately \$12 million, or 11%, as compared to the same period in 2002, primarily as a result of increases in marketing spending of approximately \$9 million. Sales and marketing expenses for the six months ended June 30, 2003 increased approximately \$30 million, or 14%, as compared to the same period in 2002, as a result of increases in marketing spending of approximately \$17 million, and compensation-related expenses of approximately \$12 million.

**Product Development.** Product development expenses consist primarily of compensation related expenses incurred for enhancements to and maintenance of the Yahoo! network, classification and organization of listings within Yahoo! properties, research and development expenses, and other operating costs.

Product development expenses in the second quarter of 2003 increased approximately \$11 million, or 30%, as compared to the same period of 2002. Product development expenses for the six months ended June 30, 2003 increased approximately \$14 million, or 21%, as compared to the same period of 2002. The increases for both the three and six month periods are the result of increases in our total compensation expense related to engineers that develop and enhance properties and services throughout the Yahoo! network.

**General and Administrative.** General and administrative expenses consist primarily of compensation related expenses and fees for professional services.

General and administrative expenses in the second quarter of 2003 increased approximately \$9 million, or 34%, as compared to the same period of 2002. General and administrative expenses for the six months ended June 30, 2003 increased approximately \$11 million, or 21%, as compared to the same period of 2002. The increases for both the three and six month periods are primarily attributable to increases professional services expenses of approximately \$6 million and \$9 million, respectively.

Overall, we currently expect total combined primary operating costs and expenses for 2003 to increase in absolute dollars as compared to 2002.

**Amortization of Intangibles.** From time to time we have purchased, and expect to continue purchasing, assets or businesses which may result in the creation of amortizable intangible assets.

Amortization of intangibles expense was approximately \$10 million for the second quarter of 2003, or 3% of net revenues, compared to approximately \$6 million, or 3% of net revenues for the second quarter of 2002. Amortization of intangibles expense was approximately \$16 million for the six months ended June 30, 2003, or 3% of net revenues, compared to approximately \$9 million, or 2% of net revenues for the six months ended June 30, 2002. The increase in amortization of intangibles is primarily the result of the additional amortizable intangibles acquired in conjunction with the Inktomi acquisition during the first quarter of 2003.

Effective January 1, 2002, we adopted the provisions of SFAS 142, Goodwill and Other Intangible Assets, and as a result, we performed a transitional impairment test of our goodwill and intangibles as of January 1, 2002. Due to, among other things, the overall softening of the global economy and the related decline in international advertising, we recorded a transitional goodwill impairment loss of approximately \$64 million, which was recorded as a cumulative effect of an accounting change in our Condensed Consolidated Statements of Operations. The fair value of the reporting unit giving rise to the transitional impairment loss was estimated using the expected present value of future cash flows.

We currently expect that amortization of intangibles for 2003 will increase in absolute dollars as compared to 2002.

**Restructuring Costs.** During 2001, we announced restructuring programs to balance our investment in growth areas with the desire to modify our near-term business plan to reflect an economic and capital market slowdown. These restructuring programs included worldwide workforce reductions of approximately \$15 million and consolidation of excess facilities and other charges of approximately \$42 million, which were classified as operating expenses in 2001.

A summary of the restructuring accrual during the six months ended June 30, 2003 is as follows (in thousands):

	Restructuring Accrual at December 31, 2002		Cash Payments		Restructuring Accrual at June 30, 2003	
Consolidation of excess facilities and other charges	\$	11,745	\$	(2,481)	\$	9,264

The restructuring accrual is included on the balance sheet in accrued expenses and other liabilities. The accrual related to the workforce reduction was paid by December 31, 2002. Amounts related to the net lease expense due to the consolidation of facilities will be paid over the respective lease terms through December 2012.

**Other Income, Net.** Other income, net was as follows (in thousands):

	Three Months Ended,		Six Months Ended	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
Interest and investment income	\$ 12,194	\$ 16,465	\$ 22,951	\$ 34,798
Investment gains (losses), net	(2,282)	4,906	(1,630)	3,013
Contract termination proceeds, net			750	2,504
Earnings in equity interests	10,001	5,500	19,730	9,800
Other	422	2,357	793	1,782
Total other income, net	\$ 20,335	\$ 29,228	\$ 42,594	\$ 51,897

Other income, net was approximately \$20 million and \$29 million, respectively, for the three months ended June 30, 2003 and 2002. Other income, net was approximately \$43 million and \$52 million, respectively, for the six months ended June 30, 2003 and 2002. The \$4 million and \$12 million decreases in interest and investment income for the three and six months ended June 30, 2003, respectively, were primarily related to our investments in debt securities and an overall decline in interest rates, and were offset by increases as a result of earnings in our equity interests of \$5 million and \$10 million, respectively, primarily related to our investment in Yahoo! Japan. Investment gains (losses), net for the three months ended June 30, 2003 included an impairment of approximately \$3 million on privately held equity investments. Investment gains (losses), net for the six months ended June 30, 2003 included a gain of approximately \$5 million on the sale of investments, offset by impairment of approximately \$7 million on privately held equity investments. Investment gains (losses), net for the three months ended June 30, 2002 included a gain of approximately \$4 million on the sale of investments. Investment gains (losses), net for the six months ended June 30,



2002 included an impairment of approximately \$6 million on privately held equity investments, offset by a gain of approximately \$8 million on the sale of investments.

Other income, net in future periods may fluctuate as a result of changes in our average investment balances held, changes in market rates or the sale of investments, and investment impairments.

**Minority Interests in Operations of Consolidated Subsidiaries.** Minority interests in operations of consolidated subsidiaries represents the minority investors' percentage share of income or losses from subsidiaries in which we hold a majority ownership interest, but less than 100%, and consolidate the subsidiaries' results in our financial statements.

Minority interests in income from operations of consolidated subsidiaries was an expense of approximately \$1.1 million and income of \$0.1 million for the three months ended June 30, 2003 and 2002, respectively. Minority interests in income from operations of consolidated subsidiaries was an expense of approximately \$3.0 million and income of \$0.4 million for the six months ended June 30, 2003 and 2002, respectively. The change was due to income in Europe, compared to losses in Europe in the same period of the prior year, as well as increased income in Korea.

**Income Taxes.** The provision for income taxes for the three and six months ended June 30, 2003 differs from the amount computed by applying the statutory federal rate principally due to foreign losses for which no tax benefit is provided and nontaxable equity earnings from certain investments. For the three and six months ended June 30, 2002, the provision for income taxes differed from the amount computed by applying the statutory federal rate principally due to foreign losses for which no tax benefit is provided, the recognition of certain capital loss carryforward benefits, nontaxable earnings from certain investments, and non-deductible stock-based compensation charges.

**Business Segment Results**

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We manage our business geographically. Our primary areas of measurement and decision-making are the United States and International. Management relies on an internal management reporting process that provides revenue and segment operating income before depreciation and amortization for making financial decisions and allocating resources. Segment operating income before depreciation and amortization includes income (loss) from operations before amortization of intangibles and depreciation. Segment operating income before depreciation and amortization (previously referred to as Segment EBITDA ) for prior years has been reclassified to include stock compensation expense, consistent with the current year presentation. Management believes that segment operating income before depreciation and amortization is an appropriate measure of evaluating the operating performance of the Company's segments. However, segment operating income before depreciation and amortization should be considered only in addition to, not as a substitute for or superior to, operating income, cash flows or other measures of financial performance prepared in accordance with generally accepted accounting principles.

Revenue is attributed to individual countries according to the international online property that generated the revenue. No single foreign country accounted for more than 10% of net revenues during the three and six months ended June 30, 2003 and 2002.

Summarized information by segment is as follows (in thousands):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2003	(1)	2002	(1)	2003	(1)	2002	(1)
Net revenues by segment:								
United States	\$ 271,345	84%	\$ 187,465	83%	\$ 509,891	84%	\$ 354,077	85%
International	50,061	16%	38,327	17%	94,463	16%	64,380	15%
Total net revenues	\$ 321,406	100%	\$ 225,792	100%	\$ 604,354	100%	\$ 418,457	100%

Segment operating income (loss) before depreciation and amortization:

	(2)		(2)		(2)		(2)	
United States	\$ 90,555	33%	\$ 38,554	21%	\$ 167,503	33%	\$ 65,383	18%
International	6,720	13%	(3,560)	(9)%	13,822	15%	(11,609)	(18)%
Total segment operating income before depreciation and amortization	\$ 97,275	30%	\$ 34,994	15%	\$ 181,325	30%	\$ 53,774	13%

	Three Months Ended		Six Months Ended	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
Segment operating income before depreciation and amortization reconciliation:				
Income from operations	\$ 62,772	\$ 7,518	\$ 117,749	\$ 3,343
Depreciation and amortization	34,503	27,476	63,576	50,431
Segment operating income before depreciation and amortization	\$ 97,275	\$ 34,994	\$ 181,325	\$ 53,774
Operating income (loss) before depreciation and amortization by segment reconciliations:				
United States				
Income from operations	\$ 60,472	\$ 13,874	\$ 111,472	\$ 20,603
Depreciation and amortization	30,083	24,680	56,031	44,780
Segment operating income before depreciation and amortization United States	\$ 90,555	\$ 38,554	\$ 167,503	\$ 65,383
International				
Income (loss) from operations	\$ 2,300	\$ (6,356)	\$ 6,277	\$ (17,260)
Depreciation and amortization	4,420	2,796	7,545	5,651
Segment operating income (loss) before depreciation and amortization International	\$ 6,720	\$ (3,560)	\$ 13,822	\$ (11,609)

- (1) Percent of total net revenues.
- (2) Segment operating income before depreciation and amortization margin.

**United States.** United States revenues in the second quarter of 2003 increased approximately \$84 million, or 45% compared to the same period in 2002. United States revenues for the six months ended June 30, 2003 increased approximately \$156 million, or 44% compared to the same period in 2002. The increase in revenues resulted from our search and marketplace properties, which includes sponsored search services, our network services offerings, which includes communications services and Yahoo! Personals, and our consumer services offerings, which includes SBC Yahoo! DSL and Dial. United States segment operating income before depreciation and amortization in the second quarter of 2003 increased approximately \$52 million, or 135% compared to the same period of 2002. United States segment operating income before depreciation and amortization for the six months ended June 30, 2003 increased approximately \$102 million, or 156% compared to the same period of 2002. The increase is primarily due to the increase in United States revenues, as well as continued efforts to control discretionary spending during the period.

**International.** International revenues in the second quarter of 2003 increased approximately \$12 million, or 31% compared to the same period in 2002. International revenues for the six months ended June 30, 2003 increased approximately \$30 million, or 47% compared to the same period in 2002. The increase was primarily due to overall strength in the European and Asian economies, which resulted in an increase in search and marketplace revenues,

which includes sponsored search revenues. International segment operating income before depreciation and amortization in the second quarter of 2003 increased approximately \$10 million compared to the same period in 2002 and for the six months ended June 30, 2003 increased approximately \$25 million compared to the same period in 2002. These increases were primarily a result of the increase in International revenues and continued efforts to control discretionary spending.

#### **Acquisition**

On March 19, 2003, we completed the acquisition of Inktomi Corporation, ( Inktomi ), a provider of original equipment manufacturer Web search and paid inclusion services. The acquisition combined Yahoo! 's global audience and Inktomi 's search technology to allow us to create a more relevant, comprehensive and higher quality search offering on the Web. These factors contributed to a purchase price in excess of the fair value of the Inktomi net tangible and intangible assets acquired, and as a result, we have recorded goodwill in connection with this transaction.

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The total estimated purchase price of approximately \$289.6 million consisted of \$272.9 million in cash consideration, approximately \$13.4 million of stock options exchanged, and direct transaction costs of approximately \$3.3 million. The value of the stock options was determined based on the average market price of our common stock over the 5-day period prior to and including the date of the acquisition.

The preliminary allocation of the purchase price to the assets acquired and liabilities assumed based on the estimated fair values was as follows (in thousands):

Cash acquired	\$	44,610
Other tangible assets acquired		26,990
Amortizable intangible assets		49,400
Goodwill		216,921
Liabilities assumed		(49,602)
Deferred stock-based compensation		1,287
Total	\$	289,606

Amortizable intangible assets consist of customer-related intangible assets and developed technology with useful lives not exceeding five years. A preliminary estimate of \$216.9 million has been allocated to goodwill. Goodwill represents the excess of the purchase price over the fair value of the net tangible and intangible assets acquired, and is not deductible for tax purposes. Goodwill will not be amortized and will be tested for impairment, at least annually. The preliminary purchase price allocation for Inktomi is subject to revision as more detailed analysis is completed and additional information on the fair value of assets and liabilities becomes available. Any change in the fair value of the net assets of Inktomi will change the amount of the purchase price allocable to goodwill. Liabilities assumed include approximately \$12.7 million of restructuring costs associated with the acquisition.

### Related Party Transactions

SOFTBANK Corp., including its consolidated affiliates ( SOFTBANK ), was approximately a 4% stockholder of the Company at June 30, 2003. We have joint ventures with SOFTBANK in France, Germany, Japan, Korea and the United Kingdom. A Managing Partner of a SOFTBANK affiliate is also a member of our Board of Directors. Revenues from SOFTBANK accounted for less than 1% of net revenues for all periods presented. We believe contracted prices are comparable to those given to unrelated customers.

In addition, the Company has license agreements with Yahoo! Japan and Yahoo! Korea from which, in each case, we have received in excess of \$60,000 in royalty payments during the six months ended June 30, 2003. Pursuant to these license agreements the Company licenses specified uses of the Yahoo! brand and business model to each of Yahoo! Japan and Yahoo! Korea on an exclusive basis in Japan and Korea, respectively, in exchange for licensing fees. Pursuant to the terms of such license agreements, Yahoo! Japan and Yahoo! Korea pay to the Company 3% of their respective revenues. Pursuant to the Yahoo! Korea license agreement, the amount payable by Yahoo! Korea to the Company for each quarter cannot be less than \$12,500.

### Critical Accounting Policies

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Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to uncollectible receivables, investment values, intangible assets, income taxes, restructuring costs and contingencies. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements: revenue recognition; valuation allowances, specifically the allowance for doubtful accounts and deferred tax assets valuation allowance; accounting for investments in private and publicly-traded securities; and goodwill impairment.

**Revenue recognition.** Our revenues are primarily generated from the sale of banner, sponsorship, and text-link advertisements, including sponsored search advertisements, transactions revenues, and revenues generated from a variety of consumer and business fee and listings-based services. In accordance with generally accepted accounting principles in the United States, the recognition of these revenues is partly based on our assessment of the probability of collection of the resulting accounts receivable balance. As a result, the timing or amount of revenue recognition may have been different if different assessments of the probability of collection of accounts receivable had been made at the time the transactions were recorded in revenue.

**Valuation Allowances.** We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. While we have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance, in the event we were to determine that we would be able to realize our deferred tax assets in the future in excess of its net recorded amount, an adjustment to the valuation allowance would likely increase stockholders' equity as substantially all of our net operating losses result from employee stock option deductions.

**Accounting for investments in private and publicly-traded securities.** We hold equity interests in companies, some of which are publicly traded and have highly volatile share prices. We record an investment impairment charge when we believe an investment has experienced a decline in value that is judged to be other than temporary. We monitor our investments for impairment by considering current factors including economic environment, market conditions and the operational performance and other specific factors relating to the business underlying the investment. Future adverse changes in these factors could result in losses or an inability to recover the carrying value of the investments that may not be reflected in an investment's current carrying value, thereby possibly requiring an impairment charge in the future. We recorded approximately \$3 million and \$7 million of impairments on the carrying value of privately held equity securities during the three and six months ended June 30, 2003, respectively. We recorded approximately \$6 million of impairments on the carrying value of privately held equity securities during the six months ended June 30, 2002, respectively.

**Goodwill Impairment.** Our long-lived assets include goodwill and other intangible assets. Statement of Financial Accounting Standards No. 142 Goodwill and Other Intangible Assets ( SFAS 142 ) requires that goodwill be tested for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis and between annual tests in certain circumstances. Application of the goodwill impairment test requires judgment, including the identification of reporting units, assigning assets and liabilities to reporting units, assigning goodwill to reporting units, and determining the fair value of each reporting unit. Significant judgments required to estimate the fair value of reporting units include estimating future cash flows, determining appropriate discount rates and other assumptions. Changes in these estimates and assumptions could materially affect the determination of fair value for each reporting unit.



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Effective January 1, 2002, we adopted SFAS 142 and performed a transitional test of our goodwill and intangible assets. Due to, among other things, the overall softening of the global economy and the related decline in international advertising, the Company recorded a goodwill impairment loss of approximately \$64 million, which was recorded during the first quarter of 2002 as a cumulative effect of an accounting change in the Company's consolidated financial statements. The fair value of the reporting unit giving rise to the transitional impairment loss was estimated using the expected present value of future cash flows. As of June 30, 2003, goodwill was approximately \$636 million. Any further impairment losses recorded in the future could have a material adverse impact on our financial condition and results of operations.

### **Recent Accounting Pronouncements**

In November 2002, the Emerging Issues Task Force ( EITF ) reached a consensus on Issue 00-21, addressing how to account for arrangements that involve the delivery or performance of multiple products, services, and/or rights to use assets. Revenue arrangements with multiple deliverables are divided into separate units of accounting if the deliverables in the arrangement meet the following criteria: (1) the delivered item has value to the customer on a standalone basis; (2) there is objective and reliable evidence of the fair value of undelivered items; and (3) delivery of any undelivered item is probable. Arrangement consideration should be allocated among the separate units of accounting based on their relative fair values, with the amount allocated to the delivered item being limited to the amount that is not contingent on the delivery of additional items or meeting other specified performance conditions. The final consensus is applicable to agreements entered into in fiscal periods beginning after June 15, 2003. The provisions of this consensus are not expected to have a significant effect on our results of operations or financial position.

In January 2003, the Financial Accounting Standards Board ( FASB ) issued Interpretation No. 46 ( FIN 46 ) Consolidation of Variable Interest Entities. Until this interpretation, a company generally included another entity in its consolidated financial statements only if it controlled the entity through voting interests. FIN 46 requires a variable interest entity, as defined, to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns. Management is currently evaluating the effect of adopting FIN 46 on its results of operations and financial position.

In April 2003, the FASB issued SFAS 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities, which amends SFAS 133 for certain decisions made by the FASB Derivatives Implementation Group. In particular, SFAS 149: (1) clarifies under what circumstances a contract with an initial net investment meets the characteristic of a derivative, (2) clarifies when a derivative contains a financing component, (3) amends the definition of an underlying to conform it to language used in FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, and (4) amends certain other existing pronouncements. This Statement is effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003. In addition, most provisions of SFAS 149 are to be applied prospectively. We do not expect the adoption of SFAS 149 to have a material impact on our financial position, cash flows or results of operations.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity ( SFAS 150 ). SFAS 150 changes the accounting for certain financial instruments that under previous guidance issuers could account for as equity. It requires that those instruments be classified as liabilities in balance sheets. The guidance in SFAS 150 is generally effective for all financial instruments entered into or modified after May 31, 2003, and otherwise is effective on July 1, 2003. We do not expect the adoption of SFAS 150 to have a material impact on our financial position, cash flows or results of operations.

## **Liquidity and Capital Resources**

Summarized cash flow information is as follows (in thousands):

**Six Months Ended**

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	June 30, 2003	June 30, 2002
Cash provided by operating activities	\$ 190,751	\$ 150,825
Cash used in investing activities	(291,544)	(257,361)
Cash provided by financing activities	861,736	35,699

We invest excess cash predominantly in debt instruments that are highly liquid, of high-quality investment grade, and predominantly have maturities of less than two years, with the intent to make such funds readily available for operating purposes. We had cash, cash equivalents and investments in marketable debt securities totaling approximately \$2.3 billion at June 30, 2003.

Cash provided by operating activities primarily consists of net income (loss) adjusted for certain non-cash items including depreciation, amortization, tax benefits from stock options, cumulative effect of accounting change, earnings in equity interests, net investment losses, and other non-cash items, and the effect of changes in working capital and other activities. Cash provided by operating activities for the six months ended June 30, 2003 of approximately \$191 million consisted primarily of net income of approximately \$98 million adjusted for non-cash items of approximately \$105 million and approximately \$12 million used by working capital and other activities. Cash provided by operating activities for the six months ended June 30, 2002 of approximately \$151 million consisted primarily of net loss of approximately \$32 million adjusted for non-cash items of approximately \$65 million, cumulative effect of accounting change of approximately \$64 million and approximately \$54 million provided by working capital and other activities.

Cash used in investing activities in the six months ended June 30, 2003 of approximately \$292 million was primarily attributable to cash paid (net of cash acquired) for acquisitions of approximately \$228 million, capital expenditures totaling approximately \$41 million, and purchases of investments in marketable securities (net of proceeds from sales and maturities) and other investments of approximately \$22 million. Capital expenditures have generally comprised purchases of computer hardware, software, server equipment and furniture and fixtures, and are currently expected to increase in 2003. Cash used in investing activities in the six months ended June 30, 2002 of approximately \$257 million was primarily attributable to cash paid (net of cash acquired) for acquisitions of approximately \$189 million, purchases of investments in marketable securities and other investments (net of proceeds from sales and maturities) of approximately \$47 million and capital expenditures of approximately \$21 million.

Cash provided by financing activities in the six months ended June 30, 2003 of approximately \$862 million was primarily attributable from proceeds from issuance of debt of approximately \$733 million and proceeds from issuance of common stock of approximately \$129 million as a result of the exercise of employee stock options. Cash provided by financing activities in the six months ended June 30, 2002 of approximately \$36 million, was primarily due to proceeds from the issuance of common stock as a result of the exercise of employee stock options.

In April 2003, we issued \$750 million of zero coupon senior convertible notes (the Notes) due April 2008, which resulted in net proceeds of approximately \$733 million after transaction fees of approximately \$17 million, which have been deferred and are included on the balance sheet in other assets. The Notes were issued at par and bear no interest. The Notes are convertible into Yahoo! common stock at a conversion price of \$41.00 per share, which would result in an aggregate of 18.3 million shares, subject to adjustment upon the occurrence of specified events. Each \$1,000 principal amount of the Notes will initially be convertible into 24.3902 shares of Yahoo! common stock prior to April 1, 2008 if the sale price of our common stock issuable upon conversion of the Notes reaches a specified threshold for a defined period of time or specified corporate transactions have occurred. The specified thresholds for conversion prior to the maturity date are (1) the closing sale price of the Company's common stock for at least 20 trading days in the 30 trading-day period ending on the last trading day of the immediately preceding fiscal quarter exceeds 110% of the conversion price on that 30<sup>th</sup> trading day, and (2) during the period beginning January 1, 2008 through the maturity date, the closing sale price of the Company's common stock on the previous trading day was 110% or more of the then current conversion price. Upon conversion, Yahoo! has the right to deliver cash in lieu of common stock. The Company may be required to repurchase all of the notes following a fundamental change of the Company, such as a change of control, prior to maturity. Yahoo! may not redeem the Notes prior to their maturity. We intend to use these funds, together with existing cash and investments, for general corporate purposes including potential future acquisitions.

On July 14, 2003, Yahoo! announced the signing of a definitive agreement to acquire Overture, a provider of commercial search services on the Internet. Under the terms of the agreement, each outstanding share of Overture will be exchanged for 0.6108 shares of Yahoo! common stock and \$4.75 in cash, which amounts to approximately \$0.3 billion in aggregate cash on the date of the announcement, and together with stock options exchanged and direct transaction costs will result in an aggregate purchase price of approximately \$1.6 billion. The transaction is subject to customary closing conditions, including regulatory approval and the approval of Overture's stockholders, and is expected to be completed in the fourth quarter of 2003.

#### *Operating Leases*

**Operating Leases.** We have entered into various non-cancelable operating lease agreements for our offices throughout the U.S. and for our international subsidiaries with original lease periods ranging up to 13 years and expiring between 2003 and 2012.

In addition, we have entered into various sublease arrangements associated with our excess facilities under the 2001 Restructuring programs. Such subleases have terms extending through 2006 and amounts estimated to be received have been included in determining the restructuring accrual.

Net lease commitments as of June 30, 2003 can be summarized as follows (in millions):

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	Gross lease commitments		Sublease income		Net lease commitments	
Six months ending December 31, 2003	\$	16.3	\$	(4.6)	\$	11.7
Years ending December 31,						
2004		28.8		(6.2)		22.6
2005		24.3		(4.0)		20.3
2006		22.3		(3.2)		19.1
2007		18.4				18.4
2008		14.5				14.5
Thereafter		96.7				96.7

We also have an agreement committing to lease two additional buildings adjacent to the headquarters in Sunnyvale, California. The buildings are expected to be ready for occupancy in the third quarter of 2003. Upon completion of the building construction, we are committed to a 15 year lease obligation, with annual lease payments under the lease of approximately \$5.1 million in year one, approximately \$6.7 million in year two, and with incremental increases of 3.5% in each of the following years. These amounts are included in the table above. After year one of the lease, we have the right to purchase the buildings for approximately \$68.9 million, plus fees, or continue leasing the buildings under the original agreement for the remaining fourteen years.

***Investment in Privately-Held Company.***

During 2002, Yahoo! acquired an equity interest of approximately 16% in Sonera zed OY ( Zed ), a Finnish company and previously wholly-owned subsidiary of a publicly-held telecommunications company. Under the terms of the investment agreement, Yahoo! has call options to acquire the remaining interests not owned by Yahoo! and a put option to sell back its shares. In addition, Zed has a put option enabling Zed to require Yahoo! to acquire the remaining interests not owned by Yahoo! if Yahoo! exercises its option to buy a majority of Zed's outstanding shares. The amount of the purchase price for the remaining equity interests in Zed not held by Yahoo! under these options is not determinable at this time but will be based on an operating performance based valuation of Zed. Yahoo! is not obligated to purchase additional equity in Zed unless it chooses to exercise the option described above. As part of the transaction, Yahoo! has agreed to provide up to 4.8 million Euro in additional funding to Zed. Other than this amount, Yahoo! is not obligated to guarantee any obligations of Zed or to provide any funding to Zed. Yahoo!'s investment in Zed was immaterial to its condensed consolidated balance sheet as of June 30, 2003.

***Other Commitments***

In the ordinary course of business, Yahoo! enters into various arrangements with vendors and other business partners, principally for marketing, technology, bandwidth and content arrangements. There are no material commitments for these arrangements extending beyond June 30, 2004.

In connection with Company's agreements, the Company provides indemnifications of varying scope and terms to customers, business partners and other parties with respect to certain matters, including, but not limited to, losses arising out of the Company's breach of such agreements and out of intellectual property infringement claims made by third parties. In addition, the Company has entered into indemnification agreements with its directors and certain of its officers that will require the Company, among other things, to indemnify them against certain liabilities that may arise by reason of their status or service as directors or officers. The Company maintains directors and officers insurance which may cover certain liabilities arising from directors and officers indemnifications. Many of these indemnifications provided by the Company do not have stipulated maximum liabilities, therefore the Company is not able to develop a reasonable estimate of the maximum liabilities. To date, the Company has not incurred material costs as a result of such obligations and has not accrued any liabilities related to such indemnifications in its financial statements.

In March 2001, our Board of Directors authorized the repurchase of up to \$500 million of Yahoo!'s outstanding shares of common stock from time to time over the next two years, depending on market conditions, share price and other factors. In March 2003, our Board of Directors authorized a two-year extension of the stock repurchase program, which extension authorizes us to repurchase up to approximately \$340 million (representing the balance of the \$500 million originally authorized in March 2001) of our outstanding shares of common stock from time to time over the next two years, depending on market conditions, share price and other factors. We may utilize equity instrument contracts to facilitate the repurchase of common stock. From March 2001 through June 30, 2003, we had repurchased 16,458,620 shares of common stock at an average of \$9.72 per share for a total amount of approximately \$160 million. Of the shares repurchased, 16,033,620 shares were purchased from SOFTBANK at an average of \$9.67 per share. No shares were repurchased during the six months ended June 30, 2003. Repurchased shares are held in treasury stock. Treasury stock is accounted for under the cost method.

We continue to increase capital expenditures and operating lease commitments, which is consistent with our increased staffing and operational expansion, and we anticipate that this will continue in the future as business conditions merit. Additionally, we will continue to evaluate possible acquisitions of, or investments in businesses, products, and technologies that are complementary to our business, which may require the use of cash. Management believes existing cash and investments will be sufficient to meet operating requirements for at least the next twelve months; however, we may sell additional equity or debt securities or obtain credit facilities to further enhance our liquidity position. The sale of additional securities could result in further dilution to our stockholders.

## RISK FACTORS

*If our competitors are more successful in attracting and retaining customers and users, then our revenues could decline.*

We compete with many other providers of online navigation, Web search, information, entertainment, business, recruitment, community, electronic commerce, and Internet access services. As we expand the scope of our Internet offerings, we will compete directly with a greater number of Internet sites, media companies, and companies providing business services across a wide range of different online services, including:

companies offering communications, Web search, information, community and entertainment services and Internet access either on a stand alone basis or integrated into other products and media properties;

vertical markets where competitors may have advantages in expertise, brand recognition, and other factors;

online employment recruiting companies; and

online merchant hosting services.

In order to compete effectively, we may need to expend significant internal engineering resources or acquire other technologies and companies to provide or enhance our capabilities. For example, our recent acquisition of Inktomi Corporation brings us leading technology in Web search, which is an important service we provide to our users. If we are unable to maintain or expand our customer and user base in the future, our revenues may decline.

*Companies such as AOL Time Warner and Microsoft may have a competitive advantage because they have greater access to content, maintain billing relationships with more customers and have access to established distribution networks.*

We face significant competition from AOL Time Warner ( AOL or America Online ) and Microsoft ( Microsoft or MSN ). The combination of America Online and Time Warner provides America Online with content from Time Warner 's movie and television, music, books and periodicals, news, sports and other media holdings; access to a network of cable and other broadband delivery technologies; and considerable resources for future growth and expansion. The America Online/Time Warner combination also provides America Online with access to a broad potential customer base consisting of Time Warner 's current customers and subscribers of its various media properties. To a less significant extent, we also face competition from other companies that have combined a variety of services under one brand in a manner similar to Yahoo!. In certain of these cases, most notably AOL and MSN, our competition has a direct billing relationship with a greater number of their users through access and other services than we have with our users through certain of our premium services. This relationship permits our competitors to have several potential advantages including the potential to be more effective than us in targeting services and advertisements to the specific taste of their users.

*Acquisitions could result in operating difficulties.*



As part of our business strategy, we acquired Inktomi Corporation in March 2003 and have completed several acquisitions (including the acquisition of HotJobs.com in February 2002). We have also recently entered into an agreement to acquire Overture and expect to enter into additional business combinations and acquisitions in the future. Acquisitions may result in dilutive issuances of equity securities, use of our cash resources, incurrence of debt and amortization of expenses related to intangible assets. The acquisitions of HotJobs and Inktomi were accompanied by a number of risks, including:

the difficulty of assimilating the operations and personnel of HotJobs, which are principally located in New York, with and into Yahoo! s operations, which are headquartered in California;

the potential disruption of our ongoing business and distraction of management;

the difficulty of incorporating HotJobs technology or content and rights into our products and media properties and unanticipated expenses related to such integration;

the failure to further successfully develop HotJobs or Inktomi s technology resulting in the impairment of amounts currently capitalized as intangible assets;

the impairment of relationships with employees and customers of HotJobs, Inktomi or our own business as a result of any integration of new management personnel; and

the potential unknown liabilities associated with HotJobs and Inktomi.

We may experience similar risks in connection with our future acquisitions, including our proposed acquisition of Overture.

We may not be successful in addressing these risks or any other problems encountered in connection with the acquisition of HotJobs and Inktomi or that we could encounter in future acquisitions, which would harm our business or cause us to fail to realize the anticipated benefits of our acquisitions.

***Our recent acquisition of Inktomi exposes our business to greater competition in the area of Web search.***

In March 2003 we completed our acquisition of Inktomi Corporation, a provider of OEM Web search and paid inclusion services. As a result of our acquisition of Inktomi, we compete directly with other providers of Web search and related search services, including, among others, AskJeeves, Google, LookSmart and Overture (which we recently agreed to acquire). Some of these competitors may have longer operating histories focusing on providing Web search services on an OEM basis, larger customer or user bases and greater brand recognition for their Web search businesses. In addition to the general acquisition risks highlighted in these risk factors, we are subject to the risk that other companies with greater operational, strategic or financial resources may choose to enter the Web search or paid inclusion spaces by acquisition or internal development, and may create greater competition for customers and users.

***Our international segment competes with local Internet service providers that may have a competitive advantage.***

On an international level, we compete directly with local providers; they may have several advantages, including greater knowledge about the particular country or local market and access to significant financial or strategic resources in such local markets. We must continue to obtain more knowledge about our users and their preferences, deepen our relationships with our users as well as increase our branding and other marketing activities in order to remain competitive and strengthen our market position internationally.

***Our intellectual property rights are valuable and any inability to protect them could dilute our brand image.***

We regard our copyrights, patents, trademarks, trade dress, trade secrets, and similar intellectual property, including our rights to certain domain names, as important to Yahoo!'s success. Effective trademark, patent, copyright, and trade secret protection may not be available in every country in which our products and media properties are distributed or made available through the Internet. Further, the efforts we have taken to protect our proprietary rights may not be sufficient or effective. If we are unable to protect our trademarks from authorized use, our brand image may be harmed. While we attempt to ensure that the quality of our brand is maintained by our licensees, our licensees may take actions that could impair the value of our proprietary rights or the reputation of our products and media properties. We are aware that third parties have, from time to time, copied significant content available on Yahoo! for use in competitive Internet services. Protection of the distinctive elements of Yahoo! may not be available under copyright law. Any impairment of our brand image could cause our stock price to drop. In addition, protecting our intellectual property and other proprietary rights can be expensive. Any increase in the unauthorized use of our intellectual property could make it more expensive to do business and consequently harm our operating results. In turn, this could harm the results of our business and lower our stock price.

***We may be subject to intellectual property infringement claims, which are costly to defend and could limit our ability to provide certain content or use certain technologies in the future.***

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Many parties are actively developing search, indexing, e-commerce and other Web-related technologies, as well as a variety of online business models and methods. We believe that these parties will continue to take steps to protect these technologies, including, but not limited to, seeking patent protection. As a result, disputes regarding the ownership of these technologies and rights associated with online business are likely to arise in the future. In addition to existing patents and intellectual property rights, we anticipate that additional third-party patents related to our services will be issued in the future. From time to time, parties assert patent infringement claims against us in the form of letters, lawsuits and other forms of communications. Currently, we are engaged in several lawsuits regarding patent issues and have been notified of a number of other potential disputes. We expect that we will increasingly be subject to patent litigation as our services expand.

In addition to patent claims, third parties have asserted and most likely will continue to assert claims against us alleging infringement of copyrights, trademark rights, trade secret rights or other proprietary rights, or alleging unfair competition or violations of privacy rights. Currently, our subsidiary LAUNCH Media, Inc. ( LAUNCH ) is engaged in a lawsuit regarding copyright issues that commenced prior to our entering into an agreement to acquire LAUNCH. In the event that we determine that licensing proprietary rights is appropriate, we cannot guarantee that we will be able to license such proprietary rights on reasonable terms or at all. We may incur substantial expenses in defending against third-party infringement claims regardless of the merit of such claims.

In the event that there is a determination that we have infringed third-party proprietary rights such as patents, copyrights, trademark rights, trade secret rights or other third party rights such as publicity and privacy rights, we could incur substantial monetary liability, be required to enter into costly royalty or licensing agreements, if available, or be prevented from using the rights, which could require us to change our business practices in the future. As a result, these claims could harm our business.

***Financial results for any particular period will not predict results for future periods.***

There can be no assurance that the purchasing pattern of customers advertising on the Yahoo! network will not continue to fluctuate, that advertisers will not make smaller and shorter-term purchases, or that market prices for online advertising will not decrease due to competitive or other factors. As the percentage of revenues from sources other than advertising increases, it may become more difficult to predict our financial results based on historical performance. Because of the rapidly changing market we serve, period-to-period comparisons of operating results are not likely to be meaningful. You should not rely on the results for any period as an indication of future performance.

***We expect our operating expenses to continue to increase as we attempt to expand the Yahoo! brand, fund product development, develop media properties and acquire other businesses.***

Yahoo! currently expects that its operating expenses will continue to increase as we expand our sales and marketing operations in areas of expected growth, continue to develop and extend the Yahoo! brand, fund greater levels of product development, develop and commercialize additional media properties and premium services, and acquire complementary businesses and technologies.

***We may be required to record a significant charge to earnings if we must reassess our goodwill or amortizable intangible assets.***

We are required under generally accepted accounting principles to review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill is required to be tested for impairment at least annually. Factors that may be considered a change in circumstances indicating that the carrying value of our amortizable intangible assets may not be recoverable include a decline in stock price and market capitalization, and slower growth rates in our industry. If our stock price and market capitalization decline, we may be required to record a significant charge to earnings in our financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined. At June 30, 2003, our goodwill and other amortizable intangible assets were \$767 million. In the first quarter of 2002, we recorded a transitional impairment charge of \$64.1 million as a cumulative effect of an accounting change, resulting from the adoption of Statement of Financial Accounting Standards No. 142 Goodwill and Other Intangible Assets.

***Approximately 68% of our net revenues are derived from marketing services. Demand from our current and potential clients for online advertising is difficult to forecast accurately.***

For the three months ended June 30, 2003, approximately 68% of our net revenues came from advertisements displayed on our online properties including transaction fees. Our ability to continue to achieve substantial advertising revenue depends upon:

growth of our user base;

broadening our relationships with advertisers to small and medium size businesses;

our user base being attractive to advertisers;

our ability to derive better demographic and other information from our users;

acceptance of the Web by advertisers as an advertising medium; and

our ability to transition and expand into other forms of advertising.

Our agreements with advertisers and sponsors generally have terms of three years or less and, in many cases, the terms are one year or less. The agreements often have payments contingent on usage or click-through levels. Some of our advertisers are Internet companies, which in certain cases, may lack financial resources to fulfill their commitments. Accordingly, it is difficult to forecast these revenues accurately. However, our expense levels are based in part on expectations of future revenues and are fixed over the short-term with respect to certain categories. We may be unable to adjust spending quickly enough to compensate for any unexpected revenue shortfall.

***If we are unable to continue to provide search and directory capabilities on terms which are acceptable to us, our revenue could significantly decline.***

We also generate a significant amount of revenue from our search and directory capabilities through an advertiser's purchase of an enhanced placement in our results. Yahoo! Sponsor Results, offered through keyword search driven inquiries, is currently provided through an agreement with Overture with an initial term ending in April 2005 and options for us to extend until April 2011. For the three and six months ended June 30, 2003, our revenues from our agreement with Overture were approximately 20% of our total net revenues. If we are unable to provide search and directory services which generate significant traffic to our Web sites, to continue to secure an arrangement with a third party provider such as Overture on terms which are acceptable to us, or we are unable to develop our own ability to provide this service, including through our pending acquisition of Overture, our revenue could significantly decline.

***The sources of our advertising revenue are changing and we must adapt to the needs of our changing mix of advertisers to maintain or increase our advertising revenues.***

We are experiencing a shift in the source of our advertising revenues from Internet companies to companies in more traditional lines of business. These advertisers often have substantially different requirements and expectations than Internet companies with respect to advertising programs. In addition, companies in more traditional lines of business have only recently begun to increase their aggregate commitments to Internet advertising. If we are unsuccessful in adapting to the needs of our changing mix of advertisers, our revenues could decline.

***Decreases or delays in advertising spending due to general economic downturns could harm our ability to generate advertising revenue.***

Expenditures by advertisers tend to be cyclical, reflecting overall economic conditions as well as budgeting and buying patterns. The overall market for advertising, including Internet advertising, has been generally characterized in recent quarters by softness of demand and the reduction of marketing and advertising budgets or the delay in spending of budgeted resources. As a result, advertising spending has decreased. Since Yahoo! derives a large part of its revenues from advertising fees, the decrease in or delay of advertising spending could reduce our revenues or negatively impact our ability to grow our revenues. Even if economic conditions do improve, marketing budgets and advertising spending may not increase from current levels.

***Due to intense competition, we may not be able to generate substantial revenues from the Internet access market.***

In 2002 we launched SBC Yahoo! DSL and SBC Yahoo! Dial, an Internet access service provided through an alliance with SBC Communications Inc. This access service combines customized content and services from Yahoo! (including browser and other communications services) and DSL transport and Internet access from SBC Internet Services (an affiliate of SBC Communications Inc.). This Internet access service competes with many large companies, some of which may have substantially greater market presence (including an existing user base), financial, technical, marketing or other resources than those committed to the product offerings with SBC. This service primarily competes directly or indirectly with established Internet services, such as AOL and the MSN; national telecommunications companies and regional Bell operating companies (other than SBC); and broadband Internet access providers such as Earthlink, Comcast, and other cable broadband providers. As a result of these and other competitive factors, this service may not be able to attract, grow or retain a customer base, which would negatively impact our ability to sell customized content and services through this channel.

*Our success in the Internet access market will depend on technical and customer service issues which we have a limited ability to control.*

Internet access services, including SBC Yahoo! DSL and SBC Yahoo! Dial, are susceptible to natural or man-made disasters such as earthquakes, floods, fires, power loss, or sabotage, as well as interruptions from technology malfunctions, computer viruses or hacker attacks. Other potential service interruptions may result from unanticipated demands on network infrastructure, increased traffic or problems in customer service to our access customers. Our ability to control technical and customer service issues is further limited by our dependence on SBC for connectivity, customer service, joint marketing and technical integration of aspects of our access service. Significant disruptions in our access service could harm our goodwill, the Yahoo! brand and ultimately could significantly and negatively impact the amount of revenue we may earn from our service.

*Some of our sponsorship arrangements may not generate anticipated revenues.*

A key element of our strategy is to generate advertising revenues through sponsored services and placements by third parties in our online media properties in addition to banner advertising. We typically receive sponsorship fees or a portion of transaction revenues in return for minimum levels of user impressions to be provided by us. These arrangements expose us to potentially significant financial risks in the event our usage levels decrease, including the following:

the fees we are entitled to receive may be adjusted downwards;

we may be required to make good on our obligations by providing alternative services;

the sponsors may not renew the arrangements or may renew at lower rates; and

the arrangements may not generate anticipated levels of shared transaction revenues, or sponsors may default on the payment commitments in such agreements as has occurred in the past.

Accordingly, any leveling off or decrease of our user base (or usage by our existing base) or the failure to generate anticipated levels of shared transaction revenues could result in a significant decrease in our revenues.

*We have spent considerable amounts of money and resources to provide a variety of communications services, but such services may not prove to be successful in generating significant revenue for us.*

Currently, a substantial portion of the traffic on our online properties is directed at our communications services, such as email, instant messaging and chat rooms, and we expect this trend to continue for the foreseeable future. We provide these and other basic communications services free of charge to users, as is the case with most of our competitors. We also offer fee-based enhancements to our email service and also depend on the use of other Yahoo! services to generate revenues from our communications service. This revenue model and alternative revenue models for our communications and electronic commerce services, such as subscription fees and commissions, are relatively unproven and may not generate sufficient revenues to be meaningful to us. As communications services become an increasingly important part of our total offering, we must continue to provide new communications applications that are compelling to users and utilize more sophisticated communications technologies to provide such applications to many types of access devices in addition to the personal computer, while continuing to develop an effective method for generating revenues for such services. In addition, the development of these technologies requires long development cycles and a more significant investment by us. If we cannot generate revenues from our communications services that are greater than the cost of providing such services, our operating results will be harmed.

*We may not be successful in expanding the number of users of our electronic commerce services.*

We have focused, and intend to continue to focus, significant resources on the development and enhancement of our electronic commerce properties. These properties, such as Yahoo! Shopping, link users with a network of retailers with whom we have relationships. Through our electronic commerce properties, we do not establish a direct billing relationship with our users as a result of any purchases they may make with



the retailers. In addition, a large number of our users currently utilize Yahoo! s online shopping services simply to gather information for future offline purchases. We will need to effectively induce information gatherers to make purchases in order for our electronic commerce properties to be successful. Finally, the success of our electronic commerce properties will also depend on, among other things, our ability to attract and retain well-known brands among our network of retailers. The revenue that we derive from our electronic commerce properties is typically in the form of a commission paid by the retailer from whom our user purchased a product. Users who had a favorable buying experience with a particular retailer may contact that retailer directly for future purchases rather than through our service. If our users bypass our electronic commerce properties, such as Yahoo! Shopping, and contact retailers directly, we will not receive any revenue for purchases made through such direct contact. Competing providers of online shopping, including merchants with whom we have relationships, may provide a more convenient and comprehensive online shopping experience due to their singular focus on electronic commerce. As a result, we may have difficulty competing with those merchants for users of electronic commerce services and as a consequence our revenue could decline or we could fail to generate significant revenues from electronic commerce. In addition, a decrease in the number of users of Yahoo! Shopping could adversely affect demand for our Yahoo! Store service as a means to market and distribute products online, which could negatively impact the amount of revenue we generate from this service.

***Our business and enterprise services, while costly to develop, may fail to gain increasing market acceptance.***

We have invested a significant amount of money and resources in the creation of our Yahoo! Enterprise Solutions offerings, which is composed of our Portals and Broadcast Groups. These services may fail to gain increasing market acceptance. Because the market for business and enterprise services is new and evolving, it is difficult to predict the size of this market and its rate of growth, if any. In addition, it is uncertain whether businesses and other organizations will utilize the Internet to any significant degree as a means of broadcasting business conferences and other events. Potential business services customers must increasingly accept audio and video broadcast services over the Internet as a viable alternative to face-to-face meetings, television or audio, audio teleconferences and video conferencing. We cannot assure you that the market for business and enterprise services will continue to grow or be sustainable. In addition, with respect to Portal Solutions, we compete with many large, well capitalized companies offering a broader range of integrated products, which provides them with a competitive advantage. If the market fails to grow, grows more slowly than expected or becomes more competitive than is currently expected, our operating results could be harmed.

***We will continue to operate in international markets in which we have limited experience and are faced with relatively higher costs and are exposed to greater risks.***

A key part of our strategy is to develop Yahoo!-branded online properties in international markets. We have developed, through joint ventures, subsidiaries and branch offices, Yahoo! properties localized for over 20 other countries. To date, we have only limited experience in developing localized versions of our products and marketing and operating our products and services internationally, and we rely on the efforts and abilities of our foreign business partners in such activities.

We believe that in light of substantial anticipated competition, we need to expand our operations in international markets quickly in order to obtain market share effectively. However, in a number of international markets, especially those in Europe, we face substantial competition from Internet Service Providers (ISPs) that offer or may offer their own navigational services. Many of these ISPs have a dominant market share in their territories. Further, foreign providers of competing online services may have a substantial advantage over us in attracting users in their country due to more established branding in that country, greater knowledge with respect to the tastes and preferences of users residing in that country and/or their focus on a single market. We have experienced and expect to continue to experience higher costs as a percentage of revenues in connection with the development and maintenance of our international online properties relative to our domestic experience. We have selected international markets that may not develop at a rate that supports our level of investment. In particular, international markets typically have been slower than domestic markets in adopting the Internet as an advertising and commerce medium.

***Our international operations are subject to greater risks.***

In addition to uncertainty about our ability to continue to generate revenues from our foreign operations and expand our international presence, there are certain risks inherent in doing business on an international level, including:

trade barriers and unexpected changes in regulatory requirements;

difficulties in developing, staffing and simultaneously managing a large number of unique foreign operations

as a result of distance, language and cultural differences;

longer payment cycles;

currency exchange rate fluctuations;

political and economic instability and export restrictions;

seasonal reductions in business activity;

risks related to government regulation including those more fully described below; and

potentially adverse tax consequences.

One or more of these factors could harm our future international operations and consequently, could harm our business, operating results, and financial condition.

***If key personnel leave unexpectedly and are not replaced, we may not be able to execute our business plan.***

We are substantially dependent on the continued services of our key personnel, including our two founders, our chief executive officer, chief financial officer, chief operating officer, chief technical officer, and our executive and senior vice presidents. These individuals have acquired specialized knowledge and skills with respect to Yahoo! and its operations. If any of these individuals were to leave Yahoo! unexpectedly, we could face substantial difficulty in hiring qualified successors and could experience a loss in productivity while any such successor obtains the necessary training and experience. Many of our management personnel have reached or will soon reach the four-year anniversary of their Yahoo! hiring date and, as a result, have become or will shortly become fully vested in their initial stock option grants. While management personnel are typically granted additional stock options subsequent to their hire date, which will usually vest over a period of four years to provide additional incentive to remain at Yahoo!, the initial option grant is typically the largest for a given position, and an employee may be more likely to leave Yahoo! s employ upon completion of the vesting period for the initial option grant.

***If we are unable to hire qualified personnel in designated growth areas, we may not be able to execute our business plan.***

We expect that we will need to hire additional personnel in designated growth areas. The competition for qualified personnel can be intense, particularly in the San Francisco Bay Area, where our corporate headquarters are located. At times, we have experienced difficulties in hiring personnel with the right training or experience, particularly in technical areas. If we do not succeed in attracting new personnel, or retaining and motivating existing personnel, we may be unable to meet our business plan and as a result our stock price may drop.

***We may have difficulty scaling and adapting our existing architecture to accommodate increased traffic and technology advances or customer requirements.***

Yahoo! is one of the most highly trafficked Websites on the Internet and is regularly serving numbers of users and delivering daily page views which are beyond previous standards for Internet usage. In addition, the services offered by Yahoo! and popular with users and customers have changed significantly in the past, are expected to change rapidly in the future, and are difficult to predict. Rapid increases in the levels or types of use of our online properties and services could result in delays or interruptions in our service. In particular, the architecture utilized for our email and certain other communication services is highly complex and may not provide satisfactory service in the future, especially as email and certain other communications services become an increasingly important service offering and as the rate of unsolicited email continues to increase in volume and complexity. In the future, we may be required to make significant changes to our architecture, including moving to a completely new architecture. If we are required to switch architectures, we may incur substantial costs and experience delays or interruptions in our service. These delays or interruptions in our service may cause users and customers to become dissatisfied with our service and move to competing providers of online services. Further, to the extent that demand for our broadcast services content and other rich media offerings increases, we will need to expand our infrastructure, including the capacity of our hardware servers and the sophistication of our software. This expansion is likely to be expensive and complex, and require additional technical expertise. As we acquire users who rely upon us for a wide variety of services, it becomes more technologically complex and costly to retrieve, store and integrate data that will enable us to track each user s preferences. An unanticipated loss of traffic, increased costs, inefficiencies or failures to adapt to new technologies or user requirements and the associated adjustments to our architecture could harm our operating results and financial condition.

***Our competitors often provide Internet access or computer hardware to our users, and our competitors could make it difficult for our users to access our services, which in turn, could reduce the number of our users.***

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Our users must access our services through an Internet service provider, or ISP, with which the user establishes a direct billing relationship using a personal computer or other access device. To the extent that an access provider (other than SBC), such as AOL Time Warner or MSN, or a computer or computing device manufacturer offers online services or properties that are competitive with those of Yahoo!, the user may find it more convenient to use the services or properties of that access provider or manufacturer. In addition, the access provider or manufacturer may make it difficult to access our services by not listing them in the access provider's or manufacturer's own directory. Also, because the access provider gathers information from the user in connection with the establishment of the billing relationship, the access provider may be more effective than us in tailoring services and advertisements to the specific tastes of the user. To the extent that a user opts to use the services offered by an access provider (other than SBC Yahoo! DSL or SBC Yahoo! Dial) or those offered by computer or computing device manufacturers rather than the services provided by us, our revenues may decline.

***More individuals are utilizing non-PC devices to access the Internet, and we may not be successful in developing a version of our service that will gain widespread adoption by users of such devices.***

In the coming years, the number of individuals who access the Internet through devices other than a personal computer, such as personal digital assistants, mobile telephones and television set-top devices, is expected to increase dramatically. Our services are designed for rich, graphical environments such as those available on personal and laptop computers. The lower resolution, functionality and memory associated with alternative devices may make the use of our services through such devices difficult, and we may be unsuccessful in our efforts to modify our online properties to provide a compelling service for users of alternative devices. As we have limited experience to date in operating versions of our service developed or optimized for users of alternative devices, it is difficult to predict the problems we may encounter in doing so, and we may need to devote significant resources to the creation, support and maintenance of such versions. If we are unable to attract and retain a substantial number of alternative device users to our online services, we will fail to capture a sufficient share of an increasingly important portion of the market for online services.

***We may not be successful in developing marketable advertising services suited for alternative devices.***

As the majority of our revenues are derived through the sale of marketing services optimized for a personal computer screen, we may not be successful at developing a viable strategy for deriving substantial revenues from online properties that are directed at the users of alternative devices. Any failure to develop revenue-generating online properties that are adopted by a significant number of alternative device users could harm our business, operating results and financial condition.

***We rely on the value of the Yahoo! brand, and the costs of maintaining and enhancing our brand awareness are increasing.***

We believe that maintaining and expanding the Yahoo! brand (and other vertical brands, including Inktomi and HotJobs) is an important aspect of our efforts to attract and expand our user and advertiser base. We also believe that the importance of brand recognition will increase due to the relatively low barriers to entry. We have spent considerable money and resources to date on the establishment and maintenance of the Yahoo! brands. We will spend increasing amounts of money on, and devote greater resources to advertising, marketing and other brand-building efforts to preserve and enhance consumer awareness of the Yahoo! brands. We may not be able to successfully maintain or enhance consumer awareness of the Yahoo! brands and, even if we are successful in our branding efforts, such efforts may not be cost-effective. If we are unable to maintain or enhance customer awareness of the Yahoo! brands in a cost effective manner, our business, operating results and financial condition would be harmed.

***The successful operation of our business depends upon the supply of critical elements from other companies and any interruption in that supply could cause service interruptions or reduce the quality of our product offerings.***

We depend upon third parties, to a substantial extent, for several critical elements of our business, including various technology, infrastructure, content development, software and distribution components.

**Technology and Infrastructure.** We rely on private third-party providers for our principal Internet connections, co-location of a significant portion of our data servers and network access. Any disruption in the Internet or network access or co-location services provided by these third-party providers or any failure of these third-party providers to handle current or higher volumes of use could significantly harm our business, operating results and financial condition. Any financial difficulties for our providers may have negative effects on our business, the nature and extent of which we cannot predict. We license technology and related databases from third parties for certain elements of our properties, including, among others, technology underlying the delivery of news, stock quotes and current financial information, chat services, street mapping and telephone listings, streaming capabilities and similar services. We have experienced and expect to continue to experience interruptions and delays in service and availability for such elements. We also rely on a third-party manufacturer for key components of our email service. Furthermore, we depend on hardware and software suppliers for prompt delivery, installation and service of servers and other equipment to deliver our products and services. Any errors, failures, interruptions, or delays experienced in connection with these third-party technologies and information services could negatively impact our relationship with users and adversely affect our brand and our business and could expose us to liabilities to third parties.

**Distribution Relationships.** In addition to our relationship with SBC, to increase traffic for our online properties and services and make them more available and attractive to advertisers and consumers, we have certain distribution agreements and informal relationships with leading Web browser providers, operators of online networks and leading Websites, software developers and computer manufacturers, and telecommunications companies. These distribution arrangements typically are not exclusive and do not extend over a significant amount of time. Further, some of our distributors are competitors or potential competitors who may not renew their distribution contracts with us. Potential distributors may not offer distribution of our properties and services on reasonable terms, or at all. In addition, as new methods for accessing the Web become available, including through alternative devices, we may need to enter into additional distribution relationships. If we fail to obtain distribution or to obtain distribution on terms that are reasonable, we may not be able to execute our business plan.

**Streaming Media Software.** We rely on the two leading providers of streaming media products, RealNetworks and Microsoft, to license the software necessary to broadcast streaming audio and video content to our users. There can be no assurance that these providers will continue to license these products to us on reasonable terms, or at all. Our users are currently able to electronically download copies of the software to play streaming media free of charge, but providers of streaming media products may begin charging users for copies of their player software or otherwise change their business model in a manner that slows the widespread acceptance of these products. In order for our broadcast services to be successful, there must be a large base of users of these streaming media products. We have limited or no control over the availability or acceptance of streaming media software, and to the extent that any of these circumstances occur, the broadcast services portion of our business will be materially adversely affected.

**Content and Search Service.** Our future success depends upon our ability to aggregate compelling content and deliver that content through our online properties. We license much of the content that attracts users to our online properties, such as news items, stock quotes, weather reports, maps and audio and video content from third parties such as Reuters. We also obtain important elements of our search service from our relationship with Google. In particular, our music and entertainment properties rely on major sports organizations, radio and television stations, record labels, cable networks, businesses, colleges and universities, film producers and distributors, and other organizations for a large portion of the content available on our properties. Our ability to maintain and build relationships with third-party content providers will be critical to our success. We may be unable to enter into or preserve relationships with the third parties whose content we seek to obtain. Many of our current licenses for third-party content extend for a period of less than two years and there can be no guarantee that they will be renewed upon their expiration. In addition, as competition for compelling content increases both domestically and abroad, our content providers may increase the prices at which they offer their content to us and potential content providers may not offer their content on terms agreeable to us. An increase in the prices charged to us by third-party content providers could harm our operating results and financial condition. Further, many of our content licenses with third parties are non-exclusive. Accordingly, other webcasters may be able to offer similar or identical content. Likewise, most sports and entertainment content available on our online properties are also available on other media like radio or television. These media are currently, and for the foreseeable future will be, much more widely adopted for listening or viewing such content than the Web. These factors also increase the importance of our ability to deliver compelling editorial content and personalization of this content for users in order to differentiate Yahoo! from other businesses. If we are unable to license or acquire compelling content, if other companies broadcast content that is similar to or the same as that provided by Yahoo!, or if we do not develop compelling editorial content or personalization services, the number of users on our online properties may not grow at all or at a slower rate than anticipated, which would decrease our



revenue.

*As we provide more audio and video content, particularly music, we may be required to spend significant amounts of money on content acquisition and content broadcasts.*

In the past, the majority of the content that we provided to our users was in print, picture or graphical format and was either created internally or licensed to us by third parties for little or no charge. However, we have been providing and intend to continue to provide increasing amounts of audio and video content to our users, such as the broadcast of music, film content, speeches, news footage, concerts and other special events, through our broadcast services and other media and entertainment properties. We believe that users of Internet services such as the Yahoo! online properties will increasingly demand high-quality audio and video content. Such content may require us to make substantial payments to third parties from whom we license or acquire such content.

For example, in order to broadcast music through our online properties, we are currently required to pay royalties both on the copyright in the musical compositions and the copyright in the actual sound recordings of the music to be broadcast. The revenue we receive as a result of our audio and video broadcasts may not justify the costs of providing such broadcasts.

***Our failure to manage growth and diversification of our business could harm us.***

We have experienced dramatic growth in personnel in recent years and expect to continue to hire additional personnel in selected areas. This growth requires significant time and resource commitments from us and our senior management. Further, as a result of recent acquisitions and international expansion, more than one-half of our employees are based outside of our Sunnyvale, California headquarters. If we are unable to effectively manage a large and geographically dispersed group of employees or anticipate our future growth, our business will be adversely affected.

In addition, our business has evolved in recent quarters to include, among other initiatives, a variety of fee-based premium services. Regulation of the Internet, including U.S. and foreign laws and regulations relating to user privacy, pricing, advertising, taxation, gambling, sweepstakes, promotions, financial market regulation, consumer protection, content regulation, quality of products and services and intellectual property ownership and infringement, may impact our evolving business in ways we have not yet anticipated. Such regulation may impose significant additional costs on our business or subject us to additional liabilities. Additionally, our business relies on our financial reporting and data systems (including our systems for billing users of our fee-based services), which have grown increasingly complex in recent quarters due to acquisitions and the diversification and complexity of our business. Our ability to operate our business efficiently depends on these systems and if we are unable to adapt to these changes, our business will be adversely affected.

***We are subject to U.S. and foreign government regulation of the Internet, the impact of which is difficult to predict.***

There are currently few laws or regulations directly applicable to the Internet. The application of existing laws and regulations to Yahoo! relating to issues such as user privacy, defamation, pricing, advertising, taxation, gambling, sweepstakes, promotions, financial market regulation, consumer protection, content regulation, quality of products and services, and intellectual property ownership and infringement can be unclear. In addition, we will also be subject to new laws and regulations directly applicable to our activities. Any existing or new legislation applicable to us could expose us to substantial liability, including significant expenses necessary to comply with such laws and regulations, and dampen the growth in use of the Web.

Several federal laws, including the following, could have an impact on our business. The Digital Millennium Copyright Act is intended, in part, to limit the liability of eligible online service providers for listing or linking to third-party Websites that include materials that infringe copyrights or other rights of others. The Children's Online Protection Act and the Children's Online Privacy Protection Act are intended to restrict the distribution of certain materials deemed harmful to children and impose additional restrictions on the ability of online services to collect user information from minors. In addition, the Protection of Children From Sexual Predators Act of 1998 requires online service providers to report evidence of violations of federal child pornography laws under certain circumstances. Such legislation may impose significant additional costs on our business or subject us to additional liabilities.

We post our privacy policy and practices concerning the use and disclosure of user data. In addition, GeoCities, a company we acquired in 1999, is required to comply with a consent order between it and the Federal Trade Commission (the "FTC"), which imposes certain obligations and restrictions with respect to information collected from users. Any failure by us to comply with our posted privacy policy, the consent order, FTC requirements or other privacy-related laws and regulations could result in proceedings by the FTC or others which could potentially have an adverse effect on our business, results of operations and financial condition. In this regard, there are a large number of legislative proposals before the United States Congress and various state legislative bodies regarding privacy issues related to our business. It is not possible to predict whether or when such legislation may be adopted, and certain proposals, if adopted, could materially and adversely affect our business through a decrease in user registrations and revenues. This could be caused by, among other possible provisions, the required use of disclaimers or other requirements before users can utilize our services.

Due to the nature of the Web, it is possible that the governments of other states and foreign countries might attempt to regulate Web transmissions or prosecute us for violations of their laws. We might unintentionally violate such laws, such laws may be modified and new laws may be enacted in the future. Any such developments (or developments stemming from enactment or modification of other laws) could increase the costs of regulatory compliance for us or force us to change our business practices.

***We may be subject to legal liability for online services.***

We host a wide variety of services that enable individuals to exchange information, generate content, conduct business and engage in various online activities on an international basis, including public message posting and services relating to online auctions and homesteading. The law relating to the liability of providers of these online services for activities of their users is currently unsettled both within the United States and abroad. Claims have been threatened and have been brought against us for defamation, negligence, copyright or trademark infringement, unlawful activity, tort, including personal injury, fraud, or other theories based on the nature and content of information that we provide links to or that may be posted online or generated by our users or with respect to auctioned materials. In addition, Yahoo! was the subject of a claim brought by certain entities in a French court regarding, among other things, the availability of certain content within our services which was alleged to violate French law. Due to the unsettled nature of the law in this area, we may be subject to similar actions in domestic or other international jurisdictions in the future. Our defense of any such actions could be costly and involve significant distraction of our management and other resources. In addition, we are aware that governmental agencies are currently investigating the conduct of online auctions.

We also periodically enter into arrangements to offer third-party products, services, or content under the Yahoo! brand or via distribution on various Yahoo! properties, including stock quotes and trading information. We may be subject to claims concerning these products, services or content by virtue of our involvement in marketing, branding, broadcasting or providing access to them, even if we do not ourselves host, operate, provide, or provide access to these products, services or content. While our agreements with these parties often provide that we will be indemnified against such liabilities, such indemnification may not be adequate.

It is also possible that, if any information provided directly by us contains errors or is otherwise negligently provided to users, third parties could make claims against us. For example, we offer Web-based email services, which expose us to potential risks, such as liabilities or claims resulting from unsolicited email, lost or misdirected messages, illegal or fraudulent use of email, or interruptions or delays in email service. Investigating and defending any of these types of claims is expensive, even to the extent that the claims do not ultimately result in liability.

***We issued \$750 million of zero coupon senior convertible notes due April 2008 which we may not be able to repay in cash and could result in dilution of our earnings per share.***

In April 2003, we issued \$750 million of zero coupon senior convertible notes due April 1, 2008. The notes are convertible into our common stock at a conversion price of \$41.00 per share, which would result in an aggregate of 18.3 million shares, subject to adjustment upon the occurrence of specified events. Therefore, each \$1,000 principal amount of the notes will initially be convertible into 24.3902 shares of our common stock prior to April 1, 2008 if the sale price of our common stock issuable upon conversion of the notes reaches a specified threshold or specified corporate transactions have occurred. We may be required to repurchase all of the notes following a fundamental change of the Company, such as a change of control, prior to maturity. Following a fundamental change of the Company, we may choose to pay the purchase price of the notes in cash, shares of our common stock, shares of common stock of the surviving corporation, or a combination of cash and shares of the applicable common stock. We may not have enough cash on hand or have the ability to access cash to pay the notes if presented on a fundamental change or at maturity. In addition, the purchase of our notes with shares of our common stock or the conversion of the notes into our common stock could result in dilution of our earnings per share.

***Our stock price has been volatile historically and may continue to be volatile.***

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The trading price of our common stock has been and may continue to be subject to wide fluctuations. During the second quarter of 2003, the closing sale prices of our common stock on the Nasdaq ranged from \$22.79 to \$32.90 per share and the closing sale price on July 30, 2003 was \$30.79 per share. Our stock price may fluctuate in response to a number of events and factors, such as quarterly variations in operating results, announcements of technological innovations or new products and media properties by us or our competitors, changes in financial estimates and recommendations by securities analysts, the operating and stock price performance of other companies that investors may deem comparable to us, and news reports relating to trends in our markets or general economic conditions.

In addition, the stock market in general, and the market prices for Internet-related companies in particular, have experienced volatility that often has been unrelated to the operating performance of such companies. These broad market and industry fluctuations may adversely affect the price of our stock, regardless of our operating performance. Additionally, volatility or a lack of positive performance in our stock price may adversely affect our ability to retain key employees, all of whom have been granted stock options.

***Our operations could be significantly hindered by the occurrence of a natural disaster or other catastrophic event.***

Our operations are susceptible to outages due to fire, floods, power loss, telecommunications failures, break-ins and similar events. In addition, a significant portion of our network infrastructure is located in Northern California, an area susceptible to earthquakes. In the past, the western United States (and California in particular) has experienced repeated episodes of diminished electrical power supply. As a result of these episodes, certain of our operations or facilities may be subject to rolling blackouts or other unscheduled interruptions of electrical power. The prospect of such unscheduled interruptions may continue for the foreseeable future and we are unable to predict their occurrence, duration or cessation. We do not have multiple site capacity for all of our services in the event of any such occurrence. Despite our implementation of network security measures, our servers are vulnerable to computer viruses, physical and electronic break-ins, and similar disruptions from unauthorized tampering with our computer systems.

***Technological or other assaults on our service could harm our business.***

We are vulnerable to coordinated attempts to overload our systems with data, resulting in denial or reduction of service to some or all of our users for a period of time. We have experienced a coordinated denial of service attack in the past, and may experience such attempts in the future. We do not carry sufficient business interruption insurance to compensate us for losses that may occur as a result of any of these events. Any such event could reduce our revenue and harm our operating results and financial condition.

***Anti-takeover provisions could make it more difficult for a third party to acquire us.***

We have adopted a stockholder rights plan and declared a dividend distribution of one right for each outstanding share of common stock to stockholders of record as of March 20, 2001. Each right entitles the holder to purchase one unit consisting of one one-thousandth of a share of our Series A Junior Participating Preferred Stock for \$250 per unit. Under certain circumstances, if a person or group acquires 15% or more of our outstanding common stock, holders of the rights (other than the person or group triggering their exercise) will be able to purchase, in exchange for the \$250 exercise price, shares of our common stock or of any company into which we are merged having a value of \$500. The rights expire on March 1, 2011 unless extended by our board of directors. Because the rights may substantially dilute the stock ownership of a person or group attempting to take us over without the approval of our board of directors, our rights plan could make it more difficult for a third party to acquire us (or a significant percentage of our outstanding capital stock) without first negotiating with our board of directors regarding such acquisition.

In addition, our board of directors has the authority to issue up to 10,000,000 shares of Preferred Stock (of which 2,000,000 shares have been designated as Series A Junior Participating Preferred Stock) and to determine the price, rights, preferences, privileges and restrictions, including voting rights, of those shares without any further vote or action by the stockholders.

The rights of the holders of our common stock may be subject to, and may be adversely affected by, the rights of the holders of any Preferred Stock that may be issued in the future. The issuance of Preferred Stock may have the effect of delaying, deterring or preventing a change of control of Yahoo! without further action by the stockholders and may adversely affect the voting and other rights of the holders of our common stock. Further, certain provisions of our charter documents, including provisions eliminating the ability of stockholders to take action by written consent and limiting the ability of stockholders to raise matters at a meeting of stockholders without giving advance notice, may have the effect of delaying or preventing changes in control or management of Yahoo!, which could have an adverse effect on the market price of our stock. In

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addition, our charter documents do not permit cumulative voting, which may make it more difficult for a third party to gain control of our Board of Directors. Further, we are subject to the anti-takeover provisions of Section 203 of the Delaware General Corporation Law, which will prohibit us from engaging in a business combination with an interested stockholder for a period of three years after the date of the transaction in which the person became an interested stockholder, even if such combination is favored by a majority of stockholders, unless the business combination is approved in a prescribed manner. The application of Section 203 also could have the effect of delaying or preventing a change of control or management.

*Terrorist attacks and the recent hostilities in Iraq have contributed to economic instability in the United States and Internationally, which could lead to reduced advertising spending by our customers.*

On September 11, 2001, the United States was the target of terrorist attacks of unprecedented scope, and in March 2003, the United States became involved in hostilities with Iraq. These events, coupled with political instability elsewhere in the world have caused volatility in the financial markets and uncertainty in the global economy. Under these circumstances, there is a risk that our existing and potential customers may decrease spending, particularly for marketing services. Because marketing services continue to constitute a majority of our revenues, any such decrease in expenditures could materially and adversely affect our operating results and financial condition. In addition, the political and economic conditions described above may contribute to increased volatility in stock prices, which may cause our stock price to decline.

*Special note regarding forward-looking statements.*

Some of the statements in this Report constitute forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as may, will, should, intend, expect, plan, anticipate, believe, estimate, predict, potential, or continue terms or other comparable terminology. This Report includes, among others for fiscal 2003, statements regarding our:

- combined revenues for marketing services, fees and listings;
- primary operating costs and expenses;
- amortization of intangibles;
- estimated goodwill from the Inktomi acquisition;
- capital expenditures;
- use of funds from the sale of convertible notes, together with cash and investments;
- operating lease arrangements;
- evaluation of possible acquisitions of, or investments in business, products and technologies; and
- existing cash and investments being sufficient to meet operating requirements.

These statements involve known and unknown risks, uncertainties, and other factors that may cause our or our industry's results, levels of activity, performance, or achievements to be materially different from any future results, levels of activity, performance, or achievements expressed or implied by such forward-looking statements. Such factors include, among others, those listed in these Risk Factors and elsewhere in this Report. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, events, levels of activity, performance, or achievements. We do not assume responsibility for the accuracy and completeness of the forward-looking statements. We do not intend to update any of the forward-looking statements after the date of this Report to conform them to actual results.



**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

We are exposed to the impact of interest rate changes, foreign currency fluctuations, and changes in the market values of our investments.

**Interest Rate Risk.** Our exposure to market rate risk for changes in interest rates relates primarily to our investment portfolio. We have not used derivative financial instruments to hedge our investment portfolio. We invest excess cash in debt instruments of the U.S. Government and its agencies, and in high-quality corporate issuers and, by policy, limit the amount of credit exposure to any one issuer. We protect and preserve invested funds by limiting default, market and reinvestment risk.

Investments in both fixed rate and floating rate interest earning instruments carry a degree of interest rate risk. Fixed rate securities may have their fair market value adversely impacted due to a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fall short of expectations due to changes in interest rates or we may suffer losses in principal if forced to sell securities which have declined in market value due to changes in interest rates. As of June 30, 2003 we had investments in debt securities with maturities less than one year of approximately \$1.4 billion. Such investments had a weighted-average yield of approximately 1.65%. Investments in debt securities with maturities between one and five years of approximately \$741 million had a weighted-average yield of approximately 2.89%. The fair market value of our long term debt is subject to interest rate risk. Generally, the fair market value of fixed interest rate debt will increase as interest rates fall and the decrease as interest rate rise. The interest changes affect the fair market value but do not impact our financial position, cash flows or results of operations.

**Foreign Currency Risk.** International revenues from our foreign subsidiaries accounted for approximately 16% of total revenues during the three and six months ended June 30, 2003. International sales are made mostly from our foreign sales subsidiaries in their respective countries 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, including, but not limited to differing economic conditions, changes in political climate, differing tax structures, other regulations and restrictions, and foreign exchange rate volatility when compared to the United States. Accordingly, our future results could be materially adversely impacted by changes in these or other factors.

Our exposure to foreign exchange rate fluctuations arises in part from intercompany accounts in which costs incurred in the United States are charged to our foreign sales subsidiaries. These intercompany accounts are typically denominated in the functional currency of the foreign subsidiary. We are also exposed to foreign exchange rate fluctuations as the financial statements 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 for the three months ended June 30, 2003 was not material.

**Investment Risk.** We invest in equity instruments of privately-held companies for business and strategic purposes. These investments are included in other long-term assets and are accounted for under the cost method when ownership is less than 20% and we do not have the ability to exercise significant influence over operations. Since our initial investment, certain of these investments in privately held companies have become marketable equity securities upon the investees completing initial public offerings. Such investments are subject to significant fluctuations in fair market value due to the volatility of the stock market and are recorded as long-term investments. For these investments in public and privately-held companies, our policy is to monitor these investments for impairment by considering current factors including economic environment, market conditions and operational performance and other specific factors relating to the business underlying the investment, and record reductions in carrying value when necessary.

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. As of June 30, 2003, net unrealized gains of approximately \$1.1 million on these investments have been recorded net of deferred taxes of \$0.4 million as a separate component of stockholders' equity.

We are exposed to market risk as it relates to changes in the market value of our investments. We invest in equity instruments of public companies, certain of which may be classified as derivatives, for business and strategic purposes and have classified these securities as available-for-sale. These available-for-sale equity investments are subject to significant fluctuations in fair value due to the volatility of the stock market and the industries in which these companies participate. We have realized gains and losses from both the sale of investments, as well as mergers and acquisitions of companies in which we have invested. As of June 30, 2003, we had available-for-sale equity investments with a fair value of approximately \$2.9 million and a cost basis of approximately \$4.1 million. The net unrealized losses of approximately \$1.1 million have been recorded net of deferred taxes of approximately \$0.4 million as a separate component of stockholders' equity and losses on derivatives of approximately \$0.4 million have been recorded in other income, net on the condensed consolidated statement of operations. Our objective in managing exposure to stock market fluctuations is to minimize the impact of stock market declines to earnings and cash flows. However, continued market volatility, as well as mergers and acquisitions, have the potential to have a material non-cash impact on our operating results in future periods.

**Item 4. Controls and Procedures**

**Disclosure Controls and Procedures.** The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of the end of the period covered by this report. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act.

**Internal Control Over Financial Reporting.** There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II OTHER INFORMATION**

### **Item 1. Legal Proceedings**

From time to time, third parties assert patent infringement claims against Yahoo! in the form of letters, lawsuits, and other forms of communication. Currently, we or our acquired subsidiaries, are engaged in several lawsuits regarding patent issues and have been notified of a number of other potential patent disputes.

In addition, from time to time we are subject to other legal proceedings and claims in the ordinary course of business, including claims of alleged infringement of trademarks, copyrights and other intellectual property rights, and a variety of claims arising in connection with our email, message boards, auction sites, shopping services, and other communications and community features, such as claims alleging defamation or invasion of privacy.

We do not believe, based on current knowledge, that any of the foregoing legal proceedings or claims are likely to have a material adverse effect on our financial position, results of operations or cash flows. However, we may incur substantial expenses in defending against third party claims. In the event of a determination adverse to Yahoo! or our subsidiaries, we may incur substantial monetary liability, and be required to change our business practices. Either of these could have a material adverse effect on our financial position, results of operations or cash flows.

On May 24, 2001, Arista Records, Inc., Bad Boy Records, BMG Music d/b/a The RCA Records Label, Capitol Records, Inc., Virgin Records America, Inc., Sony Music Entertainment Inc., UMG Recordings, Inc., Interscope Records, Motown Record Company, L.P., and Zomba Recording Corporation filed a lawsuit alleging copyright infringement against LAUNCH Media, Inc. ( LAUNCH ) in the United States District Court for the Southern District of New York. After the lawsuit was commenced, Yahoo! entered into an agreement to acquire LAUNCH. In June 2001, LAUNCH settled the LAUNCH litigation as to UMG Recordings, Inc. Our acquisition of LAUNCH closed in August 2001, and since that time LAUNCH has been a wholly owned subsidiary of Yahoo!. The plaintiffs allege, among other things, that the consumer-influenced portion of LAUNCH's LAUNCHcast service is interactive within the meaning of Section 114 of the Copyright Act and therefore does not qualify for the compulsory license provided for by the Copyright Act. The Complaint seeks declaratory and injunctive relief and damages for the alleged infringement. Yahoo! and LAUNCH do not believe that LAUNCH has infringed any rights of plaintiffs and intend to vigorously contest the lawsuit. The lawsuit is still in the preliminary, discovery phase and we do not believe it is feasible to predict or determine the outcome or resolution of the LAUNCH litigation. The range of possible resolutions of the LAUNCH litigation could include judgments against us or settlements that could require substantial payments by us, which could have a material adverse impact on our financial position, results of operations or cash flows. An estimate of the potential loss, if any, or range of loss that could arise from the LAUNCH litigation cannot be made at this time. In January 2003, LAUNCH settled the LAUNCH litigation as to Sony Music Entertainment, Inc.

### **Item 4. Controls and Procedures**



## Item 2. Changes in Securities and Use of Proceeds

In April 2003, we completed the sale of \$750 million of principal amount of Zero Coupon Senior Convertible Notes (the Notes) due April 2008, in a private placement to Qualified Institutional Buyers (as such term is defined in the Securities Act) in reliance on Rule 144A of the Securities Act, and to certain persons in offshore transactions in reliance on Regulation S. Credit Suisse First Boston was the principal placement agent in the sale of the Notes. The transaction fees associated with the Notes totaled approximately \$17 million, and the net proceeds to the Company from the offering of the Notes were approximately \$733 million. The Notes were issued at par and bear no interest. The Notes are convertible into Yahoo! common stock at a conversion price of \$41.00 per share, which would result in an aggregate of 18.3 million shares, subject to adjustment upon the occurrence of specified events. Each \$1,000 principal amount of the Notes will be initially convertible into 24.3902 shares of Yahoo! common stock prior to April 1, 2008 if the sale price of our common stock issuable upon conversion of the notes reaches a specified threshold for a defined period of time or specified corporate transactions have occurred. The specified thresholds for conversion prior to the maturity date are (1) the closing sale price of the Company's common stock for at least 20 trading days in the 30 trading-day period ending on the last trading day of the immediately preceding fiscal quarter exceeds 110% of the conversion price on that 30<sup>th</sup> trading day, and (2) during the period beginning January 1, 2008 through the maturity date, the closing sale price of the Company's common stock on the previous trading day was 110% or more of the then current conversion price. Upon conversion, Yahoo! has the right to deliver cash in lieu of common stock. The Company may be required to repurchase all of the notes following a fundamental change of the Company, such as a change of control, prior to maturity. Yahoo! can not redeem the notes prior to maturity.

## Item 3. Defaults Upon Senior Securities

None.

## Item 4. Submission of Matters to a Vote of Security Holders

On May 16, 2003, the Company held its Annual Meeting of Stockholders. At the meeting, the stockholders elected as directors Terry Semel (with 431,656,655 shares voting for and 90,093,755 withheld), Jerry Yang (with 431,373,274 voting for and 90,377,136 withheld), Roy Bostock (with 512,300,640 shares voting for and 9,449,770 withheld), Ronald Burkle (with 431,385,320 shares voting for and 90,365,090 withheld), Eric Hippeau (with 410,236,918 shares voting for and 111,513,492 withheld), Arthur Kern (with 418,554,774 shares voting for and 103,195,636 withheld), Robert Kotick (with 512,208,289 shares voting for and 9,542,121 withheld), Edward Kozel (with 430,586,588 shares voting for and 91,163,822 withheld) and Gary Wilson (with 418,570,782 shares voting for and 103,179,628 withheld).

The stockholders also approved an amendment to the Company's 1995 Stock Plan (with 292,948,430 shares voting for, 126,800,074 against, 6,078,653 abstaining and 95,923,253 broker non-votes).

The stockholders also ratified the appointment of PricewaterhouseCoopers LLP as the independent accountants for the Company for the fiscal year ending December 31, 2003 (with 509,680,357 shares voting for, 6,322,557 against, 5,747,496 abstaining, and 0 broker non-votes).



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The stockholders voted for a stockholder proposal regarding the Company's Stockholder Rights Plan (with 239,243,544 shares voting for, 180,445,085 against, 6,138,524 abstaining, and 95,923,257 broker non-votes).

The stockholders voted against a stockholder proposal regarding indexed options (with 35,788,845 shares voting for, 382,772,969 against, 7,265,337 abstaining, and 95,923,259 broker non-votes).

The stockholders voted against a stockholder proposal regarding expensing stock options (with 143,340,227 shares voting for, 273,141,978 against, 9,344,645 abstaining, and 95,923,560 broker non-votes).

### **Item 5. Other Information**

None.

**Item 6. Exhibits and Reports on Form 8-K**

a. Exhibits are incorporated herein by reference or are filed with this report as indicated below (numbered in accordance with Item 601 of Regulation S-K):

Exhibit Number	Description
3.1	Amended and Restated Certificate of Incorporation of Registrant (Filed as Exhibit 3.1 to the June 30, 2000 10-Q and incorporated herein by reference).
3.2	Amended Bylaws of Registrant (Filed as Exhibit 4.9 to the Registrant's Registration Statement on Form S-8 filed on March 5, 2002 and incorporated herein by reference).
4.1	Form of Senior Indenture (Filed as Exhibit 4.1 to the Registrant's Registration Statement on Form S-3, Registration No. 333-46458, filed September 22, 2000 [the September 22, 2000 Form S-3] and incorporated herein by reference).
4.2	Form of Subordinated Indenture (Filed as Exhibit 4.2 to the September 22, 2000 Form S-3 and incorporated herein by reference).
4.3**	Form of Senior Note.
4.4**	Form of Subordinated Note.
4.5**	Form of Certificate of Designation for preferred stock (together with preferred stock certificate).
4.6	Form of Deposit Agreement (together with Depository Receipt) (Filed as Exhibit 4.6 to the September 22, 2000 Form S-3 and incorporated herein by reference).
4.7**	Form of Warrant Agreement (together with form of Warrant Certificate).
4.8	Rights Agreement, dated as of March 15, 2001, between the Registrant and Equiserve Trust Company, N.A., as Rights Agent, including the form of Rights Certificate as Exhibit B and the summary of Rights to Purchase Preferred Stock as Exhibit C (Filed as Exhibit 4.1 to the Registrant's Current Report on Form 8-K, filed March 19, 2001 and incorporated herein by reference).
4.9	Indenture, dated as of April 9, 2003 by and between the Registrant and U.S. Bank National Association (Filed as Exhibit 4.1 to the Registrant's Current Report on Form 8-K, filed April 10, 2003 [the April 10, 2003 Form 8-K] and incorporated herein by reference).
4.10	Registration Rights Agreement, dated as of April 9, 2003, among the Registrant and Credit Suisse First Boston LLC (Filed as Exhibit 4.2 to the April 10, 2003 Form 8-K).
10.37	*Third Addendum to Overture Search Services Agreement, dated April 25, 2003 by and between the Registrant and Overture Services, Inc.
31*	Certificates of Chief Executive Officer and Chief Financial Officer pursuant to Securities Exchange Act Rules 13a-15(e) and 15d-15(e) as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 dated August 1, 2003.
32*	Certificate of Chief Executive Officer and Chief Financial Officer pursuant to section 18 U.S.C. section 1350 dated August 1, 2003.

\* Filed herewith.

\*\* To be filed by a report on Form 8-K pursuant to Item 601 of Regulation S-K or, where applicable, incorporated herein by reference from a subsequent filing in accordance with Section 305(b)(2) of the Trust Indenture Act of 1939.

Confidential treatment requested with respect to certain portions of this Exhibit.

b. Reports on Form 8-K:

On April 7, 2003, the Company filed a current report on Form 8-K which attached and incorporated by reference a press release announcing the pricing of the Company's Zero Coupon Senior Convertible Notes due April 2008.

On April 9, 2003, the Company filed a current report on Form 8-K which announced the Company's financial results for the quarter ended March 31, 2003 and certain other information. A copy of the Company's press release announcing the results and certain other information was attached and incorporated therein by reference.

On April 10, 2003, the Company filed a current report on Form 8-K which announced the completion of the Company's offering of its Zero Coupon Senior Convertible Notes due April 2008.

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On April 18, 2003, the Company filed a current report on Form 8-K which announced that Jerry Yang had established a trading plan under Rule 10b5-1.

On May 27, 2003, the Company filed an amended current report on Form 8-K/A which amended the Company's report on Form 8-K filed on February 13, 2003 and disclosed certain additional financial information.

On May 30, 2003, the Company filed a current report on Form 8-K which included a reconciliation of financial measures contained in the Company's current report on Form 8-K dated January 16, 2003 to the most directly comparable measures calculated in accordance with generally accepted accounting principles.

### Signatures

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

YAHOO! INC.

Dated: August 1, 2003

By: /s/ SUSAN DECKER  
Susan Decker  
Executive Vice President, Finance and Administration, and  
Chief Financial Officer (Principal Financial Officer)

Dated: August 1, 2003

By: /s/ PATRICIA CUTHBERT  
Patricia Cuthbert  
Vice President and Corporate Controller (Principal Accounting  
Officer)

## YAHOO! INC.

## Index to Exhibits

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4.7**	Form of Warrant Agreement (together with form of Warrant Certificate).
4.8	Rights Agreement, dated as of March 15, 2001, between the Registrant and Equiserve Trust Company, N.A., as Rights Agent, including the form of Rights Certificate as Exhibit B and the summary of Rights to Purchase Preferred Stock as Exhibit C (Filed as Exhibit 4.1 to the Registrant's Current Report on Form 8-K, filed March 19, 2001 and incorporated herein by reference).
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