

Edgar Filing: EBAY INC - Form 10-Q

EBAY INC  
Form 10-Q  
August 14, 2001

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

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FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2001.

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_.

COMMISSION FILE NUMBER 000-24821

EBAY INC.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE  
(STATE OR OTHER JURISDICTION OF  
INCORPORATION OR ORGANIZATION)

77-0430924  
(I.R.S. EMPLOYER  
IDENTIFICATION NUMBER)

2145 HAMILTON AVENUE  
SAN JOSE, CALIFORNIA 95125  
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES) (ZIP CODE)

(408) 558-7400  
(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)

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

As of July 31, 2001, there were 273,268,029 shares of the Registrant's  
common stock, \$0.001 par value, outstanding, which is the only class of common  
or voting stock of the Registrant issued as of that date.

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PART I: FINANCIAL INFORMATION

ITEM 1: FINANCIAL STATEMENTS

EBAY INC.

CONDENSED CONSOLIDATED BALANCE SHEET  
(IN THOUSANDS)

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(UNAUDITED)

DECEMBER 31  
2000

ASSETS

Current assets:

Cash and cash equivalents .....	\$ 201,87
Short-term investments .....	354,16
Accounts receivable, net .....	67,16
Other current assets .....	52,26

Total current assets ..... 675,46

Long-term investments .....	218,19
Restricted cash and investments .....	126,39
Property and equipment, net .....	125,16
Intangible assets, net .....	13,06
Deferred tax assets .....	13,89
Other assets .....	10,23

Total assets ..... \$ 1,182,40

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:

Accounts payable .....	\$ 31,72
Accrued expenses and other current liabilities .....	66,69
Deferred revenue and customer advances .....	12,65
Short-term debt .....	15,27
Income taxes payable .....	11,09

Total current liabilities ..... 137,44

Long term debt .....	11,40
Other liabilities .....	6,54
Minority interests .....	13,24

Total liabilities ..... 168,64

Contingencies (Note 7)

Stockholders' equity:

Common stock .....	26
Additional paid-in capital .....	941,28
Unearned stock-based compensation .....	(1,42)
Retained earnings .....	74,50
Accumulated other comprehensive loss .....	(87)

Total stockholders' equity ..... 1,013,76

Total liabilities and stockholders' equity ..... \$ 1,182,40

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

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## EBAY INC.

### CONDENSED CONSOLIDATED STATEMENT OF INCOME (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) (UNAUDITED)

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS
	2000	2001	2000
Net revenues .....	\$ 98,152	\$ 180,905	\$ 184,039
Cost of net revenues .....	24,204	32,872	47,587
	73,948	148,033	136,452
Operating expenses:			
Sales and marketing .....	37,093	60,117	76,591
Product development .....	13,600	17,651	25,938
General and administrative .....	20,610	25,604	37,626
Payroll tax on employee stock options ....	834	385	1,735
Amortization of acquired intangible assets	340	8,822	615
	72,477	112,579	142,505
Income (loss) from operations .....	1,471	35,454	(6,053)
Interest and other income and expense, net .....	11,432	10,147	22,554
Interest expense .....	(1,038)	(959)	(1,884)
Impairment of certain equity investments .....	--	--	--
	11,865	44,642	14,617
Income before income taxes and minority interests	11,865	44,642	14,617
Provision for income taxes .....	(5,401)	(21,276)	(6,675)
Minority interests in consolidated companies ....	995	1,242	1,275
	7,459	24,608	9,217
Net income .....	\$ 7,459	\$ 24,608	\$ 9,217
	=====	=====	=====
Net income per share:			
Basic .....	\$ 0.03	\$ 0.09	\$ 0.04
	=====	=====	=====
Diluted .....	\$ 0.03	\$ 0.09	\$ 0.03
	=====	=====	=====
Weighted average shares:			
Basic .....	249,828	267,075	246,229
	=====	=====	=====
Diluted .....	280,483	283,582	280,867
	=====	=====	=====

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

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EBAY INC.

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME  
(IN THOUSANDS)  
(UNAUDITED)

	THREE MONTHS ENDED JUNE 30	
	2000	2001
Net income .....	\$ 7,459	\$ 24,6
Other comprehensive income (loss):		
Foreign currency translation .....	(1,074)	1
Unrealized gains (losses) on investments, net .....	(7,955)	(6
Reclassification of realized gains (losses) on investments, net .....	--	(
Gains (losses) on cash flow hedges .....	--	1,0
Tax benefit (provision) .....	3,341	(
Net change in other comprehensive income (loss) .....	(5,688)	4
Comprehensive income before cumulative effect of a change in accounting principle .....	1,771	25,0
Cumulative effect of a change in accounting principle, net of tax ..	--	
Comprehensive income .....	\$ 1,771	\$ 25,0

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

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EBAY INC.

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS  
(IN THOUSANDS)  
(UNAUDITED)

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Cash flows from operating activities:	
Net income .....	
Adjustments:	
Provision for doubtful accounts and authorized credits .....	
Depreciation and amortization .....	
Amortization of unearned stock-based compensation .....	
Tax benefit on the exercise of employee stock options .....	
Impairment of certain equity investments .....	
Minority interests and other .....	
Changes in assets and liabilities:	
Accounts receivable .....	
Other current assets .....	
Intangible and other assets .....	
Deferred tax assets .....	
Accounts payable .....	
Accrued expenses and other liabilities .....	
Deferred revenue and customer advances .....	
Income taxes payable .....	
Net cash provided by operating activities .....	
Cash flows from investing activities:	
Purchases of property and equipment.....	
Purchases of investments .....	
Maturities and sales of investments .....	
Purchases of other non-current assets.....	
Proceeds from sale of property and equipment .....	
Acquisitions, net of cash acquired .....	
Net cash provided by (used in) in investing activities .....	
Cash flows from financing activities:	
Proceeds from issuance of common stock, net .....	
Proceeds from issuance of common stock by subsidiaries .....	
Principal payments on long-term debt .....	
Net cash provided by financing activities .....	
Effect of exchange rate changes on cash and cash equivalents .....	
Net increase (decrease) in cash and cash equivalents .....	
Cash and cash equivalents at beginning of period .....	
Cash and cash equivalents at end of period .....	

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

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EBAY INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

### NOTE 1--THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

#### The Company

eBay Inc. ("eBay") was incorporated in California in May 1996, and reincorporated in Delaware in April 1998. As of June 30, 2001, eBay had operations in the United States, Australia, Austria, Belgium, Brazil, Canada, France, Germany, Ireland, Italy, Japan, the Netherlands, New Zealand, Portugal, South Korea, Spain, Sweden, Switzerland and the United Kingdom. eBay pioneered online trading by developing a Web-based community in which buyers and sellers are brought together to buy and sell almost anything. The eBay online service permits sellers to list items for sale, buyers to bid on items of interest and all eBay users to browse through listed items in a fully-automated, topically-arranged service that is available online seven days a week. eBay has extended its online offerings to include regional and international trading, autos, "premium" priced items and through Half.com, eBay Stores and our "Buy it Now" features, now offers fixed-price functionality. eBay also engages in the traditional auction business through its subsidiaries, Butterfields Auctioneers Corporation ("Butterfields") and Kruse International ("Kruse") and in online payment processing through its Billpoint, Inc. ("Billpoint") subsidiary.

#### Use of estimates

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

#### Basis of presentation

The accompanying condensed consolidated financial statements as of December 31, 2000 and June 30, 2001, and for the three and the six months ended June 30, 2000 and 2001, are unaudited. The unaudited interim condensed consolidated financial statements have been prepared on the same basis as the annual consolidated financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments, necessary to present fairly eBay's financial position, as of June 30, 2001, the results of operations for the three and the six months ended June 30, 2000 and 2001, and cash flows for the six months ended June 30, 2000 and 2001. These condensed consolidated financial statements and notes thereto should be read in conjunction with eBay's audited consolidated financial statements and related notes included in eBay's Annual Report on Form 10-K for the year ended December 31, 2000 as filed with the Securities and Exchange Commission on March 28, 2001. The results for interim periods are not necessarily indicative of the expected results for any other interim period or the year ending December 31, 2001.

#### Principles of consolidation

The accompanying condensed financial statements include the financial statements of eBay and its majority owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

#### Reclassifications

Certain prior period balances have been reclassified to conform to the

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current period presentation.

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EBAY INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)  
(UNAUDITED)

### Derivative instruments

Financial Accounting Standards Board Statement No. 133, Accounting for Derivative Instruments and Hedging Activities ("SFAS No. 133"), as amended, requires companies to recognize all of their derivative instruments as either assets or liabilities at fair value in the statement of financial position. The accounting for changes in the fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument, based upon the exposure being hedged, as either a fair value hedge, cash flow hedge or a hedge of a net investment in a foreign operation.

For derivative instruments that are designated and qualify as a cash flow hedge (i.e., hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The remaining gain or loss on the derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item, if any, is recognized in current earnings during the period of change. For derivative instruments not designated as hedging instruments, the gain or loss is recognized in current earnings during the period of change.

### Recent accounting pronouncements

In March 2000, the Emerging Issues Task Force ("EITF") reached a consensus on EITF Issue No. 00-14, "Accounting for Certain Sales Incentives." This consensus provides guidance on the recognition, measurement, and income statement classification of sales incentives which are offered voluntarily by a vendor without charge to customers that can be used in, or that are exercisable by a customer as a result of, a single exchange transaction. At the April 2001 meeting, the EITF reached a consensus to defer the effective date to quarters beginning after December 15, 2001. eBay believes that implementation of EITF No. 00-14 will not have a material effect on its consolidated financial statements.

In July 2001, the Financial Accounting Standards Board issued SFAS No. 141, "Business Combinations," that requires business combinations initiated after June 30, 2001, to be accounted for using the purchase method of accounting and broadens the criteria for recording intangible assets separate from goodwill. Recorded goodwill and intangible assets will have to be evaluated against these new criteria and may result in certain intangible assets being subsumed into goodwill, or alternatively, amounts initially recorded as goodwill may be separately identified and recognized apart from goodwill. The adoption of SFAS No. 141 will not change the method of accounting used in previous business combinations accounted for under the pooling-of-interest method.

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In July 2001, the Financial Accounting Standards Board issued and SFAS No. 142, "Goodwill and Other Intangible Assets," that requires the use of a non-amortization approach to account for purchased goodwill and certain intangible assets. Under a non-amortization approach, goodwill and certain intangible assets will not be amortized into results of operations, but instead would be reviewed for impairment and written down and charged to results of operations only in the periods in which the recorded value of goodwill and certain intangible assets exceed their fair values. This Statement is effective for fiscal years beginning after December 15, 2001. eBay is currently evaluating the effect that adoption of this Statement will have on its results of operations and financial position. eBay will adopt SFAS No. 142 effective January 1, 2002, which will result in the elimination of goodwill amortization.

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EBAY INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)  
(UNAUDITED)

NOTE 2--NET INCOME PER SHARE:

Basic net income per share is computed by dividing the net income available to common stockholders for the period by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing the net income for the period by the weighted average number of common and potential common shares outstanding during the period. Potential common shares, composed of unvested, restricted common stock and incremental common shares issuable upon the exercise of stock options and warrants, are included in the calculation of diluted net income per share to the extent such shares are dilutive.

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

	THREE MONTHS ENDED JUNE 30	
	2000	2001
<b>Numerator:</b>		
Net income available to common stockholders .....	\$ 7,459 =====	\$ 24,6 =====
<b>Denominator:</b>		
Weighted average shares .....	267,630	271,0
Weighted average common shares subject to repurchase .....	(17,802)	(3,9
Denominator for basic calculation .....	249,828	267,0
<b>Weighted average effect of dilutive securities:</b>		
Warrants .....	94	
Weighted average common shares subject to repurchase.....	17,802	3,9
Incremental shares from employee stock options .....	12,759	12,4
Denominator for diluted calculation .....	280,483 =====	283,5 =====



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Net income per share:

Basic .....	\$ 0.03	\$ 0.
	=====	=====
Diluted .....	\$ 0.03	\$ 0.
	=====	=====

### NOTE 3--ACQUISITIONS:

#### Internet Auction Acquisition

On February 15, 2001, eBay acquired a majority interest in Internet Auction Co., Ltd., a South Korean company ("Internet Auction") for \$120.8 million in cash and incurred \$1.2 million of direct acquisition costs. Internet Auction introduced person-to-person trading in Korea when it launched in April 1998. Shares of Internet Auction are listed on the KOSDAQ. The transaction was accounted for using the purchase method of accounting and accordingly, the results of operations of Internet Auction have been included in eBay's consolidated financial statements from February 15, 2001. The aggregate purchase price was allocated to tangible and identifiable intangible assets acquired and liabilities assumed of Internet Auction based upon management's estimates using a valuation report prepared by an independent third party valuation consultant. Identifiable intangible assets are amortized using estimated useful lives ranging from two to five years. The excess of the aggregate purchase price over the fair value of the identifiable net assets acquired of \$82.7 million has been recognized as goodwill and is being amortized over five years. See Note 1-Recent accounting pronouncements.

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EBAY INC.

#### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED) (UNAUDITED)

The aggregate purchase price was allocated as follows (in thousands):

Net tangible assets.....		\$ 67,670
Identifiable intangible assets .....		9,000
Deferred tax liability.....		(3,600)
Goodwill.....		82,691
Minority interest.....		(33,834)
		-----
Aggregate purchase price.....		\$ 121,927
		=====

#### iBazar S.A. Acquisition

On May 18, 2001, eBay completed its acquisition of iBazar S.A. ("iBazar") in a transaction accounted for as a purchase business combination. iBazar is a French-based corporation that introduced online person-to-person trading in France and at the time of the acquisition had websites in Belgium, Brazil, France, Italy, the Netherlands, Portugal, Spain and Sweden. As consideration for the acquisition, eBay issued shares in a Belgian subsidiary exchangeable for 2,045,054 shares of eBay common stock valued at \$120.4 million, paid \$2.3 million in cash to certain shareholders and incurred acquisition-related costs of approximately \$2.9 million. The shares issued in the acquisition have been

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valued in accordance with Emerging Issue Task Force Issue No. 99-12, Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination ("EITF 99-12"). In accordance with EITF 99-12, eBay has established that the first date on which the number of eBay's shares and the amount of other consideration became fixed was May 18, 2001. EITF 99-12 precludes the use of any share prices subsequent to the consummation date of a transaction, and accordingly, eBay has valued the transaction using the average closing price of eBay shares for the five days prior to and including the closing date of May 18, 2001. The aggregate purchase price of approximately \$125.6 million has been allocated to the net tangible and identifiable intangible assets acquired and liabilities assumed on the basis of their estimated fair values on the acquisition date.

Tangible assets were valued at their respective carrying amounts as management believes that these amounts approximate their current fair values. The valuation of the identifiable intangible assets acquired was based on management's estimates using a preliminary valuation report prepared by an independent third party valuation consultant and consists of customer base, assembled workforce, developed technology and trade names. Identifiable intangible assets are amortized using estimated useful lives ranging from two to five years. eBay also identified certain assets as held for sale and valued these assets based on the expected sale proceeds adjusted for losses expected to be incurred during the holding period.

In accordance with EITF Issue No. 95-3, Recognition of Liabilities in Connection with a Purchase Business Combination, eBay has established plans to exit certain activities of iBazar and to involuntarily terminate certain iBazar employees. In accordance with this exit plan, approximately \$2 million has been accrued for the estimated costs associated with severance, contract terminations and financial advisory and legal fees and has been included in net tangible assets. As of June 30, 2001, no costs have been charged against this liability.

The excess of the purchase price over the value of the tangible and identifiable intangible assets acquired and liabilities assumed has been recorded as goodwill and is being amortized over five years. See Note 1- Recent accounting pronouncements.

The aggregate purchase price was allocated as follows (in thousands):

Net tangible assets.....		\$ 4,696
Identifiable intangible assets .....		2,140
Deferred tax liability.....		(856)
Goodwill.....		119,606
		-----
Aggregate purchase price.....		\$ 125,586
		=====

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The following unaudited pro forma financial information presents the combined results of eBay, Internet Auction and iBazar as if the acquisitions had occurred as of the beginning of 2000 and 2001, respectively, after giving effect to certain adjustments, including amortization of goodwill and other acquisition related transactions (in thousands except per share amounts):

Net revenues.....	.....
Net income (loss).....	.....
Net income (loss) per share:	
Basic.....	.....
Diluted.....	.....

The pro forma financial information does not necessarily reflect the results of operations that would have occurred had eBay, Internet Auction and iBazar constituted a consolidated entity during such periods. See Note 1- Recent accounting pronouncements

**NOTE 4--SEGMENT INFORMATION:**

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

eBay has two primary reporting segments: online trading services, consisting primarily of the eBay, Billpoint and Half.com web-based trading platforms and offline, which includes the traditional auction services of Butterfields and Kruse.

Segment selection is based upon the internal organization structure, the manner in which these operations are managed and their performance evaluated by management, the availability of separate financial information and overall materiality considerations. Segment performance measurement is based on operating income before amortization of acquired intangible assets, merger related costs, stock-based cost and expenses, impairment of certain equity investments and payroll tax on employee stock options.

The operating information for the two reporting segments are as follows (in

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thousands):

	THREE MONTHS ENDED			
	2000			
	ONLINE	OFFLINE	CONSOLIDATED	
Net revenues from external customers.....	\$88,615	\$9,537	\$ 98,152	\$
Operating income (loss) before amortization of acquired intangible assets, merger related costs, stock-based cost and expenses, impairment of certain equity investments and payroll tax on employee stock options..	\$ 6,747	\$ (1,902)	\$ 4,845	\$
Interest and other income and expense, net.....	11,216	216	11,432	
Interest expense.....	(474)	(564)	(1,038)	
Amortization of acquired intangible assets, merger related costs, stock-based cost and expenses and payroll tax on employee stock options.....	(2,646)	(728)	(3,374)	
Income (loss) before income taxes and minority interests.....	\$ 14,843	\$ (2,978)	\$ 11,865	\$

	SIX MONTHS ENDED J			
	2000			
	ONLINE	OFFLINE	CONSOLIDATED	
Net revenues from external customers.....	\$166,011	\$18,028	\$ 184,039	\$
Operating income (loss) before amortization of acquired intangible assets, merger related costs, stock-based cost and expenses, impairment of certain equity investments and payroll tax on employee stock options..	\$3,178	\$ (2,697)	\$ 481	\$
Interest and other income and expense, net.....	22,213	341	22,554	
Impairment of certain equity investments.....	--	--	--	
Interest expense.....	(748)	(1,136)	(1,884)	
Amortization of acquired intangible assets, merger related costs, stock-based cost and expenses and payroll tax on employee stock options.....	(5,728)	(806)	(6,534)	
Income (loss) before income taxes and minority interests.....	\$ 18,915	\$ (4,298)	\$ 14,617	\$

DECEMBER 31, 2000		
ONLINE	OFFLINE	CONSOLIDATED

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Total assets..... \$1,084,909 \$ 97,494 \$1,182,403 \$

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EBAY INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)  
(UNAUDITED)

NOTE 5--INVESTMENTS:

At December 31, 2000 and June 30, 2001, short and long-term investments are composed as follows (in thousands):

	DECEMBER 31, 2000	
	GROSS AMORTIZED COST	GROSS UNREALIZED GAINS
	-----	-----
Short-term investments:		
Municipal bonds and notes.....	\$ 112,488	\$ 15
Corporate securities.....	21,193	70
Government securities.....	219,674	842
	-----	-----
Total	\$ 353,355	\$ 927
	=====	=====
Long-term investments:		
Municipal bonds and notes.....	\$ 141,861	\$ 69
Government securities.....	151,732	694
Equity instruments and other.....	54,505	--
	-----	-----
Total	\$ 348,098	\$ 763
	=====	=====
		JUNE 30, 2001
		-----
	GROSS	GROSS
	AMORTIZED COST	UNREALIZED
	-----	GAINS
	-----	-----
Short-term investments:		
Municipal bonds and notes.....	\$160,748	\$1,005
Corporate securities.....	8,986	56
Government securities.....	47,445	214
Time deposits and other.....	28,026	--
	-----	-----

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Total	\$245,205	\$1,275
	=====	=====
Long-term investments:		
Municipal bonds and notes.....	\$ 26,010	\$ 213
Government securities.....	185,094	690
Equity instruments and other.....	25,491	--
	-----	-----
Total	\$236,595	\$ 903
	=====	=====

As of December 31, 2000 and June 30, 2001, long-term investments include restricted cash and investments of \$126,390 and \$129,467, respectively. With the exception of restricted cash, investments are generally classified as held to maturity.

The estimated fair values of short and long-term investments at June 30, 2001, classified by date of contractual maturity are as follows (in thousands):

	JUNE 30,
	-----
Due within one year or less.....	\$ 246
Due after one year through two years.....	46
Due after two years through three years.....	34
Due after three years through four years.....	11
Restricted cash and investments expiring in less than five years.....	129
Equity investments.....	15
	-----
	\$ 483
	=====

In accordance with our policy to assess whether an impairment loss on our investments has occurred due to declines in fair value and other market conditions, we determined that declines in fair value of certain of our equity investments were

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)  
(UNAUDITED)

other than temporary. Accordingly, during the six months ended June, 30, 2001, eBay recorded an impairment charge of \$9.9 million relating to the other than temporary impairment in the fair value of these equity investments.

NOTE 6--DERIVATIVE INSTRUMENTS:

eBay monitors and manages its financial exposures as an integral part of its overall risk-management program. eBay uses derivative instruments to minimize earnings fluctuations that may arise from volatility in U.S. interest rates. eBay entered into two interest rate swaps on June 19 and July 20, 2000

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with notional amounts of \$45 million and \$50 million that allow eBay to receive floating rate receipts based on London Interbank Offering Rate ("LIBOR") in exchange for making fixed rate payments of approximately 7% of the notional amount. These interest rate swaps were designated as cash flow hedging instruments to effectively reduce the impact of changes in interest rates on a portion of the floating rate operating lease payments relating to eBay's corporate office facilities. The fair value of the interest rate swaps as of June 30, 2001 was an unrealized loss of \$5.6 million.

During the six months ended June 30, 2001, the ineffective portion of the interest rate swaps was not material. During the six months ended June 30, 2001, \$770,000 of losses on the interest rate swaps were classified to other comprehensive income. The derivative losses reclassified into rent expense were offset by decreases in rent expense relating to the operating lease. At June 30, 2001, eBay expects to reclassify \$1.8 million of losses, net of tax, on the interest rate swaps from accumulated other comprehensive income to rent expense during the next twelve months.

eBay adopted SFAS No. 133, as amended, as of January 1, 2001. Upon adoption, the cumulative effect on net income and other comprehensive income of this change in accounting method relating to the interest rate swaps was a gain of approximately \$650,000 included in other income and expense, net, and a loss of approximately \$2.6 million, respectively, net of tax.

In addition to the interest rate swaps used in the cash flow hedging strategy described above, eBay owns equity warrants and other similar rights in certain companies as part of eBay's strategic investment strategy. These equity rights are accounted for as derivative instruments under SFAS No. 133 and the changes in fair value of these instruments are reflected in current period earnings in the financial statement line interest and other income and expense, net.

### NOTE 7--CONTINGENCIES:

#### Legal Matters

On April 25, 2000, eBay was served with a lawsuit, Gentry et.al. v. eBay Inc. et.al, filed in Superior Court in San Diego, California. The lawsuit was filed on behalf of a purported class of eBay users who purchased allegedly forged autographed sports memorabilia on eBay. The lawsuit claims eBay was negligent in permitting certain named (and other unnamed) defendants to sell allegedly forged autographed sports memorabilia on eBay. In addition, the lawsuit claims eBay violated California unfair competition law and a section of the California Civil Code which prohibits "dealers" from selling sports memorabilia without a "Certificate of Authenticity." On January 26, 2001 the court issued a ruling dismissing all claims against us in the lawsuit. The court ruled that eBay's business falls within the safe harbor provisions of 47 USC 30, which grants Internet service providers such as eBay with immunity from state claims based on the conduct of third parties. The court also noted that eBay was not a "dealer" under California law and thus not required to provide certificates of authenticity with autographs sold over our site by third parties. All counts of the plaintiffs' suit were dismissed with prejudice as to eBay. The plaintiffs have filed an appeal of this ruling. eBay believes it has meritorious defenses and intends to defend itself vigorously.

On April 25, 2001, eBay's European subsidiaries, eBay GMBH and eBay International AG, were sued by Montres Rolex S.A. and certain Rolex affiliates ("Rolex") in the regional court of Cologne, Germany. Rolex alleged that eBay's subsidiary was infringing Rolex's trademarks as result of users selling counterfeit Rolex watches through eBay's German website. The suit also alleges unfair competition. Rolex is seeking an order forbidding the sale of Rolex watches on the website as well as damages. eBay believes that it has meritorious

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defenses against this claim and intends to defend itself vigorously.

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EBAY INC.

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED) (UNAUDITED)

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

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### ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

#### FORWARD LOOKING STATEMENTS

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

#### OVERVIEW

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

A substantial portion of our revenues are derived from fees and commissions associated with online and offline trading services. Online revenue is primarily derived from listing fees, feature fees and final value fees paid by the sellers, and commissions paid by buyers for certain "premium" priced items. Sellers pay a placement fee, and by paying additional fees, sellers can have items featured in various ways. Sellers also pay a success fee based on the final purchase price. In addition, we generate fees from payment services



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provided by Billpoint and fixed price trading by Half.com. We also generate revenue from third party advertising and end-to-end services and promotions. Although we expect these end-to-end and direct advertising revenues to increase in the future, they are subject to considerable uncertainty. See "Risk Factors -- Our revenue from third party advertising and end-to-end services and promotions is subject to factors beyond our control." Offline revenue is derived from a variety of sources, including sellers' commissions, buyers' premiums, bidder registration fees and auction-related services, including appraisal and authentication. We expect that the online business will continue to represent the majority of revenue growth in the foreseeable future.

### ACQUISITIONS

#### Internet Auction Acquisition

On February 15, 2001, eBay acquired a majority interest in Internet Auction Co., Ltd., a South Korean company ("Internet Auction") for \$120.8 million in cash and incurred \$1.2 million of direct acquisition costs. Internet Auction introduced person-to-person trading in Korea when it launched in April 1998. Shares of Internet Auction are listed on the KOSDAQ. The transaction was accounted for using the purchase method of accounting and accordingly, the results of operations of Internet Auction have been included in eBay's consolidated financial statements from February 15, 2001. The aggregate purchase price was allocated to tangible and identifiable intangible assets acquired and liabilities assumed of Internet Auction based upon management's estimates using a valuation report prepared by an independent third party valuation consultant. Identifiable intangible assets are amortized using estimated useful lives ranging from two to five years. The excess of the aggregate purchase price over the fair value of the identifiable net assets acquired of \$82.7 million has been recognized as goodwill and is being amortized over five years. See Note 1 -- "Recent accounting pronouncements," in the notes to condensed consolidated financial statements.

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#### iBazar S.A. Acquisition

On May 18, 2001, eBay completed its acquisition of iBazar S.A. ("iBazar") in a transaction accounted for as a purchase business combination. iBazar, a French-based corporation that introduced online person-to-person trading in France and at the time of the acquisition had websites in Belgium, Brazil, France, Italy, the Netherlands, Portugal, Spain and Sweden. As consideration for the acquisition, eBay issued shares in a Belgian subsidiary exchangeable for 2,045,054 shares of eBay common stock valued at \$120.4 million, paid \$2.3 million in cash to certain shareholders and incurred acquisition-related costs of approximately \$2.9 million. The shares issued in the acquisition have been valued in accordance with Emerging Issue Task Force Issue No. 99-12, Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination ("EITF 99-12"). In accordance with EITF 99-12, eBay has established that the first date on which the number of eBay's shares and the amount of other consideration became fixed was May 18, 2001. EITF 99-12 precludes the use of any share prices subsequent to the consummation date of a transaction, and accordingly, eBay has valued the transaction using the average closing price of eBay shares for the five days prior to and including the closing date of May 18, 2001. The aggregate purchase price of approximately \$125.6 million has been allocated to the net tangible and identifiable intangible assets acquired and liabilities assumed on the basis of their estimated fair values on the acquisition date.

Tangible assets were valued at their respective carrying amounts as

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management believes that these amounts approximate their current fair values. The valuation of the identifiable intangible assets acquired was based on management's estimates using a preliminary valuation report prepared by an independent third party valuation consultant and consists of customer base, assembled workforce, developed technology and trade names. Identifiable intangible assets are amortized using estimated useful lives ranging from two to five years. eBay also identified certain assets as held for sale and valued these assets based on the expected sale proceeds adjusted for losses expected to be incurred during the holding period.

In accordance with EITF Issue No. 95-3, Recognition of Liabilities in Connection with a Purchase Business Combination, eBay has established plans to exit certain activities of iBazar and to involuntarily terminate certain iBazar employees. In accordance with this exit plan, approximately \$2 million has been accrued for the estimated costs associated with severance, contract terminations and financial advisory and legal fees and has been included in net tangible assets. As of June 30, 2001, no costs have been charged against this liability.

The excess of the purchase price over the value of the tangible and identifiable intangible assets acquired and liabilities assumed has been recorded as goodwill and is being amortized over five years. See Note 1 -- "Recent accounting pronouncements," in the notes to condensed consolidated financial statements.

### RESULTS OF OPERATIONS

It is difficult for us to forecast revenues or earnings accurately, and the operating results in one or more future quarters may fall below the expectations of securities analysts or investors. Although accurate revenue forecasts are difficult, we recognize the seasonal nature of our business because many of our users reduce their activities on our websites during the Thanksgiving and Christmas holidays and with the onset of good weather. We have historically experienced our strongest quarter of online growth in our first fiscal quarter, although our shift to more "practical" items may cause our seasonal patterns to look more like those of a typical retailer. Both Butterfields and Kruse have significant quarter-to-quarter variations in their results of operations depending on the timing of auctions and the availability of high quality items from large collections and estates. Butterfields typically has its best operating results in the traditional fall and spring auction seasons and has historically incurred operating losses in the first and third quarters. Kruse typically sees a seasonal peak in operations in the third quarter. Seasonal or cyclical variations in our business may become more pronounced over time and may harm our results of operations in the future.

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

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

Net Revenues

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We derive revenue from a variety of sources, including listing, success and featured item fees, third party advertising, and end-to-end services and promotions. In addition, we derive commissions and rental income from our traditional offline auction operations. Our net revenues increased by 84.2% from \$98.2 million for the three months ended June 30, 2000, to \$180.9 million for the three months ended June 30, 2001. For the six months ended June 30, 2001, net revenues increased from \$184.0 million to \$335.0 million, or 82.0%, compared to the six months ended June 30, 2000. The successive year over year growth from 2000 to 2001, was predominantly the result of increased use of our websites, reflected in the growth in the number of registered users, listings and gross merchandise sales as well as increased third party advertising revenues. Fee increases in the U.S. on January 31, 2001 and fee increases in various other international locations, combined with the consolidation of revenues from Internet Auction and iBazar, had a positive impact on revenues for the quarter. Revenues from third party advertising during the three months ended June 30, 2001, account for 10% of net revenues, up from 2% for the same period of 2000 and up from 8% for the three months ended March 31, 2001. For the six months ended June 30, 2001, third party advertising accounted for 9% of net revenues, compared to 2% for the same period of 2000. These revenues have increased primarily as a result of our strategy to increase site monetization through our partnership with AOL Time Warner. However, we continue to view our business as primarily transaction driven and over the longer term we do not expect advertising revenues to significantly increase as a percentage of total net revenues. International revenues accounted for 14% and 6% of net revenues during the three month periods ended June 30, 2001 and 2000, respectively, and 13% and 6% of net revenues during the six months ended June 30, 2001 and 2000, respectively. We expect the trend of increasing international revenues to continue as we build out our worldwide marketplace. Year to date, offline revenues were comparable to the previous year, however, for the three months ended June 30, 2001, our Butterfields subsidiary increased net revenues compared to the comparable period in 2000 primarily due increased auction revenues. We expect that future revenue growth will be largely driven by the growth of online services.

### Cost of Net Revenues

Cost of net revenues for online operations consists primarily of costs associated with customer support and site operations and includes employee and facilities costs for customer support and site operations personnel, ISP connectivity charges and depreciation on site equipment. Cost of net revenues in traditional auction operations primarily includes compensation for auction, appraisal, and customer support personnel and direct auction costs, such as event site rental. Cost of net revenues increased in absolute dollars but decreased as a percentage of net revenues from \$24.2 million or 24.7% of net revenues to \$32.9 million or 18.2% of net revenues for the three months ended June 30, 2000 and 2001. For the six months ended June 30, 2001, cost of net revenues increased in absolute terms from \$47.6 million to \$59.9 million but decreased as a percentage of net revenues from 25.9% to 17.9% as compared to the six months ended June 30, 2000. The increases in absolute dollars in expenditures were due almost entirely to our online businesses, and resulted from the continued development and expansion of our customer support and site operations departments, depreciation of the equipment required for site operations, software licensing fees and ISP connectivity charges. The decrease in cost of net revenues as a percentage of net revenues from 2000 to 2001, resulted from improved productivity and cost management in customer support and site operations and increases in higher gross margin businesses such as autos, end-to-end trading solutions and advertising. As a result of these efficiencies, we expect the cost of net revenues to increase in absolute dollars but remain above 80% as a percentage of net revenues throughout the remainder of 2001.

### Sales and Marketing

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Our sales and marketing expenses for both the online and traditional auction businesses are comprised primarily of compensation for our sales and marketing personnel, advertising, tradeshow and other promotional costs, employee and facilities costs. Sales and marketing expenses increased in absolute dollars but decreased as a percentage of sales from \$37.1 million or 37.8% of net revenues to \$60.1 million or 33.2% of net revenues for the three months ended June 30, 2000 and 2001. For the six months ended June 30, 2001, sales and marketing increased in absolute dollars but decreased as a percentage of sales from \$76.6 million or 41.6% of net revenues to \$115.7 million or 34.5% of net revenues as compared to the six months ended June 30, 2000. The successive year over year growth from 2000 to 2001 was primarily the result of

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growth in online and traditional advertising, including expenses for various marketing agreements, personnel related costs, costs associated with the use of outside services and consultants and miscellaneous user and promotional costs.

Online sales and marketing expenses are expected to increase in absolute dollars for the remainder of 2001. We expect to build our brand further with continued advertising delivered under our strategic alliances with various third parties and the expansion of international advertising. Sales and marketing expenses in the traditional auction businesses are expected to remain comparable with historic levels.

### Product Development

Product development expenses consist primarily of compensation for our product development staff, payments to outside contractors, depreciation on equipment used for development, employee and facilities costs. Our product development expenses increased from \$13.6 million or 13.9% of net revenues to \$17.7 million or 9.8% of net revenues for the three months ended June 30, 2000 and 2001. For the six months ended June 30, 2001, product development increased in absolute dollars but decreased as a percentage of sales from \$25.9 million or 14.1% of net revenues to \$33.4 million or 10.0% of net revenues as compared to the six months ended June 30, 2000. The year-over-year growth in product development cost from 2000 to 2001 was primarily the result of an increase in personnel-related costs as we increased the size of our product development staff, expenses related to contractors and consultants employed within product development departments and maintenance and depreciation for equipment used in research and development. The year over year increase also resulted from the growth of product development expenses at our Half.com subsidiary. Product development expenses are expected to increase in absolute dollars during future periods primarily from personnel additions, the continued impact of investments in our fixed price and payment businesses, additional depreciation costs as we continue to purchase equipment to improve and expand domestic and international operations and certain costs associated with the development of our next generation architecture.

### General and Administrative

General and administrative expenses consist primarily of compensation for personnel and, to a lesser extent, fees for external professional advisors, provisions for doubtful accounts, employee and facilities costs. Our general and administrative expenses increased from \$20.6 million or 21.0% of net revenues to \$25.6 million or 14.2% of net revenues for the three months ended June 30, 2000 and 2001. For the six months ended June 30, 2001, general and administrative costs increased in absolute terms from \$37.6 million to \$46.9 million but decreased as a percentage of net revenues from 20.4% to 14.0% as compared to the six months ended June 30, 2000. The year-over-year increases resulted from

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growth in personnel-related expenses to meet the demands of our expanding business, including operations in new countries and the integration of new businesses, fees for professional services, employee and facilities costs. We expect that general and administrative expenses will increase in absolute dollars in future periods as we continue to invest in the infrastructure that is necessary to manage our business.

### Payroll Tax on Employee Stock Options

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

### Amortization of Acquired Intangible Assets

From time to time we have purchased, and expect to continue purchasing, assets or businesses to support our leadership role in online trading. These purchases may result in the creation of intangible assets and lead to a corresponding increase in related amortization expense. Our amortization of acquired intangible assets increased from \$340,000 or 0.3% of net revenues to \$8.8 million or 4.9% of net revenues for the three months ended June 30, 2000 and 2001. For the six months ended June 30, 2001, amortization of acquired intangible assets increased from \$615,000 or 0.3% of net revenues to \$12.2 million or 3.6% of net revenues as compared to the six months ended June 30, 2000. The increase resulted primarily from our purchase of a majority interest in Internet Auction and the acquisition of iBazar. We expect the amortization of intangible assets to continue to increase in 2001 due to on-going amortization related to Internet Auction and iBazar.

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In July 2001, the Financial Accounting Standards Board issued and SFAS No. 142 "Goodwill and Other Intangible Assets" that requires the use of a non-amortization approach to account for purchased goodwill and certain intangibles. Under a non-amortization approach, goodwill and certain intangibles will not be amortized into results of operations, but instead would be reviewed for impairment and written down and charged to results of operations only in the periods in which the recorded value of goodwill and certain intangibles exceed their fair values. This Statement is effective for fiscal years beginning after December 15, 2001, and eBay is currently evaluating the effect that adoption of this Statement will have on its results of operations and financial position. eBay will adopt SFAS No. 142 effective January 1, 2002, which will result in the Company no longer amortizing its existing goodwill.

### Interest and Other Income and Expense, Net

Interest and other income and expense, net consists of interest earned on cash, cash equivalents and investments and foreign exchange transaction gains and losses. Our interest and other income and expense, net decreased from \$11.4 million or 11.6% of net revenues for the three months ended June 30, 2000 to \$10.1 million or 5.6% of net revenues for the three months ended June 30, 2001, primarily as a result of the decrease in the average invested balance due to the cash purchase of a majority interest in Internet Auction. Interest and other income and expense, net increased from \$22.6 million to \$25.1 million from the six months ended June 30, 2001 as compared to the six months ended June 30, 2000, primarily as a result of the increase in the average balance that was

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invested during the first three months of 2001.

### Impairment of Certain Equity Investments

As part of our overall business strategy, we have invested and will continue to invest in companies that we consider to be of strategic value. Due to the general downturn in the economy and the financial difficulties that some of these companies have experienced, we have concluded that the reduction in the fair value of certain of these investments was other than temporary and recorded an impairment charge of \$9.9 million during the three months ended March 31, 2001, which are reflected in the operating results for the six months ended June 30, 2001.

### Interest Expense

Interest expense consists of interest paid on short-term and long-term borrowings. Interest expense remained fairly constant and only decreased slightly from \$1.0 million or 1.0% of net revenues to \$959,000 or 0.5% of net revenues for the three months ended June 30, 2000 and 2001, respectively, and from \$1.9 million or 1.0% of net revenues to \$1.7 million or 0.5% of net revenues for the six months ended June 30, 2000 and 2001, respectively.

### Provision for Income Taxes

Our effective income tax rates were 42.0% and 46.4% in the three months ended June 30, 2000 and 2001, respectively, and 42.0% and 44.6% in the six months ended June 30, 2000 and 2001, respectively. The increase in the effective rate for the three and six months ended June 30, 2001, compared to the same period last year is primarily due to certain nondeductible expenses related to acquisitions and is partially offset by income from operations in foreign jurisdictions with lower effective tax rates. The provision for income taxes for both periods differs from the amount computed by applying the statutory U.S. federal rate principally due to state taxes, tax exempt interest income and nondeductible expenses. We receive tax deductions from gains realized by employees on the exercise of certain non-qualified stock options for which the benefit is recognized as a component of paid-in capital. We have provided a valuation allowance on the deferred tax assets relating to these stock option deductions.

### Stock-Based Compensation

In connection with granting certain stock options from May 1997 through May 1999, we recorded aggregate unearned compensation totaling \$13.1 million, which is being amortized over the four-year vesting period of the related options. In connection with certain stock options granted by companies that we subsequently acquired, we recorded unearned compensation totaling \$9.3 million. Amortization of unearned stock compensation was approximately \$1.4 million for the three months ended June 30, 2000, \$450,000 for the three months ended June 30, 2001 and \$3.4 million and \$1.4 million respectively for the six months ended June 30, 2000 and 2001, respectively. As of June 30, 2001, unearned compensation

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totaling \$4.2 million was recorded as a component of stockholders' equity and will be amortized as a charge against earnings over the remaining vesting period of the related options.

### LIQUIDITY AND CAPITAL RESOURCES

Since inception, eBay has financed operations primarily from net cash

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generated from operating activities. We obtained additional financing from the sale of preferred stock and warrants, proceeds from the exercise of those warrants, proceeds from the exercise of stock options, and proceeds from our initial and follow-on public offerings.

Net cash provided by operating activities was \$35.4 million and \$107.0 million for the six months ended June 30, 2000 and 2001, respectively. Net cash provided by operating activities resulted primarily from our net income before non-cash charges for depreciation and amortization, tax benefit from employee stock options and impairment of certain equity investments offset by changes in assets and liabilities, primarily accounts receivable.

Net cash used in investing activities was \$187.2 million for the six months ended June 30, 2000, and net cash provided by investing activities was \$131.5 million for the same period in 2001. In 2000, the primary use for invested cash in the periods presented was purchases of investments, property and equipment. In 2001, net cash provided by the maturity of certain short-term investments was partially offset by the cash paid for the acquisition of a majority interest in Internet Auction.

Net cash provided by financing activities was \$73.3 million for the six months ended June 30, 2000 and \$1.1 million for the same period in 2001. In 2000, net cash provided in financing activities resulted primarily from the issuance of common stock to third parties by our subsidiaries and the sale of common stock under employee stock option plans. In 2001, net cash provided in financing activities primarily resulted from the issuance of common stock under employee benefits plans.

We had no material commitments for capital expenditures at June 30, 2001, but expect such expenditures to approximate \$43 million throughout the remainder of 2001, without taking into account any acquisitions. Of the \$43 million, approximately \$18 million has been allocated to capital expenditures relating to hardware and software for the development of our new architecture. The remaining balance will be used primarily for computer equipment, furniture and fixtures and leasehold improvements. In August 2001, we amended our Interactive Marketing and Advertising Representation agreements with AOL Time Warner. The amendments extend the term of the relationship through March 2004, provide additional exclusivity for AOL Time Warner and do not result in a material change to our projected operating results and liquidity. In February 2000, we signed a promotional agreement with certain affiliates of The Walt Disney Company ("Disney") then known as GO.com. GO.com was subsequently reorganized by Disney and we have renegotiated our agreement. The revised agreement does not result in a material change to our projected operating results and liquidity.

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

### RECENT ACCOUNTING PRONOUNCEMENTS

In March 2000, the Emerging Issues Task Force ("EITF") reached a consensus on EITF Issue No. 00-14, "Accounting for Certain Sales Incentives." This consensus provides guidance on the recognition, measurement, and income statement classification of sales incentives which are offered voluntarily by a vendor without charge to customers that can be used in, or that are exercisable by a customer as a result of, a single exchange transaction. At the April 2001 meeting, the EITF reached a consensus to defer the effective date to quarters

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beginning after December 15, 2001. eBay believes that implementation of EITF No. 00-14 will not have a material effect on its consolidated financial statements.

In July 2001, the Financial Accounting Standards Board issued SFAS No. 141, "Business Combinations," that requires business combinations initiated after June 30, 2001, to be accounted for using the purchase method of accounting and broadens the criteria for recording intangible assets separate from goodwill. Recorded goodwill and intangible assets will have to be evaluated against these new criteria and may result in certain intangible assets being subsumed into

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goodwill, or alternatively, amounts initially recorded as goodwill may be separately identified and recognized apart from goodwill. The adoption of SFAS No. 141 will not change the method of accounting used in previous business combinations accounted for under the pooling-of-interest method.

In July 2001, the Financial Accounting Standards Board issued and SFAS No. 142, "Goodwill and Other Intangible Assets," that requires the use of a non-amortization approach to account for purchased goodwill and certain intangible assets. Under a non-amortization approach, goodwill and certain intangible assets will not be amortized into results of operations, but instead would be reviewed for impairment and written down and charged to results of operations only in the periods in which the recorded value of goodwill and certain intangible assets exceed their fair values. This statement is effective for fiscal years beginning after December 15, 2001, and eBay is currently evaluating the effect that adoption of this Statement will have on its results of operations and financial position. eBay will adopt SFAS No. 142 effective January 1, 2002, which will result in the Company no longer amortizing its existing goodwill.

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### RISK FACTORS THAT MAY AFFECT RESULTS OF OPERATIONS AND FINANCIAL CONDITION

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

We have a limited operating history

Our company was formed as a sole proprietorship in September 1995 and was incorporated in California in May 1996 and reincorporated in Delaware in April 1998. We have only a limited operating history on which you can base an evaluation of our business and prospects. As an online commerce company still relatively early in our development, we face substantial risks, uncertainties, expenses and difficulties. To address these risks and uncertainties, we and our subsidiaries must do the following:

- maintain and increase our number of registered users, items listed on our service and completed sales;
- expand into new areas;



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- maintain and grow our websites and customer support operations at a reasonable cost;
- continue to make trading through our service safer for users;
- maintain and enhance our brand;
- continue to develop and upgrade our technology and information processing systems;
- continue to enhance and expand our service to meet the changing requirements of our users;
- provide superior customer service;
- remain attractive to our commercial partners;
- respond to changing legal environments in a variety of countries
- respond to competitive developments; and
- attract, integrate, retain and motivate qualified personnel.

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

Our operating results may fluctuate

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

- our ability to retain an active user base, to attract new users who list items for sale and who purchase items through our service and to maintain customer satisfaction;
- our ability to keep our websites operational and to manage the number of items listed on our service;
- the amount and timing of operating costs and capital expenditures relating to the maintenance and expansion of our business, operations and infrastructure;

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- foreign, federal, state or local government regulation, including investigations prompted by items improperly listed or sold by our users;
- the introduction of new sites, services and products by us or our competitors;
- volume, size, timing and completion rate of trades on our websites;
- consumer confidence in the security of transactions on our

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websites;

- our ability to upgrade and develop our systems and infrastructure to accommodate growth;
- technical difficulties or service interruptions;
- our ability to attract new personnel in a timely and effective manner;
- our ability to retain key employees in both our online businesses and our acquisitions;
- our ability to integrate and manage our acquisitions successfully;
- our ability to expand our product offerings involving fixed price trading successfully;
- the ability of our land-based auction businesses to acquire high quality properties for auction;
- the timing, cost and availability of advertising in traditional media and on other websites and online services;
- the cost and demand for advertising on our own websites;
- the timing of payments to us and of marketing and other expenses under existing and future contracts;
- consumer trends and popularity of some categories of collectible items;
- the success of our brand building and marketing campaigns;
- the continued success of our commercial partners and technology suppliers;
- the level of use of the Internet and online services;
- increasing consumer acceptance of the Internet and other online services for commerce and, in particular, the trading of products such as those listed on our websites; and
- general economic conditions and economic conditions specific to the Internet and e-commerce industries.

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

Our failure to manage growth could harm us

We currently are experiencing a period of expansion in our headcount, facilities and infrastructure, and we anticipate that further expansion will be

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required to address potential growth in our customer base and number of listings as well as our expansion into new geographic areas, types of goods and alternative methods of sale. This expansion has placed, and

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we expect it will continue to place, a significant strain on our management, operational and financial resources. The areas that are put under strain by our growth include the following:

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

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

We may not maintain profitability

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

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

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- provide our customers with superior community and trading experiences.

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

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

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

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

Prior to the four large acquisitions we made in 1999, we had almost no experience in managing this integration process. Many of our acquisitions to date have involved either family-run companies or very early stage companies, which may worsen these integration issues. Foreign acquisitions involve special

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risks, including those related to integration of operations across different cultures, currency risks and the particular economic and regulatory risks associated with specific countries. Moreover, the anticipated benefits of any or all of our acquisitions may not be realized. Future acquisitions or mergers could result in potentially dilutive issuances of equity securities, the incurrence of debt, contingent liabilities or amortization expenses related to goodwill and other intangible assets, any of which could harm our business. Future acquisitions or mergers may require us to obtain additional equity or debt financing, which may not be available on favorable terms or at all. Even if available, this financing may be dilutive.

There are many risks associated with our international operations

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

- regulatory requirements, including regulation of "auctions," that may limit or prevent the offering of our services in local jurisdictions, may prevent enforceable agreements between sellers and buyers, may prohibit certain categories of goods or may limit the transfer of information between our foreign subsidiaries and ourselves;
- legal uncertainty regarding liability for the listings of our users, including less Internet-friendly legal systems, unique local laws and lack of clear precedent or applicable law;

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

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- potentially adverse tax consequences.

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

Our revenue from third party advertising and end-to-end services and promotions is subject to factors beyond our control

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

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

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

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

We have received in the past, and we anticipate we will receive in the future, communications alleging that certain items listed or sold through our service by our users infringe third-party copyrights, trademarks and tradenames or other

intellectual property rights. Although we have sought to work actively with the

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content community to eliminate infringing listings on our websites, some content owners have expressed the view that our efforts are insufficient. Content owners have been active in defending their rights against online companies, including eBay. Allegations of infringement of third-party intellectual property rights have in the past and may in the future result in litigation against us. Such litigation is costly for us, could result in increased costs of doing business through adverse judgment or settlement, could require us to change our business practices in expensive ways, or could otherwise harm our business. Litigation against other online companies could result in interpretations of the law that could also require us to change our business practices or otherwise increase our costs. See "--Government inquiries may lead to charges or penalties," "Legal Proceedings" and "--We are subject to intellectual property and other litigation."

Our business may be harmed by fraudulent activities on our websites

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

Government inquiries may lead to charges or penalties

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

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

Should these or any other investigations lead to civil or criminal charges against us, we would likely be harmed by negative publicity, the costs of litigation, the diversion of management time and other negative effects, even if

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we ultimately prevail. Our business would suffer if we were not to prevail in any actions like these. Even the process of providing records and information can be expensive, time consuming and result in the diversion of management attention.

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

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We are subject to laws relating to the use and transfer of personally identifiable information about our users and their transfers, especially outside of the U.S. Violation of these laws, which in many cases apply not only to third-party transfers but also to transfers of information between ourselves and our subsidiaries and between ourselves, our subsidiaries and our commercial partners could subject us to significant penalties and negative publicity and could adversely affect our company.

Third parties or governmental agencies may view our behavior as anti-competitive

Third parties have in the past and may in the future allege that actions taken by us violate the antitrust or competition laws of the U.S or other countries, or otherwise constitute unfair competition. Such claims typically are very expensive to defend, involve negative publicity and diversion of management time and effort and could result in significant judgment against us, all of which would adversely affect us.

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

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

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



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As our activities and the types of goods listed on our site expand, state regulatory agencies may claim that we are subject to licensure in their jurisdiction, either with respect to our services in general, or in order to sell certain types of goods (e.g., real estate, boats, automobiles, etc.). These claims could result in costly litigation or could require us to change our manner of doing business in ways that increase our costs or reduce our revenues or force us to prohibit listings of certain items. We could also be subject to fines or other penalties. Any of these outcomes could harm our business.

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

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

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

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

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

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be forced to implement new measures to reduce our exposure to this liability. This may require us to expend substantial resources and/or to discontinue certain service offerings, which would negatively affect our financial results. In addition, the increased attention focused upon liability issues as a result of these lawsuits and legislative proposals could harm our reputation or otherwise impact the growth of our business. Any costs incurred as a result of this liability or asserted liability could harm our business.

We are subject to intellectual property and other litigation

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

On April 25, 2001, our European subsidiaries, eBay GMBH and eBay International AG, were sued by Montres Rolex S.A. and certain Rolex affiliates ("Rolex") in the regional court of Cologne, Germany. Rolex alleged that our subsidiary was infringing Rolex's trademarks as result of users selling counterfeit Rolex watches through our German website. The suit also alleges unfair competition. Rolex is seeking an order forbidding the sale of Rolex watches on the website as well as damages. We believe that we have meritorious defenses against this claim and intend to defend ourselves vigorously.

Other third parties have from time to time claimed, in some cases through litigation, and others may claim in the future that we have infringed their past, current or future intellectual property rights. We may become more vulnerable to such claims as laws such as the Digital Millennium Copyright Act are interpreted by the courts and as we expand into jurisdictions where the underlying laws with respect to the potential liability of online intermediaries like ourselves is less favorable. We expect that we will increasingly be subject to infringement claims as the geographical reach of our services expands. These claims, whether meritorious or not, could be time-consuming, result in costly litigation, cause service upgrade delays, require expensive changes in our methods of doing business or could require us to enter into costly royalty or licensing agreements, if available. As a result, these claims could harm our business.

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

The inability to expand our systems may limit our growth

We seek to generate a high volume of traffic and transactions on our service. The satisfactory performance, reliability and availability of our websites, processing systems and network infrastructure are critical to our

reputation and our ability

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to attract and retain large numbers of users. Our revenues depend primarily on the number of items listed by users, the volume of user transactions that are successfully completed and the final prices paid for the items listed. We need to expand and upgrade our technology, transaction processing systems and network infrastructure both to meet increased traffic on our site and to implement new features and functions, including those required under our contracts with third parties. We may be unable to accurately project the rate or timing of increases, if any, in the use of our service or to expand and upgrade our systems and infrastructure to accommodate any increases in a timely fashion.

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

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

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

System failures could harm our business

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

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frequency or duration of unscheduled downtime.

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

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Risks relating to possible California power outages

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

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

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

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

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- sales of our common stock or other securities in the open market; and
- other events or factors, including these described in this "Risk Factors" section and others that may be beyond our control.

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

New and existing regulations could harm our business

We are subject to the same foreign, federal, state and local laws as other companies conducting business on the Internet. Today there are relatively few laws specifically directed towards online services. However, due to the increasing popularity and use of the Internet and online services, many laws relating to the Internet are being debated at the state and federal levels (both in the U.S. and abroad) and it is possible that laws and regulations will be adopted with respect to the Internet or online services. These laws and regulations could cover issues such as user privacy, freedom of expression,

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

Several states have proposed legislation that would limit the uses of

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personal user information gathered online or require online services to establish privacy policies. The Federal Trade Commission also has settled several proceedings regarding the manner in which personal information is collected from users and provided to third parties. Specific statutes intended to protect user privacy have been passed in many non-U.S. jurisdictions, including virtually every non-U.S. jurisdiction in which we currently have a website. Compliance with these laws, given the tight integration of our systems across different countries and the need to move data to facilitate transactions amongst our users (e.g., to payment companies, shipping companies, etc.) is necessary. Failure to comply could subject us to lawsuits, fines, statutory damages, adverse publicity and other losses that could harm our business. Changes to existing laws or the passage of new laws intended to address these issues could directly affect the way we do business or could create uncertainty on the Internet. This could reduce demand for our services, increase the cost of doing business as a result of litigation costs or increased service delivery costs, or otherwise harm our business. In addition, because our services are accessible worldwide, and we facilitate sales of goods to users worldwide, foreign jurisdictions may claim that we are required to comply with their laws. For example, a French court has recently ruled that a U.S. website must comply with French laws regarding content. As we have expanded our international activities, we have become obligated to comply with the laws of the countries in which we operate. Laws regulating Internet companies outside of the U.S. may be less favorable than those in the U.S., giving greater rights to consumers, content owners and users. Compliance may be more costly or may require us to change our business practices or restrict our service offerings relative to those in the U.S.. Our failure to comply with foreign laws could subject us to penalties ranging from fines to bans on our ability to offer our services.

Our business has been seasonal

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

We are dependent on the continued growth of online commerce

The business of selling goods over the Internet, particularly through personal trading, is new and dynamic. Our future net revenues and profits will be substantially dependent upon the widespread acceptance of the Internet and online services as a medium for commerce by consumers. Rapid growth in the use of and interest in the Internet and online services is a recent phenomenon. This acceptance and use may not continue. Even if the Internet is accepted, concerns about fraud, privacy and other problems may mean that a sufficiently broad base of consumers will not adopt the Internet as a medium of commerce. In particular, our websites require users to make publicly available personal information that some potential users may be unwilling to provide. These concerns may increase as additional publicity over privacy issues on eBay or generally over the Internet increase. Market acceptance for recently introduced services and products over the Internet is highly uncertain, and there are few proven services and products. In order to expand our user base, we must appeal to and acquire consumers who historically have used traditional means of commerce to purchase

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goods. If these consumers prove

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to be less active than our earlier users, and we are unable to gain efficiencies in our operating costs, including our cost of acquiring new customers, our business could be adversely impacted.

Our business may be subject to sales and other taxes

We do not collect sales or other similar taxes on goods sold by users through our service. One or more states may seek to impose sales tax collection obligations on companies such as ours that engage in or facilitate online commerce. Several proposals have been made at the state and local level that would impose additional taxes on the sale of goods and services through the Internet. These proposals, if adopted, could substantially impair the growth of e-commerce, and could diminish our opportunity to derive financial benefit from our activities. In 1998, the U.S. federal government enacted legislation prohibiting states or other local authorities from imposing new taxes on Internet commerce for a period of three years. This tax moratorium is scheduled to end in October 2001 and does not prohibit states or the Internal Revenue Service from collecting taxes on our income, if any, or from collecting taxes that are due under existing tax rules. A successful assertion by one or more states or any foreign country that we should collect sales or other taxes on the exchange of merchandise on our system would harm our business. Any new taxes that may be promulgated should the internet tax moratorium not be extended could also harm our business.

We are dependent on key personnel

Our future performance will be substantially dependent on the continued services of our senior management and other key personnel. Our future performance also will depend on our ability to retain and motivate our other officers and key personnel. The loss of the services of any of our executive officers or other key employees could harm our business. We do not have long-term employment agreements with any of our key personnel, and we do not maintain any "key person" life insurance policies. Our new businesses are all dependent on attracting and retaining key personnel. The land-based auction businesses are particularly dependent on specialists and senior management because of the relationships these individuals have established with sellers who consign property for sale at auction. We have had some turnover of these personnel, and continued losses of these individuals could result in the loss of significant future business and would harm us. In addition, employee turnover and other labor problems frequently increases during the period following an acquisition as employees evaluate possible changes in compensation, culture, reporting relationships and the direction of the business. These labor issues maybe more severe if employees receive no significant financial return from the acquisition transaction, as has been the case with several of our recent acquisitions. Such increased turnover could increase our costs and reduce our future revenues. Our future success also will depend on our ability to attract, train, retain and motivate highly skilled technical, managerial, marketing and customer support personnel. Competition for these personnel is intense, especially for engineers and other professionals, especially in the San Francisco Bay Area, and we may be unable to successfully attract, integrate or retain sufficiently qualified personnel. In making employment decisions, particularly in the Internet and high-technology industries, job candidates often consider the value of the stock options they are to receive in connection with their employment. Fluctuations in our stock price may make it more difficult to retain and motivate employees whose stock option strike prices are substantially above current market prices.

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Our offline auction businesses need to continue to acquire auction properties

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

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

In order to secure high quality auction properties from sellers, Butterfields and Kruse may give a guaranteed minimum price or a cash advance to a seller, based on the estimated value of the property. If the auction proceeds are less than the amount guaranteed, or less than the amount advanced and the seller does not repay the difference, the company involved will suffer a loss. In addition, under certain circumstances a buyer who believes that an item purchased at auction does not have good title, provenance or authenticity may rescind the purchase. Under these circumstances, the company involved

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will lose its commissions and fees on the sale even if the seller, in accordance with the terms and conditions of sale, in turn accepts back the item and returns the funds he or she received from the sale.

We are subject to the risks of owning real property

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

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

Our market is intensely competitive

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



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

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

Antiques: Christie's, eHammer, Sotheby's / Sothebys.com, Phillips (LVMH)

Coins & Stamps: Collectors Universe, Heritage, US Mint, Bowers and Morena

Collectibles: Franklin Mint, Go Collect, Collectiblestoday.com, wizardworld.com, Russ Cochran Comic Art Auctions, All Star Auctions

Musical Instruments: Guitar Center, Sam Ash, Mars Music, Music123.com, Gbase.com, Harmony-Central.com

Sports Memorabilia: Beckett's, Collectors Universe, Mastro, Leylands, Superior

Toys, Bean Bag Plush: Amazon.com, KB Toys, ZanyBrainy.com, Wal-Mart.com

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

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

Books, Movies, Music: Amazon.com, Barnes & Noble, Barnesandnoble.com, Alibris.com, Blockbuster, BMG, Columbia House, Best Buy, CDNow, Express.com, Emusic.com

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

Computers & Consumer Electronics: Best Buy, Buy.com, Circuit City, Compaq, CompUSA, Dell, Egghead, Fry's Electronics, Gateway, The Good Guys, MicroWarehouse, Shopping.com, 800.com, Computer Discount Warehouse, PC Connection, computer and consumer electronics retailers

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

Jewelry: Ashford.com, Mondera.com

Pottery & Glass: Just Glass, Pottery Auction, Go CollectSporting Goods/Equipment: dsports.com, FogDog.com, Footlocker, Gear.com, golfclubexchange, MVP.com, PlanetOutdoors.com, Play It Again Sports, REI, Sports Authority, Sportsline.com

Tickets: Ticketmaster, Tickets.com

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

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Business-to-Business: Ariba, BidFreight.com, Bid4Assets, BizBuyer.com, bLiquid.com, Buyer Zone, CloseOutNow.com, Commerce One, Concur Technologies, DoveBid, FreeMarkets, Iron Planet, labx.com, Oracle, Overstock.com, PurchasePro.com, RicardoBiz.com, Sabre, SurplusBin.com, Ventro, VerticalNet

Additionally, we face competition from various online auction sites including: Amazon.com, the Fairmarket Auction Network, Surplus Auction, uBid, Yahoo! Auctions and a large number of other companies using an auction format for consumer-to-consumer or business-to-consumer sales. Overseas, we face competition from Yahoo! Auctions in most countries and from a large number of regional and national competitors in each country.

The principal competitive factors for eBay include the following:

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

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

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

Some current and potential competitors have longer company operating histories, larger customer bases and greater brand recognition in other business and Internet spaces than we do. Some of these competitors also have significantly greater financial, marketing, technical and other resources. Other online trading services may be acquired by, receive

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investments from or enter into other commercial relationships with larger, well-established and well-financed companies. As a result, some of our competitors with other revenue sources may be able to devote more resources to marketing and promotional campaigns, adopt more aggressive pricing policies and devote substantially more resources to website and systems development than we can. Increased competition may result in reduced operating margins, loss of market share and diminished value of our brand. Some of our competitors have offered services for free, and others may do this as well. We may be unable to compete successfully against current and future competitors.

In order to respond to changes in the competitive environment, we may, from time to time, make pricing, service or marketing decisions or acquisitions that could harm our business. For example, we have implemented an insurance program that generally insures items up to a value of \$200, with a \$25

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deductible, for users with a non-negative feedback rating at no cost to the user. New technologies may increase the competitive pressures by enabling our competitors to offer a lower cost service. Some Internet-based applications that direct Internet traffic to certain websites may channel users to trading services that compete with us.

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

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

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

The success of our service will depend largely on the development and maintenance of the Internet infrastructure. This includes maintenance of a reliable network backbone with the necessary speed, data capacity and security, as well as timely development of complementary products, for providing reliable Internet access and services. The Internet has experienced, and is likely to continue to experience, significant growth in the numbers of users and amount of traffic. If the Internet continues to experience increased numbers of users, increased frequency of use or increased bandwidth requirements, the Internet infrastructure may be unable to support the demands placed on it. In addition, the performance of the Internet may be harmed by increased number of users or bandwidth requirements or by "viruses", "worms" and similar programs. The Internet has experienced a variety of outages and other delays as a result of damage to portions of its infrastructure, and it could face outages and delays in the future. These outages and delays could reduce the level of Internet usage as well as the level of traffic and the processing transactions on our service.

Our business is subject to online commerce security risks

A significant barrier to online commerce and communications is the secure transmission of confidential information over public networks. Our security measures may not prevent security breaches. Our failure to prevent security breaches could harm our business. Currently, a significant number of our users authorize us to bill their credit card accounts directly for all transaction fees charged by us. Billpoint's users routinely provide credit card and other financial information. We rely on encryption and authentication technology licensed from third parties to provide the security and authentication technology to effect secure transmission of confidential information, including customer credit card numbers. Advances in computer capabilities, new discoveries in the field of cryptography or other developments may result in a compromise or

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breach of the technology used by us to protect customer transaction data. A number of websites have reported breaches of their security. Any compromise of our security could harm our reputation and, therefore, our business. In addition, a party who is able to circumvent our security measures could misappropriate proprietary information or cause interruptions in our operations. An individual has claimed to have misappropriated some of our confidential information by breaking into our

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computer system. We may need to expend significant resources to protect against security breaches or to address problems caused by breaches. These issues are likely to become more difficult as we expand the number of places where we operate. Security breaches could damage our reputation and expose us to a risk of loss or litigation and possible liability. Our insurance policies carry low coverage limits, which may not be adequate to reimburse us for losses caused by security breaches.

We must keep pace with rapid technological change to remain competitive

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

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

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

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

Our growth will depend on our ability to develop our brand

We believe that our historical growth has been largely attributable to word of mouth. We have benefited from frequent and high visibility media exposure both nationally and locally. We believe that continuing to strengthen our brand will be critical to achieving widespread acceptance of our service. Promoting and positioning our brand will depend largely on the success of our

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marketing efforts and our ability to provide high quality services. In order to promote our brand, we will need to increase our marketing budget and otherwise increase our financial commitment to creating and maintaining brand loyalty among users. Brand promotion activities may not yield increased revenues, and even if they do, any increased revenues may not offset the expenses we incurred in building our brand. If we do attract new users to our service, they may not conduct transactions over our service on a regular basis. If we fail to promote and maintain our brand or incur substantial expenses in an unsuccessful attempt to promote and maintain our brand, our business would be harmed.

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

We regard the protection of our URLs, copyrights, service marks, trademarks, trade dress and trade secrets as critical to our success. We rely on a combination of patent, copyright, trademark, service mark and trade secret laws and contractual restrictions to protect our proprietary rights in products and services. We have entered into confidentiality and invention assignment agreements with our employees and contractors, and nondisclosure agreements with parties with whom we conduct business in order to limit access to and disclosure of our proprietary information. These contractual arrangements and the other steps taken by us to protect our intellectual property may not prevent misappropriation of our technology or deter independent third-party development of similar technologies. We pursue the registration of our URLs, trademarks and service marks in the U.S. and internationally. Effective copyright, service mark, trademark, trade dress and trade secret protection is very expensive to maintain and may require litigation. Protection may not be available in every country in which our services are made available online. Furthermore, we must also protect our URLs in an increasing number of jurisdictions, a process that is expensive and may not be successful in every location. We have licensed in the

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past, and expect to license in the future, certain of our proprietary rights, such as trademarks or copyrighted material, to third parties. These licensees may take actions that might diminish the value of our proprietary rights or harm our reputation. We also rely on certain technologies that we license from third parties, such as Oracle Corporation, Microsoft and Sun Microsystems Inc., the suppliers of key database technologies, the operating system and specific hardware components for our service. These third-party technology licenses may not continue to be available to us on commercially reasonable terms. The loss of these technologies could require us to obtain substitute technologies of lower quality or performance standards or at greater cost.

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

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

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conditions are met. This restriction could have the effect of delaying or preventing a change of control.

We are controlled by certain stockholders, executive officers and directors

Our executive officers and directors (and their affiliates) own nearly 50% of our outstanding common stock. As a result, they have the ability to effectively control our company and direct our affairs and business, including the election of directors and approval of significant corporate transactions. This concentration of ownership may have the effect of delaying, deferring or preventing a change in control of our company and may make some transactions more difficult or even impossible without the support of these stockholders. Any of these events could decrease the market price of our common stock.

### ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

#### INTEREST RATE RISK

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

Investments in both fixed rate and floating rate interest earning instruments carry varying degrees of interest rate risk. Fixed rate securities may have their fair market value adversely impacted due to a rise in interest rates. In general, longer dated securities are subject to greater interest rate risk than shorter dated securities. While floating rate securities generally are subject to less interest rate risk than fixed rate securities, floating rate securities may produce less income than expected if interest rates decrease. Due in part to these factors, our investment income may fall short of expectations or we may suffer losses in principal if securities are sold that have declined in market value due to changes in interest rates. As of June 30, 2001, our fixed income investments earned a pretax yield of approximately 5.1% and had a weighted average maturity of 0.2 years. If interest rates were to instantaneously increase (decrease) by 100 basis points using a duration modeling technique, the fair market value of the total investment portfolio could decrease (increase) by approximately \$1.9 million. Assuming an average investment balance of \$750 million, if rates were to increase (decrease) by 100 basis points, this would translate to an increase (decrease) in interest income of \$7.5 million annually.

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

the total \$126.4 million operating lease. Of the \$126.4 million operating lease, the interest rate is fixed on \$95 million, with the balance of \$31.4 million remaining at a floating rate of interest based on the spread over 3-month LIBOR.

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If the 3-month LIBOR rates were to increase (decrease) by 100 basis points, then our lease payments would increase (decrease) by \$78,000 per quarter.

### EQUITY PRICE RISK

We are exposed to equity price risk on the marketable portion of equity investments we hold, typically as the result of strategic investments in strategic partners as such investments are subject to considerable market risk due to their volatility. We typically do not attempt to reduce or eliminate our market exposure in these equity investments.

### FOREIGN CURRENCY RISK

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

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## PART II: OTHER INFORMATION

### ITEM 1: LEGAL PROCEEDINGS

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

On April 25, 2001, our European subsidiaries, eBay GMBH and eBay International AG, were sued by Montres Rolex S.A. and certain Rolex affiliates ("Rolex") in the regional court of Cologne, Germany. Rolex alleged that our subsidiary was infringing Rolex's trademarks as result of users selling

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counterfeit Rolex watches through our German website. The suit also alleges unfair competition. Rolex is seeking an order forbidding the sale of Rolex watches on the website as well as damages. We believe that we have meritorious defenses against this claim and intend to defend ourselves vigorously.

Other third parties have from time to time claimed, in some cases through litigation, and others may claim in the future that we have infringed their past, current or future intellectual property rights. We may become more vulnerable to such claims as laws such as the Digital Millennium Copyright Act are interpreted by the courts and we expand into jurisdictions where the underlying laws with respect to the potential liability of our online intermediaries like ourselves is less favorable. We expect that we will increasingly be subject to infringement claims as the geographical reach of our services expands. These claims, whether meritorious or not, could be time-consuming, result in costly litigation, cause service upgrade delays, require expensive changes in our methods of doing business or could require us to enter into costly royalty or licensing agreements, if available. As a result, these claims could harm our business.

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

### ITEM 2: CHANGES IN SECURITIES AND USE OF PROCEEDS

On May 18, 2001, we completed our previously announced acquisition of iBazar S.A., a French company that introduced online person-to-person trading in France and currently has websites in Belgium, Brazil, France, Italy, the Netherlands, Portugal, Spain and Sweden. iBazar was acquired pursuant to a Contribution Agreement, dated February 21, 2001, by and among eBay, a wholly-owned Belgian subsidiary of eBay ("eBay Sub") and seven shareholders of iBazar (collectively, the "Shareholders"). In exchange for the contribution of the Shareholders' shares of iBazar to eBay Sub, we issued shares in eBay Sub exchangeable for 2,045,054 shares of our common stock. This transaction was exempt from the registration requirements of the Securities Act pursuant to Section 4(2) thereof or Rule 506 of the rules and regulations thereunder.

On June 1, 2001, we issued 24,194 shares of our common stock to John Slocum, the former owner of Blackthorne Software, as a portion of the consideration for the sale to us in December 1999 of the Blackthorne business. This transaction was exempt from the registration requirements of the Securities Act pursuant to Section 4(2) or Rule 505 of the rules and regulations thereunder.

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### ITEM 3: DEFAULTS UPON SENIOR SECURITIES

Not applicable.

### ITEM 4: SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

We held our Annual Meeting of Stockholders on May 25, 2001. The following is a brief description of each matter voted upon at the meeting and the number of votes cast for, withheld, or against and the number of abstentions with respect to each matter. The two directors proposed by eBay for re-election were elected to new, three-year terms by the following vote:



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DIRECTOR NAME -----	DIRECTOR SHARES VOTED FOR -----	SHARES WITHHELD AUTHORITY -----
Philippe Bourguignon	246,174,605	216,773
Margaret C. Whitman	234,475,302	11,916,076

The stockholders approved our 2001 Equity Incentive Plan: shares voted for: 212,058,684; shares voted against: 33,935,549; shares abstaining: 397,145.

The stockholders approved the appointment of the auditors: shares voted for: 244,383,462; shares voted against: 1,938,402; shares abstaining: 69,514.

### ITEM 5: OTHER INFORMATION

Not applicable.

### ITEM 6: EXHIBITS AND REPORTS ON FORM 8-K

#### (a) Exhibits.

10.15 Retention Bonus Plan between Registrant and Maynard Webb, dated January 10, 2001 (Corrected)\*

10.20 Retention Bonus Plan between Registrant and Jeffrey D. Jordan, dated April 3, 2001

\*Corrects the first three payment amounts that had been incorrectly calculated under the Retention Bonus Plan for Maynard Webb, dated January 10, 2001, previously filed as an Exhibit to the Registrant's 10-K for the fiscal year ended December 31, 2000.

#### (b) Reports on Form 8-K.

On June 1, 2001, we filed a report on Form 8-K announcing we had completed our acquisition of iBazar.

On June 15, 2001, we filed an amended report on Form 8-K/A providing the historical financial statements of iBazar S.A., and related unaudited pro forma financial information.

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### SIGNATURES

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

eBay INC.

Date: August 13, 2001

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PRINCIPAL EXECUTIVE OFFICER:

By: /s/ MARGARET C. WHITMAN

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Margaret C. Whitman  
President and  
Chief Executive Officer

PRINCIPAL FINANCIAL OFFICER

By: /s/ RAJIV DUTTA

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Rajiv Dutta  
Chief Financial Officer

PRINCIPAL ACCOUNTING OFFICER:

By: /s/ MARK J. RUBASH

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Mark J. Rubash  
Vice President, Finance and  
Chief Accounting Officer

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EXHIBIT INDEX

Exhibits

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