EBAY INC
Form 10-Q
May 15, 2003

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended March 31, 2003.

or

o 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	**77-0430924**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification Number)*
2145 Hamilton Avenue **San Jose, California**	**95125**
(Address of principal executive offices)	*(Zip Code)*

(408) 376-7400

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes þ No o

As of April 30, 2003, there were 317,497,841 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.

TABLE OF CONTENTS

Table of Contents

PART I: FINANCIAL INFORMATION

Item 1: *Financial Statements*

eBay Inc.

CONDENSED CONSOLIDATED BALANCE SHEET

	December 31, 2002	March 31, 2003
	(In thousands, except par value amounts) (Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$1,109,313	$1,554,418
Short-term investments	89,690	122,283
Accounts receivable, net	131,453	157,263
Funds receivable	41,014	83,885
Other current assets	96,988	95,825
Total current assets	1,468,458	2,013,674
Long-term investments	470,227	361,989
Restricted cash and investments	134,644	127,736
Property and equipment, net	218,028	241,800
Goodwill	1,456,024	1,470,867
Intangible assets, net	279,465	267,742
Deferred tax assets	84,218	76,861
Other assets	13,380	12,306
	$4,124,444	$4,572,975
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 47,424	$ 54,039
Funds payable and amounts due to customers	50,396	97,277
Accrued expenses and other current liabilities	199,323	218,022
Deferred revenue and customer advances	18,846	20,535
Short-term debt	2,970	3,340
Income taxes payable	67,265	71,642
Total current liabilities	386,224	464,855
Long-term debt	13,798	13,122
Deferred tax liabilities	111,843	106,677
Other liabilities	22,874	20,693
Minority interests	33,232	42,437
Total liabilities	567,971	647,784
Stockholders equity:		
Convertible Preferred Stock, $0.001 par value; 10,000 shares authorized; no shares issued or outstanding		
	311	316

Common Stock, $0.001 par value; 900,000 shares authorized: 311,277 and 315,777 shares issued and outstanding		
Additional paid-in capital	3,108,443	3,362,518
Unearned stock-based compensation	(5,253)	(3,267)
Retained earnings	414,474	518,666
Accumulated other comprehensive income	38,498	46,958
Total stockholders equity	3,556,473	3,925,191
	$4,124,444	$4,572,975

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

Table of Contents

eBay Inc.

CONDENSED CONSOLIDATED STATEMENT OF INCOME

	Three Months Ended March 31,	
	2002	2003
	(In thousands, except per share amounts) (Unaudited)	
Net revenues	$245,106	$476,492
Cost of net revenues	41,277	92,098
Gross profit	203,829	384,394
Operating expenses:		
Sales and marketing	73,104	123,760
Product development	24,307	34,332
General and administrative	32,493	63,000
Payroll expense on employee stock options	1,679	3,290
Amortization of acquired intangible assets	1,530	11,868
Total operating expenses	133,113	236,250
Income from operations	70,716	148,144
Interest and other income, net	7,387	7,704
Interest expense	(685)	(31)
Impairment of certain equity investments	(1,181)	(230)
Income before income taxes and minority interests	76,237	155,587
Provision for income taxes	(29,411)	(49,018)
Minority interests in consolidated companies	758	(2,378)
Net income	$ 47,584	$104,191
Net income per share:		
Basic	$ 0.17	$ 0.33
Diluted	$ 0.17	$ 0.32
Weighted average shares:		
Basic	278,332	313,658
Diluted	284,891	321,259

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

Table of Contents

eBay Inc.

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Three Months Ended March 31,	
	2002	**2003**
	(In thousands) (Unaudited)	
Net income	$47,584	$104,191
Other comprehensive income (loss):		
Foreign currency translation	(5,101)	8,382
Unrealized losses on investments, net	(3,553)	(1,127)
Investment losses included in net income		353
Unrealized gains on cash flow hedges	1,299	681
Estimated tax benefit	887	171
Net change in other comprehensive income (loss)	(6,468)	8,460
Comprehensive income	$41,116	$112,651

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

Table of Contents

eBay Inc.

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

	Three Months Ended March 31,	
	2002	2003
	(In thousands) (Unaudited)	
Cash flows from operating activities:		
Net income	$ 47,584	$ 104,191
Adjustments:		
Provision for doubtful accounts and authorized credits	8,148	9,137
Provision for transaction losses		8,993
Depreciation and amortization	13,011	32,020
Amortization of unearned stock-based compensation	913	2,272
Tax benefit on the exercise of employee stock options	29,411	41,340
Impairment of certain equity investments	1,181	230
Minority interests and other	(2,042)	1,778
Changes in assets and liabilities, net of effect of acquisitions:		
Accounts receivable	(27,832)	(34,824)
Funds receivable		(42,871)
Other current assets	(1,561)	1,258
Other non-current assets	1,218	1,140
Deferred tax assets	(2,411)	616
Accounts payable	507	6,826
Due to customers and funds payable		46,881
Accrued expenses and other liabilities	21,041	4,904
Deferred revenue and customer advances	732	1,744
Income taxes payable	2,373	4,371
Net cash provided by operating activities	92,273	190,006
Cash flows from investing activities:		
Purchases of property and equipment	(11,494)	(43,908)
Purchases of investments	(208,245)	(135,153)
Maturities and sales of investments	200,509	218,360
Acquisitions, net of cash acquired	(43,557)	(4,389)
Net cash provided by (used in) investing activities	(62,787)	34,910
Cash flows from financing activities:		
Proceeds from issuance of common stock, net	27,004	217,385
Principal payments on long-term debt	(3,296)	(307)
Net cash provided by financing activities	23,708	217,078
Effect of exchange rate changes on cash and cash equivalents	(312)	3,111
Net increase in cash and cash equivalents	52,882	445,105
Cash and cash equivalents at beginning of period	523,969	1,109,313
Cash and cash equivalents at end of period	$ 576,851	$ 1,554,418

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

Table of Contents

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 March 31, 2003, through our wholly-owned and majority-owned subsidiaries and affiliates, we had websites directed towards the United States, Australia, Austria, Belgium, Canada, France, Germany, Ireland, Italy, the Netherlands, New Zealand, Singapore, South Korea, Spain, Sweden, Switzerland, Taiwan and the United Kingdom. We 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. Through our PayPal service, we enable any business or consumer with email to send and receive online payments.

On October 3, 2002, we completed our acquisition of PayPal, Inc. or PayPal in a tax-free, stock-for-stock transaction. PayPal provides an online global payments platform and is headquartered in Mountain View, California. The PayPal financial statements are included in our consolidated financial statements from October 4, 2002.

In this document we , our and us refer to eBay Inc. and its subsidiaries, unless the context otherwise requires.

Use of Estimates

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

Principles of Consolidation and Basis of Presentation

The accompanying condensed consolidated financial statements include 100 percent of the assets and liabilities of eBay and our majority-owned subsidiaries and the interests of minority investors are recorded as minority interests. All significant intercompany balances and transactions have been eliminated in consolidation. Investments in entities where we hold more than a 20 percent but less than a 50 percent ownership interest and have the ability to significantly influence the operations of the investee are accounted for using the equity method of accounting and the investment balance is included in long term investments, while our share of the investees operations is included in other income.

Certain prior period balances have been reclassified to conform to the current period presentation.

Stock-based Compensation

Consistent with predominant industry practice, we account for stock-based employee compensation arrangements using the intrinsic value method, which calculates compensation expense based on the difference, if any, on the date of the grant, between the fair value of our stock and the exercise price. Generally accepted accounting principles require companies who choose to account for stock option grants using the intrinsic value method to also determine the fair value of option grants using the Black-Scholes model and to disclose the impact of fair value accounting in a note to the financial statements. The impact of recognizing

Table of Contents

eBay Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

the fair value of option grants as an operating expense would have substantially reduced our net income, as follows (in thousands, except per share amounts):

	Three Months Ended March 31,	
	2002	2003
Net income, as reported	$ 47,584	$ 104,191
Add: Amortization of stock-based compensation expense determined under the intrinsic value method	913	2,272
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of tax	(47,314)	(29,643)
Pro forma net income	$ 1,183	$ 76,820
Earnings per share:		
Basic as reported	$ 0.17	$ 0.33
pro forma	$ 0.00	$ 0.24
Diluted as reported	$ 0.17	$ 0.32
pro forma	$ 0.00	$ 0.24

We account for stock-based arrangements issued to non-employees using the fair value based method, which calculates compensation expense based on the fair value of the stock granted using the Black-Scholes option pricing model at the date of grant.

Recent Accounting Pronouncements

Consolidation of Variable Interest Entities

In January 2003, the FASB issued FIN 46, Consolidation of Variable Interest Entities, which would require us to include our San Jose facilities lease arrangement in our Consolidated Financial Statements effective July 1, 2003. Under this new accounting standard, our balance sheet subsequent to July 1, 2003, would reflect additions for office properties totaling $126.4 million, lease obligations of $122.5 million and non-controlling minority interests of $3.9 million. Our income statement subsequent to July 1, 2003, would reflect the reclassification of our San Jose facilities lease payments from operating expense to interest expense on the related lease obligations, a $5.6 million after-tax charge for depreciation for periods from lease inception through July 1, 2003, and incremental depreciation expense for periods subsequent to July 1, 2003.

In the event that we terminate the lease arrangement and acquire ownership of the San Jose facilities prior to the adoption of FIN 46, we would not incur the cumulative depreciation charge of $5.6 million; instead, the $126.4 million cost of acquiring the facilities would be allocated between land and buildings, with the amount allocated to buildings being depreciated over the estimated useful life of the facilities. In addition, we would settle our two interest rate swaps used to establish a fixed rate of interest for $95 million of our financing arrangement. At March 31, 2003, settlement of our two interest rate swaps in connection with a lease termination would have resulted in a pre-tax loss of $10.2 million.

We have not yet decided whether we will keep the existing lease financing arrangement or terminate the arrangement and acquire ownership of the facilities. Whether or not we keep the existing lease financing arrangement, we anticipate recording incremental annual operating expenses of $1.7 million, net of taxes, for the recognition of depreciation expense on the buildings.

Table of Contents

eBay Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Amendment of SFAS 133

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

Note 2 Net Income Per Share

Basic net income per share is computed by dividing the net income 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 potentially dilutive shares outstanding during the period. Potentially dilutive securities, composed of unvested, restricted common stock and incremental common shares issuable upon the exercise of stock options and warrants, are included in diluted net income per share to the extent such shares are dilutive.

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

	Three Months Ended March 31,	
	2002	2003
Numerator:		
Net income	$ 47,584	$ 104,191
Denominator:		
Weighted average common shares	278,755	313,715
Weighted average unvested restricted common stock	(423)	(57)
Denominator for basic calculation	278,332	313,658
Weighted average effect of dilutive securities:		
Weighted average unvested restricted common stock	423	57
Employee stock options	6,136	7,544
Denominator for diluted calculation	284,891	321,259
Net income per share:		
Basic	$ 0.17	$ 0.33
Diluted	$ 0.17	$ 0.32

A number of potentially dilutive shares were excluded from the calculation of diluted net income per share because they were anti-dilutive. For the three months ended March 31, 2002 and March 31, 2003, this number amounted to approximately 1.3 million and 2.0 million shares, respectively.

8

Table of Contents

eBay Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3 Business Combinations, Goodwill and Intangible Assets

Pro Forma Financial Information

The following unaudited pro forma financial information presents the combined results of eBay and PayPal as if the acquisitions had occurred as of the beginning of 2002, after applying certain adjustments, including amortization of acquired intangible assets and other acquisition related transactions (in thousands except per share amounts):

	Three Months Ended March 31,	
	2002	2003
	(Unaudited)	
Net revenues	$293,867	$476,492
Net income	$ 47,729	$104,191
Net income per share:		
Basic	$ 0.16	$ 0.33
Diluted	$ 0.15	$ 0.32

The pro forma financial information does not necessarily reflect the results of operations that would have occurred had eBay and PayPal constituted a consolidated entity during such periods. See Note 1 The Company and Summary of Significant Accounting Policies, Recent Accounting Pronouncements.

Goodwill

Goodwill information for each reportable segment is as follows (in thousands):

	December 31, 2002	Goodwill Acquired	Goodwill Disposed of	Adjustments	March 31, 2003
Segments:					
U.S.	$ 118,649	$3,987	$	$	$ 122,636
International	294,761			5,839	300,600
Payments	1,061,867			5,017	1,066,884
	$1,475,277	$3,987	$	$10,856	$1,490,120

The increase in goodwill during the three months ended March 31, 2003 resulted from business acquisitions and from purchase price and foreign currency translation adjustments relating to goodwill associated with prior period acquisitions. Goodwill of approximately $4.0 million resulted from our January 2003 acquisition of CARad Inc., a provider of online auction management services for car dealers. Purchase price adjustments related to our October 2002 acquisition of PayPal resulted in $5.0 million of additional goodwill and are included in the adjustments column. Foreign currency translation adjustments of $5.8 million are included in the adjustments column.

eBay Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Intangible Assets

The components of acquired identifiable intangible assets are as follows (in thousands):

	December 31, 2002			March 31, 2003		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Intangible assets:						
Developed technologies	$ 27,825	$ (8,353)	$ 19,472	$ 28,095	$ (10,379)	$ 17,716
Customer lists	208,811	(10,723)	198,088	209,254	(18,420)	190,834
Trademarks	65,140	(3,235)	61,905	66,935	(6,090)	60,845
All other	733	(733)		733	(733)	
	$ 302,509	$ (23,044)	$ 279,465	$ 305,017	$ (35,622)	$ 269,395

All of our acquired identifiable intangible assets are subject to amortization. Acquired identifiable intangible assets are comprised of developed technologies, customer lists, trademarks, and other acquired intangible assets including contractual agreements. Developed technologies are being amortized over a weighted average period of approximately three years. Customer lists are being amortized over a weighted average period of approximately seven years. Trademarks are being amortized over a weighted average period of approximately seven years. No significant residual value is estimated for the intangible assets. Aggregate amortization expense for intangible assets totaled $1.1 million and $11.9 million for the three months ended March 31, 2002 and 2003, respectively.

As of March 31, 2003, expected future intangible asset amortization expense is as follows (in thousands):

Fiscal Years:	
2003 (remaining nine months)	$ 36,298
2004	47,648
2005	44,405
2006	38,488
2007	37,212
Thereafter	65,344
	$ 269,395

We account for our investment in 33% of EachNet using the equity method of accounting and the total investment, including identifiable intangible assets, deferred tax liabilities and goodwill, is classified on our balance sheet as a long-term investment. As of March 31, 2003, the goodwill resulting from the acquisition of our 33% interest totaled $19.3 million and identifiable intangible assets totaled $1.7 million.

Note 4 Segment Information

Segment selection is based upon our internal organization structure, the manner in which our operations are managed, the measurement of the performance of our operations evaluated by management in the chief operating decision-maker capacity, the availability of separate financial information, and overall materiality considerations.

We have identified three reporting segments: U.S., International and Payments. The U.S. segment comprises U.S. online trading platforms other than those of our PayPal and Billpoint subsidiaries. The International segment comprises our international online trading platforms. The Payments segment comprises

Table of Contents

eBay Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

our global payments platform consisting of PayPal and Billpoint. The payments amounts reflect Billpoint s historical operations and PayPal s operations for the post-acquisition periods subsequent to the October 3, 2002 acquisition. We have previously announced that we intend to discontinue Billpoint s operations in the first half of 2003. Billpoint s operations will continue to be reflected in the Payments segment results until the wind-down of Billpoint s operations is complete.

Direct contribution consists of revenues less direct costs. Direct costs include specific costs of net revenues, sales and marketing expenses, and general and administrative expenses over which segment managers have direct discretionary control, such as advertising and marketing programs, customer support expenses, bank charges, provisions for doubtful accounts, authorized credits and transaction losses. Expenses over which segment managers do not have discretionary control, such as site operations costs, product development expenses, and general and administrative costs, are monitored by management through shared cost centers and are not evaluated in the measurement of segment performance.

The following tables illustrate the financial performance of our reporting segments (in thousands):

	Three Months Ended March 31,							
	2002				2003			
	U.S.	International	Payments	Consolidated	U.S.	International	Payments	Consolidated
	(Unaudited)							
Net revenues from external customers	$187,768	$52,551	$4,787	$245,106	$242,469	$138,817	$95,206	$476,492
Direct costs	69,153	23,954	5,413	98,520	92,422	50,868	54,867	198,157
Direct contribution	118,615	28,597	(626)	146,586	150,047	87,949	40,339	278,335
Operating expenses and indirect costs of sales				75,870				130,191
Income from operations				70,716				148,144
Interest and other income, net				7,387				7,704
Interest expense				(685)				(31)
Impairment of certain equity investments				(1,181)				(230)
Income before income taxes and minority interests				$ 76,237				$155,587

	December 31, 2002				March 31, 2003			
	U.S.	International	Payments	Consolidated	U.S.	International	Payments	Consolidated
Total assets	$1,858,235	$583,252	$1,682,957	$4,124,444	$2,097,202	$702,581	$1,773,192	$4,572,975

The following tables illustrate our financial performance by geography (in thousands):

	Three Months Ended March 31,	
	2002	2003
United States net revenues	$192,555	$319,170
International net revenues	52,551	157,322
Net revenues	$245,106	$476,492

eBay Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	December 31, 2002	March 31, 2003
United States long-lived assets	$1,648,753	$1,669,927
International long-lived assets	304,765	310,482
Total long-lived assets	$1,953,518	$1,980,409

Note 5 Investments

At December 31, 2002 and March 31, 2003, short and long-term investments were classified as available-for-sale securities, except for restricted cash and investments, and are reported at fair value as follows (in thousands):

	December 31, 2002			
	Gross Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Short-term investments:				
Municipal bonds and notes	$ 46,158	$ 157	$	$ 46,315
Government securities				
Time deposits and other	43,299	152	(76)	43,375
Total	$ 89,457	$ 309	$ (76)	$ 89,690
Long-term investments:				
Restricted cash and investments	$133,541	$1,103	$	$134,644
Municipal bonds and notes	388,535	2,320		390,855
Government securities	35,232	281	(291)	35,222
Equity investments	44,150			44,150
Total	$601,458	$3,704	$(291)	$604,871

	March 31, 2003			
	Gross Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Short-term investments:				
Municipal bonds and notes	$ 71,872	$ 717	$	$ 72,589
Government securities				
Time deposits and other	49,401	293		49,694
Total	$121,273	$1,010	$	$122,283

Long-term investments:				
Restricted cash and investments	$127,114	$ 793	$(171)	$127,736
Municipal bonds and notes	285,384	1,239	(59)	286,564
Government securities	32,146	122	(62)	32,206
Equity investments	43,219			43,219
Total	$487,863	$2,154	$(292)	$489,725

Table of Contents

eBay Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The estimated fair value of short and long-term investments classified by date of contractual maturity at March 31, 2003, are as follows (in thousands):

	March 31, 2003
One year or less	$122,283
One year through two years	153,856
Two years through three years	143,705
Three years through four years	21,209
Restricted cash and investments expiring in less than four years	127,736
Equity investments	43,219
	$612,008

During the three months ended March 31, 2003 and March 31, 2002, we recorded impairment charges totaling $230,000 and $1.2 million, respectively, as a result of the deterioration of the financial condition of certain of our private equity investees. These impairment losses are identified as part of our normal process of assessing the quality of our investment portfolio and reflect declines in fair value and other market conditions that we believe are other than temporary.

Note 6 Property and Equipment

	December 31, 2002	March 31, 2003
	(In thousands)	
Property and equipment, net:		
Computer equipment and software	$ 266,589	$ 296,313
Land and buildings	31,926	41,913
Aviation equipment	30,473	30,473
Furniture and fixtures	18,916	23,548
Leasehold improvements	19,345	22,455
Vehicles and other	12,540	9,198
	379,789	423,900
Accumulated depreciation and amortization	(161,761)	(182,100)
	$ 218,028	$ 241,800

During the three months ended March 31, 2003, we capitalized $4.7 million of software development costs associated with the development of site features and functionality improvements, the development of our V3 platform architecture and the development of seller tools. At December 31, 2002 and March 31, 2003, unamortized software development costs totaled $21.4 million and $23.3 million, respectively. Total depreciation expense for property and equipment was $11.9 million and $20.2 million for the three months ended March 31, 2002 and 2003, respectively.

Note 7 Contingencies

Litigation and Other Legal Matters

On April 25, 2001, our European subsidiaries, eBay GmbH and eBay International AG, were sued by Montres Rolex S.A. and certain Rolex affiliates, or Rolex, in the regional court of Cologne, Germany. The suit subsequently was transferred to the regional court in Dusseldorf, Germany. Rolex alleged that our subsidiaries

Table of Contents

eBay Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

were infringing Rolex s trademarks as a result of users selling counterfeit Rolex watches through our German website. The suit also alleged unfair competition. Rolex sought an order forbidding the sale of Rolex watches on the website as well as damages. In December 2002, a trial was held in the matter and the court ruled in favor of eBay on all causes of action. Rolex has appealed the ruling, but the appeal has not yet been briefed or heard.

On September 26, 2001, a complaint was filed by MercExchange LLC against us, our Half.com subsidiary and ReturnBuy, Inc. in the Eastern District of Virginia (No. 2:01-CV-736) alleging infringement of three patents (relating to online auction technology, multiple database searching and electronic consignment systems) and seeking a permanent injunction and damages (including treble damages for willful infringement). We answered the complaint, denying the allegations. In April 2002, we filed four motions for summary judgment relating to the three patents in suit. The court denied three of those motions and deferred ruling on the fourth motion. A Markman hearing was held in July 2002 to define certain disputed terms in the patents, and in October 2002 the court issued its claim construction findings. In October 2002, the court gave us leave to amend our answer to include a claim that MercExchange committed fraud on the patent office during the prosecution of one of the patents. On the same date, the court granted in part our pending summary judgment motion, effectively invalidating the patent related to online auction technology and rendering it unenforceable. This ruling also substantially reduced MercExchange s ability to claim damages. In November 2002, we filed two additional summary judgment motions regarding the patents. One motion was denied as moot; the other was denied because the court found there were triable issues of fact. In February 2003, we filed an additional summary judgment motion, which was subsequently denied. Only two patents remain in the case at this time. Trial of the matter began on April 23, 2003. We believe we have meritorious defenses and will defend ourselves vigorously. However, even if successful, our defense against this action will be costly and could divert our management s time. If the plaintiff were to prevail on any of its claims, we might be forced to pay significant damages and licensing fees, modify our business practices or even be enjoined from conducting a significant part of our U.S. business. Any such results could materially harm our business. We are unable to determine what potential losses we may incur if this lawsuit were to have an unfavorable outcome.

On September 6, 2002, a complaint was filed by First USA Bank, N.A. against PayPal in the District of Delaware (No. 02-CV-1462) alleging infringement of two patents relating to assigning an alias to a credit card so as to eliminate the need for the physical presence of the card in a financial transaction and seeking a permanent injunction and damages. Factual discovery in the case is scheduled to end June 25, 2003, expert discovery is scheduled to take place from July to September 2003, and trial is scheduled for March 1, 2004. PayPal believes it has meritorious defenses and intends to defend itself vigorously. However, even if successful, our defense against this action will be costly and could divert management s time. If the plaintiff were to prevail on its claims, PayPal might be forced to pay significant damages and licensing fees or modify its business practices. Any such result could materially harm our business. We are unable to determine what potential losses we may incur if this suit were to have an unfavorable outcome.

On August 16, 2002, Charles E. Hill & Associates, Inc., or Hill, filed a lawsuit in the U.S. District Court for the Eastern District of Texas (No. 2:02-CV-186) alleging that we and 17 other companies, primarily large retailers, infringed three patents owned by Hill generally relating to electronic catalog systems and methods for transmitting and updating data at a remote computer. The suit seeks an injunction against continuing infringement, unspecified damages, including treble damages for willful infringement, and interest, costs, expenses and fees. In January 2003, the court granted the collective defendants motion to transfer the case from the court where it was filed in Marshall, Texas to the Federal District Court for the Southern District of Indiana. We believe that we have meritorious defenses and intend to defend ourselves vigorously.

On February 20, 2002, PayPal was sued in California state court in a purported class action alleging that its restriction of customer accounts and failure to promptly unrestrict legitimate accounts violates state consumer protection law and is an unfair business practice and a breach of PayPal s User Agreement. This

Table of Contents

eBay Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

action was refiled with a different named plaintiff on June 6, 2002, and a related action was filed in the U.S. District Court for the Northern District of California on the same day. On March 12, 2002, PayPal was sued in the U.S. District Court for the Northern District of California in a purported class action alleging that its restrictions of customer accounts and failure to promptly unrestrict legitimate accounts violates federal and state consumer protection and unfair business practice law. The federal court has denied PayPal s motion to compel individual arbitration as required by the PayPal User Agreement and has invalidated that provision of the User Agreement. PayPal has appealed that decision to the U.S. Court of Appeals for the Ninth Circuit. The two federal court actions have been consolidated into a single case. PayPal is defending itself vigorously, but if it is unable to prevail in these lawsuits, it may have to change its anti-fraud operations in a manner that will harm its business and pay substantial damages. Even if its defense is successful, the litigation could damage PayPal s reputation, could require significant management time, will be costly and could require changes to its customer service and operations that could increase its costs and decrease the effectiveness of its anti-fraud program.

Three purported class action complaints were filed following announcement of the PayPal merger in July 2002 in the court of Chancery in the State of Delaware in and for New Castle County by alleged stockholders of PayPal. Two additional purported class action complaints were filed in the Superior Court of the State of California, County of Santa Clara, by alleged PayPal stockholders. These complaints name as defendants PayPal and each member of its board of directors as well as eBay. The complaints are purported class actions that allege, among other things, that eBay controlled PayPal prior to the execution of their merger agreement, the defendants breached fiduciary duties they assertedly owed to PayPal s stockholders in connection with PayPal entering into the merger agreement and the exchange ratio in the merger is unfair and inadequate. The plaintiffs seek, among other things, an award of unspecified compensatory damages. We believe that each of the lawsuits is without merit and intend to defend ourselves vigorously.

PayPal completed its exit from the business of processing payments for online gambling merchants in November 2002. Approximately 6% of PayPal s revenues in 2002 were derived from this business. Beginning in July 2002, PayPal provided documents and information related to its services to online gambling merchants in response to a federal grand jury subpoena issued at the request of the U.S. Attorney for the Eastern District of Missouri. On March 28, 2003, PayPal received a letter from the U.S. Attorney for the Eastern District of Missouri indicating its contention that PayPal s provision of services to online gambling merchants violated 18 U.S.C. § 1960 of the USA PATRIOT Act, which prohibits the transmission of funds that are known to have been derived from a criminal offense or are intended to be used to promote or support unlawful activity, thereby subjecting PayPal to potential civil forfeiture of the amounts it received in connection with such activities as well as potential criminal liability. The letter offered a complete settlement of all possible claims and charges from the U.S. Attorney for the Eastern District of Missouri if PayPal paid the purported amount of its earnings derived from online gambling merchants during the nine-month period from October 26, 2001 to July 31, 2002, plus interest. PayPal acted in the good faith belief that its conduct did not violate 18 U.S.C. § 1960 and PayPal calculates that the amount of its earnings from online gaming activities was less than asserted in the letter. Although the outcome of this matter is not yet determinable, the monetary amounts associated with this matter are not expected to have a material impact on our financial position, results of operations or cash flows.

Other third parties have from time to time claimed, and others may claim in the future that we have infringed their past, current or future intellectual property rights. We have in the past been forced to litigate such claims. 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 copyright and trademark infringement claims as the geographical reach of our services expands. We also expect that we will increasingly be subject to patent infringement claims as our services expand. In particular, we expect that patent infringement claims involving various aspects of our

Table of Contents

eBay Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Payments business will continue to be made. We have been notified of several potential intellectual property disputes and are subject to a suit by Tumbleweed Communications Corporation that is currently ongoing. 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 other disputes that arise in the ordinary course of business. We believe that the ultimate resolution of these disputes will not have a material adverse impact on our financial position, results of operations or cash flows.

Note 8 Employee Benefit Plans

Employee Stock Purchase Plan

We have an employee stock purchase plan for all eligible employees. Under the plan, shares of our common stock may be purchased over an offering period with a maximum duration of two years at 85% of the lower of the fair market value on the first day of the applicable offering period or on the last day of the six-month purchase period. Employees may purchase shares having a value not exceeding 10% of their gross compensation during an offering period. No shares were purchased during the three months ended March 31, 2002 and 2003. At March 31, 2003, approximately 1.8 million shares were reserved for future issuance. On each January 1, the aggregate number of shares reserved for issuance under the employee stock purchase plan will be increased automatically by the number of shares purchased under this plan in the preceding calendar year.

Stock Option Plans

We have stock option plans for directors, officers and employees, under which we have made to date only nonqualified and incentive stock option grants. These stock options generally vest 25% one year from the date of grant and the remainder vests at a rate of 2.08% per month and expire 10 years from the date of grant. Stock options issued prior to June 1998 were exercisable immediately, subject to repurchase rights held by us, which lapse over the vesting period. At March 31, 2003, stock options for 15.8 million shares were available for future grant.

The following table summarizes activity under our stock option plans for the three months ended March 31, 2002 and 2003 (shares in thousands):

	Three Months Ended March 31,			
	2002		2003	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of period	35,097	$46.24	37,176	$53.73
Granted	6,540	58.59	7,331	78.51
Exercised	(2,536)	10.77	(4,502)	46.30
Cancelled	(617)	54.94	(903)	60.95
Outstanding at end of period	38,484	50.54	39,102	59.06
Options exercisable at end of period	10,717	47.88	11,312	54.81
		$26.11		$31.97

Weighted average grant date fair value of options granted during period		

16

Table of Contents

eBay Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes information about fixed stock options outstanding at March 31, 2003 (shares in thousands):

	Options Outstanding at March 31, 2003			Options Exercisable at March 31, 2003	
Range of Exercise Prices	Number of Shares Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number of Shares Exercisable	Weighted Average Exercise Price
$ 0.02 - $ 40.06	7,619	7.4 years	$30.63	3,157	$20.96
$41.63 - $ 56.30	7,263	8.7	52.67	1,499	49.16
$56.32 - $ 60.55	6,774	8.8	58.34	1,195	58.37
$60.65 - $ 72.97	6,842	8.2	65.39	2,496	65.51
$73.18 - $ 77.55	7,525	9.1	76.79	1,484	75.39
$77.56 - $116.31	3,079	8.1	88.69	1,481	91.19
	39,102	8.4	$59.06	11,312	$54.81

	Exercisable		Unexercisable		Total	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
In-the-Money	10,306	$50.89	26,869	$59.78	37,175	$57.32
Out-of-the-Money	1,006	95.02	921	90.20	1,927	92.72
Total options outstanding	11,312	$54.81	27,790	$60.79	39,102	$59.06

In-the-money options are options with an exercise price lower than the $85.31 closing price of our common stock on March 31, 2003. Out-of-the-money options are options with an exercise price greater than the $85.31 closing price of our common stock on March 31, 2003.

	Three Months Ended March 31,	
	2002	2003
Grants during period as percent of outstanding shares	2%	2%
Total outstanding grants in-the-money as a percent of outstanding shares	7%	12%
Total outstanding grants as a percent of outstanding shares	14%	12%
Grants to named officers as a percent of total grants during the period*	13%	17%
Grants to named officers as a percent of total outstanding shares*	0%	0%
Total outstanding grants to named officers as a percent of total outstanding grants*	10%	12%

Total outstanding grants to named officers as a percent of total outstanding shares*	1%	1%

* Named officers are the chief executive officer and the other four most highly-compensated executive officers during the twelve months ended December 31, 2002.

Table of Contents

eBay Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Fair Value Disclosures

We calculated the fair value of each option grant on the date of grant using the Black-Scholes option pricing model. The following are the assumptions used for each respective period:

	Three Months Ended March 31,	
	2002	**2003**
Risk-free interest rates	3.75%	2.1%
Expected lives (in years)	3.0	3.0
Dividend yield	0%	0%
Expected volatility	68%	68%

For options granted prior to our initial public offering, the fair value of option grants was determined using the Black-Scholes option pricing model with a zero volatility assumption. For options granted subsequent to our initial public offering, the fair value of option grants was determined using the Black-Scholes option pricing model with volatility assumptions based on actual or expected fluctuations in the price of our common stock.

Note 9 Subsequent Events

Property Purchase

On April 22, 2003, we entered agreements to purchase certain developed commercial real property consisting of a five-building office campus located in San Jose, California and certain undeveloped land that is adjacent to this property. The purchase price for the campus is \$95.0 million. The purchase price for the undeveloped land adjacent to the campus is approximately \$29.2 million. With respect to the campus, we made initial deposits of \$5.0 million through May 1, 2003. The balance of the purchase price for the campus is to be paid by us on or before the expected closing date of June 30, 2003. The undeveloped land is subject to an agreement between the current owner and the City of San Jose. The City has agreed to assign its interest in the undeveloped land to us. The balance of the purchase price for the land is to be paid by us on or before the expected closing date of May 27, 2003. Our plan following the closing of these purchases is to occupy approximately one-half of the existing campus, with the balance of the rentable area to be occupied by the current tenants.

Table of Contents

Item 2: ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

FORWARD LOOKING STATEMENTS

This quarterly report on Form 10-Q contains forward-looking statements based on our current expectations about our company and our industry. You can identify these forward-looking statements when you see us using words such as may, will, should, expect, anticipate, beli estimate, intend, plan and other similar expressions. You can also identify forward-looking statements by discussions of strategy, plans or intentions. These forward-looking statements involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of the factors described in the Risk Factors That May Affect Results of Operations and Financial Condition section below and elsewhere in this report. All forward-looking statements are qualified by and should be read in conjunction with those risk factors. Except as may be required by applicable law, we undertake no obligation to publicly update any forward-looking statements for any reason, even if new information becomes available or other events occur in the future.

Overview

About eBay

We pioneered online trading by developing a Web-based marketplace in which a community of buyers and sellers are brought together in an entertaining, intuitive, easy-to-use environment to browse, buy and sell an enormous variety of items. Through our PayPal service, we enable any business or consumer with email to send and receive online payments securely, conveniently and cost-effectively.

Results of Operations

	Three Months Ended March 31,	
	2002	**2003**
Net revenues	100.0%	100.0%
Cost of net revenues	16.8	19.3
Gross profit	83.2	80.7
Operating expenses:		
Sales and marketing	29.8	26.0
Product development	9.9	7.2
General and administrative	13.3	13.2
Payroll taxes on stock option gains	0.7	0.7
Amortization of acquired intangible assets	0.6	2.5
Total operating expenses	54.3	49.6
Income from operations	28.9	31.1
Interest and other income, net	3.0	1.6
Interest expense	(0.3)	(0.0)
Impairment of certain equity investments	(0.5)	(0.0)
Income before income taxes and minority interests	31.1	32.7
Provision for income taxes	(12.0)	(10.3)
Minority interests in consolidated companies	0.3	(0.5)

Net income	19.4%	21.9%

Table of Contents

Net Revenues

	Three Months Ended March 31, 2002	Percent Change	Three Months Ended March 31, 2003
	(In thousands, except percent changes)		
Transaction net revenues			
U.S.	$157,153	49%	$234,876
International	51,724	166%	137,504
Payments	4,787	1,847%	93,179
Total transaction net revenues	213,664	118%	465,559
3rd party advertising net revenues			
U.S.	18,206	(70)%	5,492
International	827	59%	1,313
Payments			2,027
Total 3rd party advertising net revenues	19,033	(54)%	8,832
End-to-end services net revenues			
U.S.	4,869	(57)%	2,101
Total end-to-end services net revenues	4,869	(57)%	2,101
Offline net revenues	7,540	(100)%	
Total net revenues	$245,106	94%	$476,492
U.S. segment net revenues	$187,768	29%	$242,469
International segment net revenues	52,551	164%	138,817
Payments segment net revenues	4,787	1,889%	95,206
	$245,106	94%	$476,492

Net Revenues by Geography

	Three Months Ended March 31, 2002	Percent Change	Three Months Ended March 31, 2003
	(In thousands, except percent changes)		
U.S. net revenues	$192,555	66%	$319,170
International net revenues	52,551	199%	157,322
Total net revenues	$245,106	94%	$476,492

Net revenues are allocated between U.S. and International geographies based upon the country in which the seller, payment recipient, advertiser or end-to-end service provider is located.

20

	Three Months Ended March 31, 2002	Percent Change	Three Months Ended March 31, 2003
	(In millions, except percentages)		
Supplemental Operating Data:			
Confirmed registered users	46.1	49%	68.8
Active users	19.8	57%	31.1
Number of items listed	138.0	59%	219.7
Gross merchandise sales	$3,107	71%	$5,317
PayPal accounts			27.2
PayPal number of payments			50.5
PayPal total payment volume			$2,628

Our net revenues result from fees associated with our transaction, third-party advertising and end-to-end services in our U.S., International and Payments segments. Transaction revenue is derived primarily from listing, feature and final value fees paid by sellers and fees from payment processing services. Revenue from third-party advertising is derived principally from the sale of online banner and sponsorship advertisements for cash and through barter arrangements. End-to-end services revenue is derived principally from contractual arrangements with third parties that provide transaction services to eBay users. Offline services revenue was derived from a variety of sources including seller commissions, buyer premiums, bidder registration fees and auction-related services including appraisal and authentication. We divested our offline subsidiaries during the third and fourth quarters of 2002.

The growth in net revenues from the three months ended March 31, 2002 to the three months ended March 31, 2003, was primarily the result of increased auction transaction activity, reflected in the growth of the number of registered users, listings and gross merchandise sales and our acquisition of PayPal in October 2002 which contributed approximately 20% of our net revenues during the three months ended March 31, 2003.

Revenue from U.S. and International Segments

Transaction Net Revenue

U.S. segment transaction net revenue increased 49% from the three months ended March 31, 2002 to the three months ended March 31, 2003. International segment transaction net revenue increased 166% over the same period. The growth in U.S. and International segment transaction net revenues was primarily the result of increased auction transaction activity, reflected in the growth of the number of registered users, listings and gross merchandise sales. We experienced transaction net revenue growth across all categories from the three months ended March 31, 2002 to the three months ended March 31, 2003, with motors, computers, consumer electronics, collectibles, and books/ music/ movies making the most significant impact. International segment transaction net revenue as a percentage of consolidated transaction net revenue was 24% in the three months ended March 31, 2002 and 30% in the three months ended March 31, 2003. This growth is primarily the result of strong performance in Germany, the United Kingdom, Canada and South Korea. We expect international segment transaction net revenues will continue to grow in significance to our business as we develop and deploy our global marketplace. In addition, new regulations in the European Union relating to the collection of value-added taxes, or VAT, on digital services will require us to collect and remit VAT on our own fees beginning in July 2003. We intend to work with the relevant tax authorities to clarify our obligations under these regulations and to change our software to permit the billing of these taxes. The increased costs to our European users may reduce their activity on our websites and could adversely affect our international transaction net revenues.

Third-party Advertising Net Revenue

U.S. third-party advertising net revenue decreased in absolute dollars and as a percentage of total U.S. segment net revenues from $18.2 million in the three months ended March 31, 2002, representing 10% of

Table of Contents

U.S. segment net revenues, to $5.5 million in the three months ended March 31, 2003, representing 2% of U.S. segment net revenues. Revenues from U.S. segment third-party advertising decreased primarily as a result of a general deterioration in the online advertising market that adversely impacted our advertising sales through AOL Time Warner, Inc., or AOL, our exclusive advertising sales representative. International segment third-party advertising net revenue decreased as a percentage of total International net revenues from 2% in the three months ended March 31, 2002 to 1% in the three months ended March 31, 2003. Although the absolute dollar amount of International segment third-party advertising net revenues increased, the decrease in International segment third-party advertising as a percentage of total International segment net revenues was primarily the result of transaction net revenues growing faster than advertising net revenues. We continue to view our business as primarily transaction driven and we expect third-party advertising net revenues in future periods to continue to decrease as a percentage of total net revenues and in absolute dollars. Additionally, our advertising sales representative agreement with AOL terminated on March 31, 2003. AOL will continue to electronically deliver our online advertisements for a specified wind-down period. Our third-party advertising revenues in future periods will be dependent on the efforts of our existing internal sales staff.

End-to-End Services Net Revenue

U.S. segment end-to-end services net revenue decreased in absolute dollars and as a percentage of total U.S. segment net revenues from $4.9 million in the three months ended March 31, 2002, representing 3% of U.S. segment net revenues to $2.1 million in the three months ended March 31, 2002, representing 1% of U.S. segment net revenues. As end-to-end services are contractual and are largely dependent upon contractual terms and our users adoption of third-party products and services, we expect end-to-end services revenue in future periods to fluctuate from period to period. In general, however, as we continue to view our business as primarily transaction driven, we expect these revenues to decrease as a percentage of total net revenues and in absolute dollars.

Offline Net Revenue

Offline net revenue decreased from $7.5 million in the three months ended March 31, 2002, representing 3% of total net revenue to $0 in the three months ended March 31, 2003. We divested our Butterfields and Kruse subsidiaries in the third and fourth quarters of 2002, respectively, and accordingly do not expect to earn offline net revenue in the foreseeable future.

Net Revenues from Payments Segment

Net revenues from the Payments segment are generated from eBay s Billpoint operations for the three months ended March 31, 2002 and primarily from PayPal s operations for the three months ended March 31, 2003.

Transaction Net Revenue

Payments segment transaction net revenue increased 1,847% from $4.8 million in the three months ended March 31, 2002 to $93.2 million for the three months ended March 31, 2003. The growth was primarily the result of our acquisition of PayPal. For the three months ended March 31, 2003, PayPal recorded transaction net revenue of $92.2 million. We continue to expect to winddown our Billpoint payment operations by the end of June 2003.

Third-party Advertising Net Revenues

Payments segment revenues from third-party advertising increased in absolute dollars and as a percentage of total Payments segment net revenues from zero in the three months ended March 31, 2002 to $2.0 million in the three months ended March 31, 2003, representing 2% of Payments segment net revenues. The growth is due to the addition of third-party advertising revenues from PayPal. We continue to view our business as primarily transaction driven, and we expect Payments segment third-party advertising net revenues in future periods to continue to decrease as a percentage of total net revenues.

Table of Contents

Cost of Net Revenues

	Three Months Ended March 31, 2002	Percent Change	Three Months Ended March 31, 2003
	(In thousands, except percentages)		
Cost of net revenues	$41,277	123%	$92,098
As a percentage of net revenues	17%		19%

Cost of net revenues consists primarily of costs associated with customer support, site operations, and payment processing. Significant cost components include employee compensation and facilities costs for customer support, site operations, Internet connectivity charges, depreciation of site equipment, payment processing fees, amortization of required capitalization of major site and product development costs, including the amortization of capitalized costs related to the development of our third generation V3 site architecture, costs to provide end-to-end services and promotions and corporate overhead allocations.

Cost of net revenues increased in absolute dollars and as a percentage of net revenues from the three months ended March 31, 2002 to the three months ended March 31, 2003. The increase in absolute dollars and as a percentage of net revenues was due to increased payment processing costs resulting from our acquisition of PayPal and continued development and expansion of our customer support and site operations infrastructure. The increase in payment processing costs totaled $36.5 million and consists of credit card interchange fees, and other bank and processing charges. The increases in customer support and site operations costs were primarily the result of increased personnel costs of $6.4 million and depreciation and other facilities and equipment maintenance costs of $6.3 million. We expect the cost of net revenues to increase in absolute dollars but to remain generally comparable as a percentage of net revenues for the remainder of 2003.

Operating Expenses

Sales and Marketing

	Three Months Ended March 31, 2002	Percent Change	Three Months Ended March 31, 2003
	(In thousands, except percentages)		
Sales and marketing	$73,104	69%	$123,760
As a percentage of net revenues	30%		26%

Sales and marketing expenses consist primarily of employee compensation for our category development and marketing staff, advertising, tradeshow and other promotional costs, certain trust and safety programs and corporate overhead allocations.

Sales and marketing expenses increased in absolute dollars from the three months ended March 31, 2002 to the three months ended March 31, 2003, primarily as the result of increased advertising and marketing costs. Our advertising costs increased by $39.2 million and were directed towards a national television advertising campaign and several category focused print and on-line advertising campaigns. Additionally, personnel costs increased by $3.4 million, expenses related to tradeshows and user programs increased by $2.1 million and our professional services fees increased by $1.4 million. Our advertising efforts target the acquisition of registered users and activation of existing users through television, print media placements, promotional agreements with Internet portals and other online service providers. Sales and marketing expenses are expected to increase in absolute dollars, and to remain generally comparable as a percentage of net revenues for the remainder of 2003.

Product Development

	Three Months Ended March 31, 2002	Percent Change	Three Months Ended March 31, 2002
	(In thousands, except percentages)		
Product development	$24,307	41%	$34,332
As a percentage of net revenues	10%		7%

Product development expenses consist primarily of employee compensation, payments to outside contractors, depreciation on equipment used for development and corporate overhead allocations. Product development expenses are net of required capitalization of major site and product development efforts, including the development of our third generation V3 site architecture. These capitalized costs totaling $2.8 million in the three months ended March 31, 2002 and $4.7 million in the three months ended March 31, 2003 are reflected as a cost of revenue when amortized. We anticipate that we will continue to devote significant resources to product development in the future as we add new features and functionality to the eBay and PayPal platforms.

Product development expenses increased in absolute dollars from the three months ended March 31, 2002 to the three months ended March 31, 2003, primarily as a result of a $3.5 million increase in personnel costs and a $6.5 million increase in maintenance and depreciation costs for equipment used in development. The increase in these costs resulted from the development of additional site features and functionality such as enhanced search functionality, improved seller tools, and PayPal integration. Product development expenses are expected to increase in absolute dollars for the remainder of 2003, as we develop new site features and functionality and continue to improve and expand operations across all our segments. We expect product development expenses to remain generally comparable as a percentage of net revenues for the remainder of 2003.

General and Administrative

	Three Months Ended March 31, 2002	Percent Change	Three Months Ended March 31, 2003
	(In thousands, except percentages)		
General and administrative	$32,493	94%	$63,000
As a percentage of net revenues	13%		13%

General and administrative expenses consist primarily of employee compensation, provision for doubtful accounts, provisions for transaction losses associated with our Payments segment, insurance, fees for external professional advisors and corporate overhead allocations.

General and administrative expenses increased in absolute dollars from the three months ended March 31, 2002 to the three months ended March 31, 2003, as a result of increases of $17.8 million in personnel costs, primarily related to the addition of PayPal employees in various trust and safety functions, $9.0 million in the provision for Payments segment transaction losses, and $4.1 million in fees for professional services. These costs increased to meet the demands of our expanding business, including growing international operations and the integration of acquired businesses. We expect general and administrative expenses to increase in absolute dollars for the remainder of 2003, as we continue to invest in the infrastructure that is necessary to support our business. Additionally, we expect general and administrative expenses to remain generally comparable as a percentage of net revenues for the remainder of 2003.

Table of Contents

Payroll Expense on Employee Stock Options

	Three Months Ended March 31, 2002	Percent Change	Three Months Ended March 31, 2003
	(In thousands, except percentages)		
Payroll tax expense from employee stock options	$ 1,679	96%	$ 3,290
As a percentage of net revenues	1%		1%

We are subject to employer payroll taxes on employee gains resulting from exercises of non-qualified stock options. These employer payroll taxes are recorded as a charge to operations in the period in which such options are exercised and sold based on actual gains realized by employees. Our quarterly results of operations and cash flows could vary significantly depending on the actual period that stock options are exercised by employees and, consequently, the amount of employer payroll taxes assessed. We expect exercises of employee stock option grants will result in increased payroll tax costs for the remainder of 2003, partially as a result of gains from the exercise of PayPal options assumed in the merger. In general, we expect payroll taxes on employee stock option gains to increase during periods in which our stock price is high relative to historical levels.

Amortization of Acquired Intangible Assets

	Three Months Ended March 31, 2002	Percent Change	Three Months Ended March 31, 2003
	(In thousands, except percentages)		
Amortization of acquired intangible assets	$ 1,530	676%	$ 11,868
As a percentage of net revenues	1%		2%

From time to time we have purchased, and we expect to continue purchasing, assets or businesses to accelerate category and geographic expansion, increase the features and functionality available to our users and maintain a leading role in online trading. These purchase transactions may result in the creation of acquired intangible assets and lead to a corresponding increase in the amortization expense in future periods.

Intangible assets consist of purchased customer lists, developed technologies, trade names, and other intangible assets. Intangible assets, excluding goodwill, are being amortized using the straight-line method over estimated useful lives ranging from two to seven years. We believe the straight-line method of amortization best represents the distribution of economic value of the identified intangible assets.

Goodwill represents the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired in a business combination. In accordance with Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets, goodwill is no longer subject to amortization. Rather, goodwill is subject to at least an annual assessment for impairment, applying a fair-value based test.

Amortization of acquired intangible assets increased from the three months ended March 31, 2002 to the three months ended March 31, 2003, primarily as a result of the amortization of acquired intangible assets related to our acquisition of PayPal. Without taking into account the impact of potential future acquisitions, we expect amortization from acquired intangible assets to remain comparable in absolute dollars but to decrease as a percentage of revenues for the remainder of 2003.

Table of Contents

Non-Operating Items

Interest and Other Income, Net

	Three Months Ended March 31, 2002	Percent Change	Three Months Ended March 31, 2003
	(In thousands, except percentages)		
Interest and other income, net	$7,387	4%	$7,704
As a percentage of net revenues	3%		2%

Interest and other income, net consists of interest earned on cash, cash equivalents, and investments as well as foreign exchange transaction gains and losses and other miscellaneous non-operating transactions.

Our interest and other income, net increased from the three months ended March 31, 2002 to the three months ended March 31, 2003, primarily as a result of an increase in our cash, cash equivalents, and investments balances partially offset by a decline in the weighted-average interest rate of our portfolio. Our weighted average interest rate was approximately 3.1% in the three months ended March 31, 2002 compared to 1.9% in the three months ended March 31, 2003. We expect that interest and other income, net, will increase in absolute dollars for the remainder of 2003, as our cash, cash equivalents, and investments balances continue to grow.

Interest Expense

	Three Months Ended March 31, 2002	Percent Change	Three Months Ended March 31, 2003
	(In thousands, except percentages)		
Interest expense	$685	(95)%	$ 31
As a percentage of net revenues	0%		0%

Interest expense consists of interest charges on mortgage notes and capital leases. Interest expense decreased from the three months ended March 31, 2002 to the three months ended March 31, 2003, as a result of a reduction in outstanding mortgage notes balances in connection with the sale of several of the underlying properties in 2002 and lower interest rates.

In January 2003, the FASB issued FIN 46, Consolidation of Variable Interest Entities, which would require us to include our San Jose facilities lease arrangement in our Consolidated Financial Statements effective July 1, 2003. Under this new accounting standard, our balance sheet subsequent to July 1, 2003, would reflect additions for office properties totaling $126.4 million, lease obligations of $122.5 million and non-controlling minority interests of $3.9 million. Our income statement subsequent to July 1, 2003, would reflect the reclassification of our San Jose facilities lease payments from operating expense to interest expense on the related lease obligations, a $5.6 million after-tax charge for depreciation for periods from lease inception through July 1, 2003, and incremental depreciation expense for periods subsequent to July 1, 2003.

In the event that we terminate the lease arrangement and acquire ownership of the San Jose facilities prior to the adoption of FIN 46, we would not incur the cumulative depreciation charge of $5.6 million; instead, the $126.4 million cost of acquiring the facilities would be allocated between land and buildings, with the amount allocated to buildings being depreciated over the estimated useful life of the facilities. In addition, we would settle our two interest rate swaps used to establish a fixed rate of interest for $95 million of our financing arrangement. At March 31, 2003, settlement of our two interest rate swaps in connection with a lease termination would have resulted in a pre-tax loss of $10.2 million.

We have not yet decided whether we will keep the existing lease financing arrangement or terminate the arrangement and acquire ownership of the facilities. Whether or not we keep the existing lease financing arrangement, we anticipate recording incremental annual operating expenses of $1.7 million, net of taxes, for the recognition of depreciation expense on the buildings.

Table of Contents

Impairment of Certain Equity Investments

	Three Months Ended March 31, 2002	Percent Change	Three Months Ended March 31, 2003
	(In thousands, except percentages)		
Impairment of certain equity investments	$1,181	(81)%	$230
As a percentage of net revenues	0%		0%

During the three months ended March 31, 2003 and December 31, 2002, we recorded impairment charges totaling $230,000 and $1.2 million, respectively, as a result of the deterioration of the financial condition of certain of our private equity investees. These impairment losses are identified as part of our normal process of assessing the quality of our investment portfolio and reflect declines in fair value and other market conditions that we believe are other than temporary.

We expect that the fair value of our equity investments will fluctuate from time to time and future impairment assessments may result in additional charges to our operating results.

Provision for Income Taxes

	Three Months Ended March 31, 2002	Percent Change	Three Months Ended March 31, 2003
	(In thousands, except percentages)		
Provision for income taxes	$29,411	67%	$49,018
As a percentage of net revenues	12%		10%
Effective tax rate	38%		32%

The provision for income taxes differs from the amount computed by applying the statutory U.S. federal rate principally due to non-deductible expenses related to acquisitions, state taxes, subsidiary losses for which we have not provided a benefit and other permanent differences that increase the effective tax rate. These amounts are offset by decreases resulting from foreign income with lower effective tax rates and tax-exempt interest income.

We receive tax deductions from the gains realized by employees on the exercise of certain non-qualified stock options for which the benefit is recognized as a component of stockholders equity. We have provided a full valuation allowance on the deferred tax assets relating to these stock option deductions due to the uncertainties associated with our future stock price and the timing of employee stock option exercises. To the extent that additional stock option deductions are not generated in future years, we will have the ability, subject to carryforward limitations, to utilize up to $217.6 million of additional deferred tax assets to reduce future income tax liabilities. When recognized, the tax benefit of tax deductions related to stock options are accounted for as a credit to additional paid-in capital rather than a reduction of the income tax provision.

The lower effective tax rate for the three months ended March 31, 2003, as compared to the effective tax rate for the three months ended March 31, 2002, reflects the increasing profit contribution from our international operations.

Minority Interests

	Three Months Ended March 31, 2002	Percent Change	Three Months Ended March 31, 2003
	(In thousands, except percentages)		

Minority interest in consolidated company	$758	(414)%	$(2,378)
As a percentage of net revenues	0%		0%

Minority interests in consolidated companies represents the minority investor s percentage share of income or losses from subsidiaries in which we hold a majority ownership interest and consolidate the subsidiaries results in our financial statements.

Table of Contents

Third parties held minority interests in Internet Auction, our majority-owned South Korean subsidiary, for the three months ended March 31, 2003. The significant change in minority interests from the three months ended March 31, 2002 to the three months ended March 31, 2003, primarily resulted from Internet Auction generating net income in the three months ended March 31, 2003, compared to a loss for the same period in 2002. We expect that minority interests in consolidated companies will continue to fluctuate in future periods. If Internet Auction continues to be profitable, the minority interests adjustment on the statement of income will continue to decrease our net income by the minority investor s share of Internet Auction s net income.

Impact of Foreign Currency Translation

The growth in our international operations has increased our exposure to foreign currency fluctuations. We have foreign currency denominated net revenues, costs and expenses. These income statement amounts are translated into U.S. dollars at the average exchange rates in each applicable period. To the extent the U.S. dollar weakens against foreign currencies, the translation of these foreign currency denominated transactions results in increased net revenues, operating expenses and net income. Similarly, our net revenues, operating expenses and net income will decrease when the U.S. dollar strengthens against foreign currencies.

A significant portion of our international net revenues, operating expenses and net income are denominated in Euros. During the three months ended March 31, 2003, the U.S. dollar weakened against the Euro and our weighted-average translation rate used to convert Euro denominated transactions into U.S. dollar equivalents, decreased by approximately 21% and 7% compared to the weighted-average translation rate used for the three months ended March 31, 2002 and December 31, 2002, respectively. These weighted-average translation rate changes for the Euro resulted in increased net revenues of approximately $17.2 million and $6.1 million for the three months ended March 31, 2003 and December 31, 2002, respectively, as well as increased operating expenses of approximately $7.6 million and $2.7 million for the three months ended March 31, 2003 and December 31, 2002, respectively.

We expect our international operations will continue to grow in significance as we develop and deploy our global marketplace. As a result, foreign currency fluctuations in future periods could become more significant or even have a negative impact on our net revenues and net income.

Liquidity and Capital Resources

Cash Flows

Since inception, we have financed operations primarily from net cash generated from operating activities. In addition, we have 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. During the three months ended March 31, 2003, we were primarily financed by proceeds of stock option exercises and from our income from operations.

Net cash provided by operating activities was $92.3 million in the three months ended March 31, 2002 and $190.0 million in the three months ended March 31, 2003. Net cash provided by operating activities resulted primarily from our net income, tax benefits on the exercise of stock options and non-cash charges for depreciation and amortization. These sources of cash were partially offset by changes in assets and liabilities.

Net cash used in investing activities was $62.8 million in the three months ended March 31, 2002. Net cash provided by investing activities was $34.9 million in the three months ended March 31, 2003. The primary use for invested cash in the periods presented was for purchases of property and equipment and acquisitions. These uses of cash were partially offset by the net proceeds from purchases, maturities and sales of investments. The primary source of cash provided by investing activities was maturities and sales of investments.

Net cash provided by financing activities was $23.7 million in the three months ended March 31, 2002 and $217.1 million in the three months ended March 31, 2003. Net cash provided by financing activities was primarily due to the issuance of common stock associated with stock option exercises.

Table of Contents

Commitments and Contingencies

We expect capital expenditures to approximate $330 million for the remainder of 2003, without taking into account any acquisitions or costs associated with the potential acquisition of ownership of our San Jose facilities currently subject to an operating lease agreement. Of the $330 million, approximately $160 million and $6 million has been allocated for the purchase of additional corporate office facilities and leasehold improvements in San Jose, California and Vancouver, British Columbia, respectively. We also estimate that the required capitalization of product development costs will approximate $24 million through the remainder of 2003. The remaining balance will be used primarily for the purchase of computer hardware and software of approximately $130 million, and furniture and fixtures, leasehold improvements and other corporate assets of approximately $10 million.

Leases

In January 2003, the FASB issued FIN 46, Consolidation of Variable Interest Entities, which would require us to include our San Jose facilities lease arrangement in our Consolidated Financial Statements effective July 1, 2003. Under this new accounting standard, our balance sheet subsequent to July 1, 2003, would reflect additions for office properties totaling $126.4 million, lease obligations of $122.5 million and non-controlling minority interests of $3.9 million. Our income statement subsequent to July 1, 2003, would reflect the reclassification of our San Jose facilities lease payments from operating expense to interest expense on the related lease obligations, a $5.6 million after-tax charge for depreciation for periods from lease inception through July 1, 2003, and incremental depreciation expense for periods subsequent to July 1, 2003.

In the event that we terminate the lease arrangement and acquire ownership of the San Jose facilities prior to the adoption of FIN 46, we would not incur the cumulative depreciation charge of $5.6 million; instead, the $126.4 million cost of acquiring the facilities would be allocated between land and buildings, with the amount allocated to buildings being depreciated over the estimated useful life of the facilities. In addition, we would settle our two interest rate swaps used to establish a fixed rate of interest for $95 million of our financing arrangement. At March 31, 2003, settlement of our two interest rate swaps in connection with a lease termination would have resulted in a pre-tax loss of $10.2 million.

We have not yet decided whether we will keep the existing lease financing arrangement or terminate the arrangement and acquire ownership of the facilities. Whether or not we keep the existing lease financing arrangement, we anticipate recording incremental annual operating expenses of $1.7 million, net of taxes, for the recognition of depreciation expense on the buildings.

Subsequent Events

Property Purchase

On April 22, 2003, we entered agreements to purchase certain developed commercial real property consisting of a five-building office campus located in San Jose, California and certain undeveloped land that is adjacent to this property. The purchase price for the campus is $95.0 million. The purchase price for the undeveloped land adjacent to the campus is approximately $29.2 million. With respect to the campus, we made initial deposits of $5.0 million through May 1, 2003. The balance of the purchase price for the campus is to be paid by us on or before the expected closing date of June 30, 2003. The undeveloped land is subject to an agreement between the current owner and the City of San Jose. The City has agreed to assign its interest in the undeveloped land to us. The balance of the purchase price for the land is to be paid by us on or before the expected closing date of May 27, 2003. Our plan following the closing of these purchases is to occupy approximately one-half of the existing campus, with the balance of the rentable area to be occupied by the current tenants.

Table of Contents

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.

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 and to activate existing users to list items for sale, purchase items through our service or use our payment services;
- the amount and timing of operating costs and capital expenditures relating to the maintenance and expansion of our businesses, operations and infrastructure;
- foreign, federal, state or local government regulation, including investigations prompted by items listed, sold or paid for by our users;
- our ability to comply with the requirements of entities whose services are required for our operations, such as the credit card associations;
- the success of our geographical and product expansion;
- the introduction of new sites, services and products by us or our competitors;
- volume, size, timing and completion rate of transactions on our websites;
- consumer confidence in the safety and security of transactions on our websites;
- our ability to upgrade and develop our systems, infrastructure and customer service capabilities to accommodate growth at a reasonable cost;
- our ability to keep our websites operational at a reasonable cost;
- our ability to develop product enhancements at reasonable cost;
- our ability to integrate successfully and cost effectively manage our acquisitions, including the acquisition of PayPal;
- our ability to manage fraud loss and credit card charge back rates and the payment funding mix at PayPal;
- the cost and demand for advertising on our websites;
- technical difficulties or service interruptions involving our websites or services provided to our users by third parties (such as photo hosting);
- our ability to attract new personnel in a timely and effective manner;
- our ability to retain key employees in our online businesses, including PayPal;
- our ability to expand our product offerings involving fixed-price trading;

the costs and results of litigation that involves us;

the results of regulatory decisions that affect us;

the actions of our competitors;

the timing, cost and availability of advertising in traditional media and on other websites and online services;

the timing of payments to us and of marketing and other expenses under existing and future contracts;

the success of our brand building and marketing campaigns;

the continued financial strength 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, for the trading of products such as those listed on our websites;

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

geopolitical events such as war, threat of war or terrorist actions.

Our limited operating history and the increased variety of services offered on our websites 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 substantially all of our net revenues each quarter come from transactions involving sales or payments during that quarter. Due to the inherent difficulty in forecasting revenues it is also difficult to forecast income statement expenses as a percentage of net revenues. Quarterly and annual income statement expenses as a percentage of net revenues may be significantly different from historical or projected rates. 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.

We may not maintain our level of profitability.

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

maintain sufficient transaction volume to attract buyers and sellers;

attract new users and keep existing users active on our websites;

manage the costs of our business, including the costs associated with maintaining and developing our websites, customer support, fraud and chargebacks and international and product expansion;

increase the awareness of our brands; and

provide our customers with superior community and trading experiences.

We are investing heavily in marketing and promotion, customer support, further development of our websites, technology and operating infrastructure development. The costs of these investments are expected to remain significant into the future. In addition, 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 other companies, some of whom do not charge for transactions on their sites and others who are facilitating trading through varied pricing formats (e.g., fixed-price, reverse auction, group buying) 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.

Table of Contents

Our business is adversely affected by anything that causes our users to spend less time on their computers, including national events and seasonal factors.

Anything that diverts our users from their customary level of usage of our websites could adversely affect our business. We would therefore be adversely affected by geopolitical events such as war, the threat of war or terrorist activity. Similarly, our results of operations historically have been seasonal in nature because many of our users reduce their activities on our websites during the holidays, such as during the Thanksgiving (in the U.S.) and Christmas periods, and with the onset of good weather during the summer months. We have historically experienced our strongest quarters of online growth in our first and fourth fiscal quarters. PayPal has shown similar seasonality, except that its strongest quarter of online growth has historically been the fourth fiscal quarter.

There are many risks associated with our international operations.

Our international expansion has been rapid and we have only limited experience in many of the countries in which we now do business. Our international business, especially in Germany, the U.K., Canada and Korea, has also become critical to our revenues and profits. 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 many countries, we compete with local companies who understand the local market better than we do. We may not be successful in expanding into particular international markets or in generating revenues from foreign operations. For example, in 2002 we withdrew from the Japanese market. 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 auctioneering, banking, and money transmitting, that may limit or prevent the offering of our services in some jurisdictions, may prevent enforceable agreements between sellers and buyers, may prohibit certain categories of goods, may require special licensure, or may limit the transfer of information between our foreign subsidiaries and ourselves;
- legal uncertainty regarding liability for the listings of our users, including uncertainty as a result of less Internet-friendly legal systems, unique local laws and lack of clear precedent or applicable law;
- different employee/employer relationships and the existence of workers councils and labor unions;
- difficulties in staffing and managing foreign operations;
- longer payment cycles, different accounting practices and greater problems in collecting accounts receivable;
- potentially adverse tax consequences, including local taxation of our fees or of transactions on our websites;
- higher telecommunications and Internet service provider costs;
- strong local competitors;
- more stringent consumer and data protection laws;
- cultural ambivalence to, or non-acceptance of, online trading;
- seasonal reductions in business activity;
- expenses associated with localizing our products, including offering customers the ability to transact business in the local currency;
- laws and business practices that favor local competitors;
- profit repatriation restrictions, foreign currency exchange restrictions and exchange rate fluctuations;

Table of Contents

changes in a specific country s or region s political or economic conditions; and

differing intellectual property laws.

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.

We intend to expand PayPal s services internationally. Both we and PayPal have limited experience with the payments business outside of the U.S. In addition to all of the factors listed above, we expect that successful international expansion of PayPal s business will require successful integration with local payment providers (including banks, credit and debit card associations, electronic fund transfer systems and others) and in some countries may require a close commercial relationship with a local bank. We do not know if these or other factors may prevent, delay or limit PayPal s expansion or reduce its profitability. Any limitation on our ability to expand PayPal internationally could harm our business.

Our business may be subject to sales and other taxes.

We do not collect sales or other similar taxes on goods or services sold by users through our services. One or more states or any foreign country may seek to impose value-added taxes, or VAT, or sales or use tax collection or record-keeping obligations on companies such as ours that engage in or facilitate online commerce. Such taxes could be imposed if, for example, we were ever deemed to be an auctioneer or the agent of our sellers. 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, which has been extended through November 1, 2003. This moratorium 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. New regulations in the European Union relating to the collection of VAT on digital services will require us to collect and remit VAT on our own fees beginning in July 2003. We intend to work with relevant tax authorities to clarify our obligations under these regulations and will change our software to permit the billing of these taxes. We expect substantial ongoing costs associated with complying with the VAT rules throughout Europe and the increased cost to our users may reduce their activity on our websites. Both of these effects could adversely affect our business. 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.

PayPal is subject to unique risks that could harm our business.

PayPal faces significant risks of loss due to fraud and disputes between senders and recipients. If PayPal is unable to deal effectively with fraudulent transactions, PayPal s losses from fraud would increase, and its business would be harmed.

PayPal faces significant risks of loss due to fraud and disputes between senders and recipients, including:

unauthorized use of credit card and bank account information and identity theft;

merchant fraud and other disputes over the quality of goods and services;

potential breaches of system security;

potential employee fraud; and

use of PayPal s system by customers to make or accept payment for illegal or improper purposes.

For the year ended December 31, 2002 and the three months ended March 31, 2003, PayPal s provision for transaction losses totaled $28.8 million and $9.0 million, respectively, representing 0.41% and 0.34% of PayPal s total payment volume. In January 2003 PayPal increased the withdrawal limit for unverified international users to $500 per month in certain countries. This increase may result in higher transaction losses.

PayPal incurs chargebacks and other losses from merchant fraud, payment disputes and insufficient funds, and its liability from these items could have a material adverse effect on its business and result in PayPal losing the right to accept credit cards for payment. If PayPal is prohibited from accepting credit cards for payment, its ability to compete could be impaired, and our business would suffer.

PayPal incurs substantial losses from merchant fraud, including claims from customers that merchants have not performed, that their goods or services do not match the merchant s description or that the customer did not authorize the purchase. PayPal also incurs losses from erroneous transmissions and from customers who have closed bank accounts or have insufficient funds in them to satisfy payments. PayPal s liability for such items could have a material adverse effect on its business, and if they become excessive, could result in PayPal losing the right to accept credit cards for payment. If PayPal were unable to accept credit cards, the velocity of trade on eBay could decrease, in which case our business would suffer. PayPal has been assessed substantial fines in the past, and excessive chargebacks may arise in the future. PayPal has taken measures to detect and reduce the risk of fraud, but these measures may not be effective. If these measures do not succeed, our business will suffer.

Unauthorized use of credit cards and bank accounts could expose PayPal to substantial losses. If PayPal is unable to detect and prevent unauthorized use of cards and bank accounts, its business would suffer.

The highly automated nature of, and liquidity offered by, PayPal s payment product makes PayPal an attractive target for fraud. In configuring its product, PayPal faces an inherent trade-off between customer convenience and security. Identity thieves and those committing fraud using stolen credit card or bank account numbers, often in bulk and in conjunction with automated mechanisms of online communication, potentially can steal large amounts of money from businesses such as PayPal s. PayPal believes that several of PayPal s current and former competitors in the electronic payments business have gone out of business or significantly restricted their businesses largely due to losses from this type of fraud. PayPal expects that technically knowledgeable criminals will continue to attempt to circumvent PayPal s anti-fraud systems. If they are successful, our business will be harmed.

PayPal s processes to reduce fraud losses depend in part on its ability to restrict the withdrawal of customer funds while it investigates suspicious transactions. PayPal has been and could be sued by plaintiffs alleging that PayPal s restriction and investigation processes violate federal and state law on consumer protection and unfair business practice, and are inconsistent with PayPal s user agreement. If PayPal is unable to defend itself successfully, it could be required to restructure its anti-fraud processes in ways that would harm its business, and to pay substantial damages.

As part of PayPal s program to reduce fraud losses, it may temporarily restrict the ability of customers to withdraw their funds if those funds or their account activity are identified by PayPal s anti-fraud models as suspicious. PayPal is subject to several purported class action lawsuits challenging its procedures and disclosures with respect to suspicious accounts, and if PayPal s processes are found to violate federal or state law on consumer protection and unfair business practices, it could be subject to an enforcement action or fines. In addition, many customers who are subject to such restrictions complain to regulatory agencies. If PayPal loses this litigation or becomes subject to an enforcement action, it could be required to restructure its anti-fraud processes in ways that would harm its business, and to pay substantial damages. Even if PayPal is able to defend itself successfully, the litigation or enforcement action could cause damage to its reputation, could consume substantial amounts of its management s time and attention, and could require PayPal to change its customer service and operations in ways that could increase its costs and decrease the effectiveness of its anti-fraud program.

Any failure to provide effective customer support could result in the loss of customers and inability to attract new customers, which would harm PayPal s business.

Because it is providing a financial service and operating in a more regulated environment, PayPal, unlike eBay, must provide telephone as well as email customer service, and must resolve certain customer contacts within shorter time frames. PayPal has received negative publicity with respect to its customer service and is the subject of purported class action lawsuits alleging, among other things, failure to resolve promptly certain account restrictions. If PayPal is unable to provide quality customer support operations in a cost-effective manner, its users may have negative experiences, PayPal may receive additional negative publicity and its ability to attract new customers may be damaged. Current and future revenues could suffer, or its operating margins may decrease. In addition, negative publicity about or experiences with PayPal s customer support could cause eBay s reputation to suffer or affect consumer confidence in eBay as a whole.

Security and privacy breaches in PayPal s electronic transactions may expose PayPal to additional liability and result in the loss of customers, either of which events could harm its business.

Any inability on PayPal s part to protect the security and privacy of its electronic transactions could have a material adverse effect on its profitability. A security or privacy breach could:

- expose PayPal to additional liability;
- increase PayPal s expenses relating to resolution of these breaches; and
- deter customers from using PayPal s product.

PayPal s data security measures may not effectively counter evolving security risks or address the security and privacy concerns of existing and potential customers. Any failures in PayPal s security and privacy measures could have a material adverse effect on our business.

PayPal could incur substantial losses from employee fraud and, as a result, its business would suffer.

The large volume of payments that PayPal handles for its customers makes it vulnerable to employee fraud or other internal security breaches. PayPal is required to reimburse customers for any funds stolen as a result of such breaches. Any such fraud or security breaches could adversely affect our business.

PayPal s payment system might be used for illegal or improper purposes, which could expose it to additional liability and harm its business.

Despite measures PayPal has taken to detect and prevent identity theft, unauthorized uses of credit cards and similar misconduct, its payment system remains susceptible to potentially illegal or improper uses. These may include illegal online gambling, fraudulent sales of goods or services, illicit sales of prescription medications or controlled substances, software and other intellectual property piracy, money laundering, bank fraud, child pornography trafficking, prohibited sales of alcoholic beverages and tobacco products and online securities fraud. Despite measures PayPal has taken to detect and lessen the risk of this kind of conduct, these measures may not succeed. The processing of these payments could expose PayPal to liability. In addition, future regulations under the USA PATRIOT Act may require PayPal to revise the procedures it takes to verify the identity of customers and to monitor more closely international transactions. PayPal s business could suffer if customers use its system for illegal or improper purposes, or if usage of its system is reduced because of increased verification requirements.

PayPal s discontinuance of its processing of payments for online gambling merchants will reduce its revenue and profits; its past processing of these accounts could subject it to liability.

PayPal completed its exit from the business of processing payments for online gambling merchants in November 2002. Approximately 6% of PayPal s revenues in 2002 were derived from this business. The loss of these revenues and related profits will adversely affect PayPal s financial results. As a result of having been in this business, PayPal has become subject to two inquiries related to payments made through its service to online gambling merchants. In August 2002, PayPal reached agreement with the Attorney General of the State of New York that it would cease processing payments from its New York members to such merchants and pay the State of New York $200,000 in penalties and disgorged profits and to cover the cost of investigation. Beginning in July 2002, PayPal provided documents and information related to its services to online gambling merchants in response to a federal grand jury subpoena issued at the request of the U.S. Attorney for the Eastern District of Missouri. On March 28, 2003, PayPal received a letter from the U.S. Attorney for the Eastern District of Missouri indicating its contention that PayPal s provision of services to online gambling merchants violated 18 U.S.C. § 1960 of the USA PATRIOT Act, which prohibits the transmission of funds that are known to have been derived from a criminal offense or are intended to be used to promote or support unlawful activity, thereby subjecting PayPal to potential civil forfeiture of the amounts it received in connection with such activities as well as potential criminal liability. The letter offered a complete settlement of all possible claims and charges from the U.S. Attorney for the Eastern District of Missouri if PayPal paid the purported amount of its earnings derived from online gambling merchants during the nine-month period from October 26, 2001 to July 31, 2002, plus interest. PayPal acted in the good faith belief that its conduct did not violate 18 U.S.C. § 1960 and PayPal calculates that the amount of its earnings from online gaming activities was less than asserted in the letter. Should this investigation lead to a civil or criminal charge against PayPal, we would be harmed by negative publicity, the cost of litigation and the diversion of management time, even if PayPal ultimately prevails. Any finding of a civil or criminal violation by PayPal, or potentially any settlement, could also endanger PayPal s ability to obtain, maintain or renew money transmitter licenses in jurisdictions where it requires such licenses to operate, which would materially harm our business.

Changes to card association rules or practices could negatively affect PayPal s service and, if it does not comply with the rules, could result in a termination of PayPal s ability to accept credit cards. If PayPal is unable to accept credit cards, our business would suffer.

Because PayPal is not a bank, it cannot belong to and directly access the Visa and MasterCard credit card associations or the Automated Clearing House, or ACH, payment network. As a result, PayPal must rely on banks and their service providers to process its transactions. PayPal must comply with the operating rules of the credit card associations and the National Automated Clearing House Association, or NACHA, as they apply to merchants. The associations member banks set these rules, and the associations interpret the rules. Some of those member banks compete with PayPal. Visa, MasterCard, American Express or Discover could adopt new operating rules or interpretations of existing rules which PayPal or its processors might find difficult or even impossible to comply with, in which case PayPal could lose its ability to give customers the option of using credit cards to fund their payments. If PayPal were unable to accept credit cards, its business would be seriously damaged. In addition, if PayPal were unable to accept credit cards, the velocity of trade on eBay could decrease and our business would suffer.

In 2001, Visa indicated that some of PayPal s practices violated its operating rules, and PayPal implemented changes in response. In January 2002, PayPal received correspondence through its credit card processor that three issues remained unresolved. These issues relate to PayPal s international membership fees, its fees for international credit card funded payments, and its process for obtaining authorization to charge a customer s Visa account if the customer s ACH transfer fails. In connection with these issues, PayPal s processor was assessed fines totaling $130,000 by Visa in 2002, $110,000 of which PayPal s processor has passed through to PayPal. PayPal has implemented changes to its practices to resolve these issues, and believes these changes have resolved all outstanding issues that resulted in compliance fines from Visa. However, these changes could make the PayPal service less attractive to its customers.

PayPal s status under state, federal and international financial services regulation is unclear. Violation of or compliance with present or future regulation could be costly, expose PayPal to substantial liability, force PayPal to change its business practices or force PayPal to cease offering its current product.

PayPal operates in an industry subject to government regulation. PayPal currently is subject to some states money transmitter regulations, to federal regulations in its role as transfer agent and investment adviser to the PayPal Money Market Fund, and to federal electronic fund transfer and money laundering regulations. In the future, PayPal might be subjected to:

- state or federal banking regulations;
- additional states money transmitter regulations and federal money laundering regulations;
- international banking or financial services regulations or laws governing other regulated industries; or
- U.S. and international regulation of Internet transactions.

If PayPal is found to be in violation of any current or future regulations, PayPal could be:

- exposed to financial liability, including substantial fines which could be imposed on a per transaction basis and disgorgement of its profits;
- forced to change its business practices; or
- forced to cease doing business altogether or with the residents of one or more states or countries.

Any change to PayPal s business practices that makes the service less attractive to customers or prohibits its use by residents of a particular jurisdiction could decrease the velocity of trade on eBay, in which case our business would suffer.

If PayPal were found to be subject to or in violation of any laws or regulations governing banking, it could be subject to liability and forced to change its business practices.

PayPal believes that the licensing or approval requirements of the Office of the Comptroller of the Currency, the Federal Reserve Board and other federal or state agencies that regulate banks, bank holding companies or other types of providers of electronic commerce services do not apply to PayPal, except for certain money transmitter licenses mentioned below. However, one or more states may conclude that, under its or their statutes, PayPal is engaged in an unauthorized banking business. PayPal received written communications from regulatory authorities in New York, most recently in February 2002, and Louisiana expressing the view that its service as it formerly operated constituted an unauthorized banking business, and from authorities in California and Idaho in 2001 that its service might constitute an unauthorized banking business. PayPal has taken steps to address these states concerns, and has received a conclusion from the New York Banking Department that its current business model does not constitute illegal banking. PayPal also has obtained licenses to operate as a money transmitter in California, Louisiana and Idaho. However, we cannot assure you that the steps PayPal has taken to address state regulatory concerns will be effective in all states. If PayPal is found to be engaged in an unauthorized banking business in one or more states, it might be subject to monetary penalties and adverse publicity and might be required to cease doing business with residents of those states. Even if the steps it has taken to resolve these states concerns are deemed sufficient by the state regulatory authorities, PayPal could be subject to fines and penalties for its prior activities. The need to comply with state laws prohibiting unauthorized banking activities could also limit PayPal s ability to enhance its services in the future. Any change to PayPal s business practices that makes the service less attractive to customers or prohibits its use by residents of a particular jurisdiction could decrease the velocity of trade on eBay, in which case our business would suffer.

If PayPal were found to be subject to or in violation of any laws or regulations governing money transmitters, it could be subject to liability and forced to change its business practices.

A number of states have enacted legislation regulating money transmitters and PayPal has applied for licenses under this legislation in 28 jurisdictions. To date, PayPal has obtained licenses in 20 states and the District of Columbia. As a licensed money transmitter, PayPal is subject to bonding requirements, restrictions on its investment of customer funds, reporting requirements and inspection by state regulatory agencies. If PayPal s pending applications were denied, or if it were found to be subject to and in violation of any money services laws or regulations, PayPal also could be subject to liability or forced to cease doing business with residents of certain states or to change its business practices. Any change to PayPal s business practices that

Table of Contents

makes the service less attractive to customers or prohibits its use by residents of a particular jurisdiction could decrease the velocity of trade on eBay, in which case our business would suffer. Even if PayPal is not forced to change its business practices, it could be required to obtain licenses or regulatory approvals that could impose a substantial cost on PayPal.

If PayPal were to be found subject to or in violation of any laws or regulations governing electronic fund transfers, it could be subject to liability and forced to change its business practices.

Although there have been no definitive interpretations to date, PayPal has assumed that its service is subject to the Electronic Fund Transfer Act and Regulation E of the Federal Reserve Board. As a result, among other things, PayPal must provide advance disclosure of changes to its service, follow specified error resolution procedures and absorb losses from transactions not authorized by the consumer. In addition, PayPal is subject to the financial privacy provisions of the Gramm-Leach-Bliley Act and related regulations. As a result, some customer financial information that PayPal receives is subject to limitations on reuse and disclosure. Additionally, pending legislation at the state and federal levels may restrict further PayPal s information gathering and disclosure practices. Existing and potential future privacy laws may limit PayPal s ability to develop new products and services that make use of data gathered through its service. The provisions of these laws and related regulations are complicated, and PayPal does not have extensive experience in complying with these laws and related regulations. Even technical violations of these laws can result in penalties of up to $1,000 assessed for each non-compliant transaction. During the year ended December 31, 2002 and the three months ended March 31, 2003, PayPal processed approximately 348,000 and 560,000 transactions per day, respectively, and any violations could expose PayPal to significant liability.

PayPal is subject to laws and regulations on money laundering and reporting of suspicious activities that could have a material adverse impact on its business and could subject it to civil and criminal liability.

PayPal is subject to money laundering laws and regulations that prohibit, among other things, its involvement in transferring the proceeds of criminal activities. These laws and regulations require PayPal to operate an anti-money laundering program that contains at least the following elements: written policies and procedures (including those relating to customer identification), training for employees, designation of a compliance officer, and regular independent review of the program. PayPal has adopted a program to comply with these regulations, but any errors or failure to implement the program properly could lead to lawsuits, administrative action, fines and/or prosecution by the government. PayPal is also subject to regulations that require it to report suspicious activities involving transactions of $2,000 or more and to obtain and keep more detailed records on the senders and recipients in certain transfers of $3,000 or more. The interpretation of suspicious activities in this context is uncertain. Future regulations under the USA PATRIOT Act may require PayPal to revise the procedures it takes to verify the identity of its customers and to monitor more closely international transactions. These regulations could impose significant costs on PayPal and make it more difficult for new customers to join its network. PayPal could be required to learn more about its customers before opening an account, to obtain additional verification of international customers and to monitor its customers activities more closely. These requirements could raise PayPal s costs significantly and reduce the attractiveness of its product. Failure to comply with federal and state money laundering laws could result in significant criminal and civil lawsuits, penalties and forfeiture of significant assets.

PayPal s status under banking or financial services laws or other laws in countries outside the U.S. is unclear. The cost of obtaining any required licenses or regulatory approvals in these countries could affect PayPal s future profitability.

PayPal currently offers its product to customers with credit cards in 37 countries outside the U.S. In 19 of these countries, customers can withdraw funds to local bank accounts. In these countries, it is not clear whether, in order to provide its product in compliance with local law, PayPal needs to be regulated as a bank or financial institution or otherwise. If PayPal were found to be subject to and in violation of any foreign laws or regulations, it could be subject to liability, forced to change its business practices or forced to suspend operations in one or more countries. Alternatively, PayPal could be required to obtain licenses or regulatory approvals that could impose a substantial cost on it and involve considerable delay to the provision or development of its product. Implementation of PayPal s plans to enhance the attractiveness of its product for international customers, in particular its plans to offer customers the ability to transact business in major currencies in addition to the U.S. dollar, will increase the risks that it could be found to be in violation of laws or regulations in countries outside the U.S. In the fourth quarter of 2002, PayPal began offering customers the ability to send or receive payments in Pounds, Euros, Canadian Dollars or Yen, in addition to U.S. dollars.

PayPal s financial success will remain highly sensitive to changes in the rate at which its customers fund payments using credit cards rather than bank account transfers or existing PayPal account balances. PayPal s profitability could be harmed if the rate at which customers fund using credit cards goes up.

PayPal pays significant transaction fees when senders fund payment transactions using credit cards, nominal fees when customers fund payment transactions by electronic transfer of funds from bank accounts and no fees when customers fund payment transactions from an existing PayPal account balance. For the year ended December 31, 2002 and the three months ended March 31, 2003, senders funded 49.8% and 55.6%, respectively, of PayPal s payment volume using credit cards. Senders may resist funding payments by electronic transfer from bank accounts because of the greater protection offered by credit cards, including the ability to dispute and reverse merchant charges, because of frequent flier miles or other incentives offered by credit cards or because of generalized fears regarding privacy or loss of control in surrendering bank account information to a third party.

Increases in credit card processing fees could increase PayPal s costs, affect its profitability, or otherwise limit its operations.

From time to time, Visa, MasterCard, American Express and Discover increase the interchange fees that they charge for each transaction using their cards. MasterCard implemented an increase to its interchange fees effective April 2003. PayPal s credit card processors have the right to pass any increases in interchange fees on to PayPal. Any such increased fees could increase PayPal s operating costs and reduce its profit margins. Furthermore, PayPal s credit card processors require it to pledge cash as collateral with respect to PayPal s acceptance of Visa, MasterCard, American Express and Discover and the amount of cash that PayPal is required to pledge could be increased at any time.

PayPal has limited experience in managing and accounting accurately for large amounts of customer funds. PayPal s failure to manage these funds properly would harm its business.

PayPal s ability to manage and account accurately for customer funds requires a high level of internal controls. PayPal has neither an established operating history nor proven management experience in maintaining, over a long term, these internal controls. As PayPal s business continues to grow, it must strengthen its internal controls accordingly. PayPal s success requires significant public confidence in its ability to handle large and growing transaction volumes and amounts of customer funds. Any failure to maintain necessary controls or to manage accurately customer funds could diminish customer use of PayPal s product severely.

Customer complaints or negative publicity about our customer service could affect use of our services adversely and, as a result, our business could suffer.

Customer complaints or negative publicity about our customer service could diminish severely consumer confidence in and use of our services. Breaches of our customers privacy and our security measures could have the same effect. Measures we sometimes take to combat risks of fraud and breaches of privacy and security can damage relations with our customers. These measures heighten the need for prompt and accurate customer service to resolve irregularities and disputes. PayPal has received negative media coverage, as well as public criticism regarding customer disputes. Effective customer service requires significant personnel expense, and this expense, if not managed properly, could impact our profitability significantly. Any inability by us to manage or train our customer service representatives properly could compromise our ability to handle customer complaints effectively. If we do not handle customer complaints effectively, our reputation may suffer and we may lose our customers confidence.

Table of Contents

Our integration of PayPal may be difficult.

While eBay has acquired smaller companies in the past, the acquisition of PayPal represents by far the largest acquisition by eBay to date. We expect that the process of integrating PayPal s business into the eBay platform, and pursuing opportunities for PayPal s growth outside of the eBay platform, will be relatively difficult and will require significant attention from management. This may divert management s attention from its focus on eBay s principal business for an extended period of time. In addition, PayPal will continue to operate as an independent wholly owned subsidiary of eBay. Because PayPal will be relatively independent, efficient cooperation between eBay and PayPal following the merger will be crucial for a successful integration of PayPal s business into the eBay platform. PayPal s pre-merger Chief Executive Officer left the company at the time the merger was consummated and the pre-merger Chief Technical Officer, Chief Operating Officer and Chief Financial Officer left the company shortly thereafter. Accordingly, PayPal s new Chief Executive Officer and certain other members of its management have only limited experience with PayPal. There can be no assurance that PayPal s business will be integrated into the eBay platform in a timely and efficient manner or that any of the anticipated benefits of the merger will be realized. If these benefits are not realized, our business and operating results will be harmed.

Our failure to manage growth could harm us.

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

The Websites. We must constantly add new hardware, update software and add new engineering personnel to accommodate the increased use of our and our subsidiaries websites and the new products and features we are regularly introducing. This 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 are in the midst of a significant multiyear project to enhance our current technical architecture. If this project is not successful, our business could be harmed. 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 and the increased level of trust and safety activity we provide worldwide. If we are unable to 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 operating 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. If our new hires perform poorly, or if we are unsuccessful in hiring, training, managing 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. The

Table of Contents

additional headcount and capital investments we are adding increase our cost base, which will make it more difficult for us to offset any future revenue shortfalls by offsetting expense reductions in the short term.

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 or paid for through PayPal. 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 (including PayPal users), 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. 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.

We are subject to intellectual property and other litigation.

On April 25, 2001, our European subsidiaries, eBay GmbH and eBay International AG, were sued by Montres Rolex S.A. and certain Rolex affiliates, or Rolex, in the regional court of Cologne, Germany. The suit subsequently was transferred to the regional court in Dusseldorf, Germany. Rolex alleged that our subsidiaries were infringing Rolex s trademarks as a result of users selling counterfeit Rolex watches through our German website. The suit also alleged unfair competition. Rolex sought an order forbidding the sale of Rolex watches on the website as well as damages. In December 2002, a trial was held in the matter and the court ruled in favor of eBay on all causes of action. Rolex has appealed the ruling, but the appeal has not yet been briefed or heard.

On September 26, 2001, a complaint was filed by MercExchange LLC against us, our Half.com subsidiary and ReturnBuy, Inc. in the Eastern District of Virginia (No. 2:01-CV-736) alleging infringement of three patents (relating to online auction technology, multiple database searching and electronic consignment systems) and seeking a permanent injunction and damages (including treble damages for willful infringement). We answered the complaint, denying the allegations. In April 2002, we filed four motions for summary judgment relating to the three patents in suit. The court denied three of those motions and deferred ruling on the fourth motion. A Markman hearing was held in July 2002 to define certain disputed terms in the patents, and in October 2002 the court issued its claim construction findings. In October 2002, the court gave us leave to amend our answer to include a claim that MercExchange committed fraud on the patent office during the prosecution of one of the patents. On the same date, the court granted in part our pending summary judgment motion, effectively invalidating the patent related to online auction technology and rendering it unenforceable. This ruling also substantially reduced MercExchange s ability to claim damages. In November 2002, we filed two additional summary judgment motions regarding the patents. One motion was denied as moot; the other was denied because the court found there were triable issues of fact. In February 2003, we filed an additional summary judgment motion, which was subsequently denied. Only two patents remain in the case at this time. Trial of the matter began on April 23, 2003. We believe we have meritorious defenses and will defend ourselves vigorously. However, even if successful, our defense against this action will be costly and could divert our management s time. If the plaintiff were to prevail on any of its claims, we might be forced to pay significant damages and licensing fees, modify our business practices or even be enjoined from conducting a significant part of our U.S. business. Any such results could materially harm our business. We are unable to determine what potential losses we may incur if this lawsuit were to have an unfavorable outcome.

Table of Contents

On September 6, 2002, a complaint was filed by First USA Bank, N.A. against PayPal in the District of Delaware (No. 02-CV-1462) alleging infringement of two patents relating to assigning an alias to a credit card so as to eliminate the need for the physical presence of the card in a financial transaction and seeking a permanent injunction and damages. Factual discovery in the case is scheduled to end June 25, 2003, expert discovery is scheduled to take place from July to September 2003, and trial is scheduled for March 1, 2004. PayPal believes it has meritorious defenses and intends to defend itself vigorously. However, even if successful, our defense against this action will be costly and could divert management s time. If the plaintiff were to prevail on its claims, PayPal might be forced to pay significant damages and licensing fees or modify its business practices. Any such result could materially harm our business. We are unable to determine what potential losses we may incur if this suit were to have an unfavorable outcome.

On August 16, 2002, Charles E. Hill & Associates, Inc., or Hill, filed a lawsuit in the U.S. District Court for the Eastern District of Texas (No. 2:02-CV-186) alleging that we and 17 other companies, primarily large retailers, infringed three patents owned by Hill generally relating to electronic catalog systems and methods for transmitting and updating data at a remote computer. The suit seeks an injunction against continuing infringement, unspecified damages, including treble damages for willful infringement, and interest, costs, expenses and fees. In January 2003, the court granted the collective defendants motion to transfer the case from the court where it was filed in Marshall, Texas to the Federal District Court for the Southern District of Indiana. We believe that we have meritorious defenses and intend to defend ourselves vigorously.

On February 20, 2002, PayPal was sued in California state court in a purported class action alleging that its restriction of customer accounts and failure to promptly unrestrict legitimate accounts violates state consumer protection law and is an unfair business practice and a breach of PayPal s User Agreement. This action was refiled with a different named plaintiff on June 6, 2002, and a related action was filed in the U.S. District Court for the Northern District of California on the same day. On March 12, 2002, PayPal was sued in the U.S. District Court for the Northern District of California in a purported class action alleging that its restrictions of customer accounts and failure to promptly unrestrict legitimate accounts violates federal and state consumer protection and unfair business practice law. The federal court has denied PayPal s motion to compel individual arbitration as required by the PayPal User Agreement and has invalidated that provision of the User Agreement. PayPal has appealed that decision to the U.S. Court of Appeals for the Ninth Circuit. The two federal court actions have been consolidated into a single case. PayPal is defending itself vigorously, but if it is unable to prevail in these lawsuits, it may have to change its anti-fraud operations in a manner that will harm its business and pay substantial damages. Even if its defense is successful, the litigation could damage PayPal s reputation, could require significant management time, will be costly and could require changes to its customer service and operations that could increase its costs and decrease the effectiveness of its anti-fraud program.

Three purported class action complaints were filed following announcement of the PayPal merger in July 2002 in the court of Chancery in the State of Delaware in and for New Castle County by alleged stockholders of PayPal. Two additional purported class action complaints were filed in the Superior Court of the State of California, County of Santa Clara, by alleged PayPal stockholders. These complaints name as defendants PayPal and each member of its board of directors as well as eBay. The complaints are purported class actions that allege, among other things, that eBay controlled PayPal prior to the execution of their merger agreement, the defendants breached fiduciary duties they assertedly owed to PayPal s stockholders in connection with PayPal entering into the merger agreement and the exchange ratio in the merger was unfair and inadequate. The plaintiffs seek, among other things, an award of unspecified compensatory damages. We believe that each of the lawsuits is without merit and intend to defend ourselves vigorously.

Other third parties have from time to time claimed, and others may claim in the future, that we have infringed their past, current or future intellectual property rights. We have in the past been forced to litigate such claims. 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 copyright and trademark infringement claims as the geographical reach of our services expands. We also expect that we will increasingly be subject to patent infringement claims as our services expand. In particular, we expect that patent infringement claims involving various aspects of our Payments business will continue to be made. We have been notified of several potential disputes and are subject to a suit by Tumbleweed Communications Corporation that is currently ongoing. 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.

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 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.

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 buyer protection programs. Other than through these programs, 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 is increasing, and such publicity could damage our reputation, reduce our ability to attract new users and diminish the value of our brand name. We expect to continue to receive communications 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 who could take action against us, including imposing fines or seeking injunctions.

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

Table of Contents

PayPal completed its exit from the business of processing payments for online gambling merchants in November 2002. Approximately 6% of PayPal s revenues in 2002 were derived from this business. Beginning in July 2002, PayPal provided documents and information related to its services to online gambling merchants in response to a federal grand jury subpoena issued at the request of the U.S. Attorney for the Eastern District of Missouri. On March 28, 2003, PayPal received a letter from the U.S. Attorney for the Eastern District of Missouri indicating its contention that PayPal s provision of services to online gambling merchants violated 18 U.S.C. § 1960 of the USA PATRIOT Act, which prohibits the transmission of funds that are known to have been derived from a criminal offense or are intended to be used to promote or support unlawful activity, thereby subjecting PayPal to potential civil forfeiture of the amounts it received in connection with such activities as well as potential criminal liability. The letter offered a complete settlement of all possible claims and charges from the U.S. Attorney for the Eastern District of Missouri if PayPal paid the purported amount of its earnings derived from online gambling merchants during the nine-month period from October 26, 2001 to July 31, 2002, plus interest. PayPal acted in the good faith belief that its conduct did not violate 18 U.S.C. § 1960 and PayPal calculates that the amount of its earnings from online gaming activities was less than asserted in the letter. Should this investigation lead to a civil or criminal charge against PayPal, we would be harmed by negative publicity, the cost of litigation and the diversion of management time, even if PayPal ultimately prevails. Any finding of a civil or criminal violation by PayPal, or potentially any settlement, could also endanger PayPal s ability to obtain, maintain or renew money transmitter licenses in jurisdictions where it requires such licenses to operate, which would materially harm our business.

A large number of transactions occur on our websites. We believe that government regulators have received a substantial number of consumer complaints about both eBay and PayPal, 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 steps we take to protect our users from fraud and about our operations. 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, customer support procedures and operating procedures. If one or more of these agencies is not satisfied with our response to current or future inquiries, the resultant investigations and potential fines or other penalties could harm our business.

We 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 us.

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

We have acquired a number of businesses, including our acquisitions of Half.com, Internet Auction, iBazar, HomesDirect.com, NeoCom, PayPal and CARad Inc. We expect to continue to evaluate and consider a wide array of potential strategic transactions, including business combinations, acquisitions and dispositions of businesses, technologies, services, products and other assets, including interests in our existing subsidiaries and joint ventures. At any given time we may be engaged in discussions or negotiations with respect to one or more of such transactions. Any of such transactions could be material to our financial condition and results of operations. There is no assurance that any such discussions or negotiations will result in the consummation of any transaction. The process of integrating any acquisition, including the acquisition of PayPal, 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, as well as a shift of focus from operating the businesses to issues of integration and future products;

declining 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.

Foreign acquisitions involve special risks, including those related to integration of operations across different cultures, languages, currency risks and the particular economic, political 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.

Our inability to extend or renegotiate the terms of contractual arrangements with third parties who provide services to our users could harm us.

Although we generally have been able to renew or extend the terms of contractual arrangements with our third party service providers on acceptable terms, there can be no assurance that we will continue to be able to do so in the future. Our contractual arrangement with Internet Pictures Corporation, or iPIX, our exclusive third-party photo hosting service provider since 2000, is scheduled to expire on September 30, 2003, subject to certain post-termination obligations, and we do not expect to renew the contract in its current form. Over 60% of items listed on the eBay websites during the quarter ended March 31, 2003 included photos hosted by iPIX, and our research indicates that online items accompanied by a photo typically sell at a greater rate than items not accompanied by a photo. We are currently working to build equivalent functionality ourselves. We are also in negotiations with iPIX with respect to a possible transaction that involves iPIX s technology and services and involves an aggregate consideration amount that is not expected to exceed $15 million. We may be unable to successfully conclude our negotiations with iPIX or successfully develop our own equivalent photo hosting functionality prior to September 30, 2003. If we were unable to build equivalent functionality or effectively manage the transition from third party hosting, our business would be adversely affected.

Problems with third parties who provide services to our users could harm us.

A number of third parties provide services to our users that indirectly benefit us. Such services include seller tools that automate and manage listings, merchant tools that manage listings and interface with inventory management software, photo hosting, and other services. In many cases we have contractual agreements with these companies, which may give us a direct financial interest in their success, while in other cases we have none. In either circumstance, financial, regulatory or other problems that prevent these companies from providing services to our users could reduce the number of listings on our websites or make completing transactions on our websites more difficult, and thereby harm our business.

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

Third parties, including PayPal before its acquisition by us, 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 judgments 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 previously settled lawsuit against Bidder s Edge. Although the Antitrust Division has closed this inquiry, if the Department of Justice or any other antitrust agency were to 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.

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 allow the sale of certain items (e.g., real estate, boats, automobiles). We are currently subject to potential regulation under the Office of Banks and Real Estate, or OBRE, in Illinois concerning the applicability of the Illinois Auction law to our services. In August 2002, Illinois amended the Illinois auction law to provide for a special regulatory regime for Internet auction listing services. We expect to register as an Internet auction listing service in Illinois following the adoption of regulations under the amended statute. Although we do not expect this registration to have a negative impact on our business, other regulatory and licensure 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 for some locations. 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.

Our revenues from third-party advertising and end-to-end services are subject to factors beyond our control and are expected to decrease.

We recognize 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 revenues historically have been dependent in significant part on the performance of AOL s sales force. Our advertising sales relationship with AOL terminated on March 31, 2003, and we are now dependent on the efforts of our existing internal sales staff. Reduction in these revenues would adversely affect our results. At this time, we expect third-party advertising and end-to-end services revenues to decrease substantially on an absolute basis in 2003 relative to 2002.

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, claims of defamation or other injury have been made in the past and could be made in the future against us for content posted in the Feedback Forum. Claims like these are more likely and may have a higher probability of success in jurisdictions outside the U.S. If we become liable for information provided by our users and carried on our service in any jurisdiction in which we operate, we could be directly harmed and we may be forced to implement new measures to reduce our exposure to this liability. This may require us to expend substantial resources and/or to discontinue certain service offerings, which would negatively affect our financial results. In addition, the increased attention focused upon liability issues as a result of these lawsuits and legislative proposals could harm our reputation or otherwise impact the growth of our business. Any costs incurred as a result of this liability or asserted liability could harm our business.

The inability to expand our systems may limit our growth.

We seek to generate a high volume of traffic and transactions on our services. The satisfactory performance, reliability and availability of our websites, processing systems and network infrastructure are critical to our reputation and our ability to attract and retain large numbers of users. Our revenues depend primarily on the number of items listed by users, the volume of user transactions that are successfully completed, the final prices paid for the items listed and the volume of payment transactions by our payment customers. 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 project accurately 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 with our existing systems any newly developed or purchased technologies or businesses such as PayPal. These difficulties could harm or limit our ability to expand our business.

Unauthorized break-ins or other assaults on our services 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. eBay has 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 services.

System failures could harm our business.

Our system has been designed around industry standard architectures to reduce downtime in the event of outages or catastrophic occurrences. Our services provide 24 hours-a-day, seven days-a-week availability, subject to a weekly scheduled two-hour maintenance period. Our systems and operations are vulnerable to damage or interruption from earthquakes, floods, fires, power loss, telecommunication failures, terrorist attacks, computer viruses, computer denial of service attacks 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. Only some of our systems are fully redundant 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, a decision to close a facility we are using without adequate notice for financial reasons or other unanticipated problems at our hosting facilities could result in lengthy interruptions in our services. In addition, the failure by our hosting facilities 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.

Table of Contents

We have experienced system failures from time to time. eBay s 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 services 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 on our websites, our reputation and brand could be permanently harmed. We have been taking steps to increase the reliability and redundancy of our systems. These steps are expensive, reduce our margins and may not be successful in reducing the frequency or duration of unscheduled downtime.

Our infrastructure could prove unable to handle a larger volume of customer transactions. Any failure to accommodate transaction growth could impair customer satisfaction, lead to a loss of customers, impair our ability to add customers or increase its costs, all of which would harm our business.

Because our customers may use our products for critical transactions, any errors, defects or other infrastructure problems could result in damage to our customers businesses. These customers could seek significant compensation from us for their losses. Even if unsuccessful, this type of claim likely would be time consuming and costly for us to address.

We are exposed to fluctuations in currency exchange rates.

Net revenues outside the United States accounted for approximately 26% of our net revenues in the year ended December 31, 2002 and 29% of our net revenues in the three months ended March 31, 2003. Because a significant and growing portion of our business is conducted outside the United States, we face exposure to adverse movements in non-U.S. currency exchange rates. The results of operations of our internationally focused websites are exposed to foreign exchange rate fluctuations as the financial results of the applicable subsidiaries are translated from the local currency into U.S. dollars upon consolidation. In connection with its multi-currency service, PayPal fixes exchange rates twice per day, and thus may face financial exposure if exchange rates move rapidly or if the rate is set incorrectly. As exchange rates vary, net sales and other operating results, when translated, may differ materially from expectations. In particular, to the extent the U.S. dollar strengthens against the Euro, our European revenues and profits will be reduced as the result of these translation adjustments.

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 regulation;
- events affecting PayPal s business;
- announcements by us or our competitors of significant acquisitions, strategic partnerships, joint ventures, new products or capital commitments;
- unanticipated economic or political events;

sales of our common stock or other securities in the open market; and

other events or factors, including these described in this Risk Factors That May Affect Results of Operations and Financial Condition section and others that may be beyond our control.

In addition, the trading prices of Internet stocks in general, and ours in particular, have experienced extreme price and volume fluctuations in recent periods. These fluctuations often have been unrelated or disproportionate to the operating performance of these companies. The 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 our initial public offering price and from our stock price during 2002. This trading price and valuation may not be sustained. Negative changes in the public s perception of the prospects of Internet or e-commerce or technology companies have in the past and may in the 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 and off the Internet. Today there are relatively few laws specifically directed towards online services. However, due to the increasing popularity and use of the Internet and online services, many laws relating to the Internet are being debated at the state and federal levels (both in the U.S. and abroad) and it is possible that laws and regulations will be adopted with respect to the Internet or online services. These laws and regulations could cover issues such as user privacy, freedom of expression, pricing, fraud, content and quality of products and services, taxation, advertising, intellectual property rights and information security. Applicability to the Internet of existing laws governing issues such as property ownership, copyrights and other intellectual property issues, taxation, libel, obscenity and personal privacy is uncertain. The vast majority of these laws were adopted prior to the advent of the Internet and related technologies and, as a result, do not contemplate or address the unique issues of the Internet and related technologies. Those laws that do reference the Internet, such as the U.S. Digital Millennium Copyright Act and the European Union s (E.U.) Directive on Distance Selling and Electronic Commerce are only now beginning to be interpreted by the courts and implemented by the E.U. Member States, and so their applicability and scope remain somewhat uncertain. In addition, numerous states and foreign jurisdictions, including the State of California, where our headquarters is located, have regulations regarding how auctions may be conducted and the liability of auctioneers in conducting such auctions. No final legal determination has been made with respect to the applicability of the California regulations to our business to date and little precedent exists in this area. Several states and some foreign jurisdictions have attempted, and may attempt in the future, imposing such regulations upon us or our users, which could harm our business. In addition, as the nature of the products listed by our users changes, we may become subject to new regulatory restrictions, such as licensure as an auto dealer or real estate broker.

Several domestic jurisdictions have proposed, and Minnesota has recently passed, legislation that would limit the uses of personal user information gathered online or offline. Many jurisdictions already have such laws and continuously consider strengthening them, especially against online services. eBay and PayPal in certain instances are subject to some of these current laws. PayPal may be subject to recently enacted legislation in several states and countries imposing greater restrictions on the ability of financial services companies to share user information with third parties without affirmative user consent. The U.S. Federal Trade Commission also has settled several proceedings against companies 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 where we currently have a website. Compliance with these laws, given the tight integration of our systems

Table of Contents

across different countries and the need to move data to facilitate transactions amongst our users (e.g., to payment companies, shipping companies, etc.), is both necessary and difficult. Failure to comply could subject us to lawsuits, fines, criminal penalties, 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 or 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, the Australian high court has ruled that a U.S. website in certain circumstances must comply with Australian laws regarding libel. 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 criminal fines to bans on our ability to offer our services.

We are dependent on the continued growth of online commerce.

The business of selling goods over the Internet, particularly through online 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 goods. If these consumers prove to be less active than our earlier users, and we are unable to gain efficiencies in our operating costs, including our cost of acquiring new customers, our business could be adversely impacted.

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, we do not maintain any key person life insurance policies, and our Chief Executive Officer has fully vested the vast majority of her equity incentives. Our new businesses are all dependent on attracting and retaining key personnel. In addition, employee turnover and other labor problems frequently increase during the period following an acquisition as employees evaluate possible changes in compensation, culture, reporting relationships and the direction of the business. Such increased turnover could increase our costs and reduce our future revenues. Our future success also will depend on our ability to attract, train, retain and motivate highly skilled technical, managerial, marketing and customer support personnel. Competition for these personnel is intense, and we may be unable to successfully attract, integrate or retain sufficiently qualified personnel. In making employment decisions, particularly in the Internet and high-technology industries, job candidates often consider the value of the stock options they are to receive in connection with their employment. Fluctuations in our stock price may make it more difficult to retain and motivate employees whose stock option strike prices are substantially above current market prices.

Our industry 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 provides new, rapidly evolving and intensely competitive channels for the sale of all types of goods. We expect competition to intensify in the future as the barriers to entry into these channels are relatively low, as current offline and new competitors can easily launch online sites at a nominal cost using commercially available software or partnering with any one of a number of successful electronic commerce companies. Our broad-based competitors include the vast majority of traditional department, warehouse, discount and general merchandise stores, emerging online retailers, online classified services, and other shopping channels such as offline and online home shopping networks. These include most prominently: Wal-Mart, Kmart, Target, Sears, Macy s, JC Penney, Costco, Office Depot, Staples, OfficeMax, Sam s Club, Amazon.com, Buy.com, AOL.com, Yahoo! Shopping, MSN, QVC and Home Shopping Network/HSN.com.

We face competition from local, regional and national specialty retailers and exchanges in each of our categories of products. For example:

Antiques: Bonhams, Christie s, eHammer, Sotheby s, Phillips (LVMH), antique dealers and sellers

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/ Musicians Friend, Sam Ash, Gbase.com, Harmony-Central.com, musical instrument retailers and manufacturers

Sports Memorabilia: Beckett s, Collectors Universe, Mastro, Leylands, ThePit.com, Superior

Toys, Hobbies, Dolls, Bears: Toys R Us, Amazon.com/ Toysrus.com, KB Toys/ KBToys.com, FAO Inc. (FAO Schwarz, Zany Brainy, the Right Start), Lego, TY Inc.

Premium Collectibles: Bonhams, Christies, DuPont Registry, Greg Manning Auctions, iCollector, Lycos/ Skinner Auctions, Millionaire.com, Phillips (LVMH), Sotheby s, other premium collectibles dealers and sellers

Automotive (used cars and parts): Advance Auto Parts, Autonation.com, AutoPartsPlace, AutoTrader.com, Autozone, Barrett-Jackson, California Classics, CarMax, Cars.com, CarsDirect.com, Collectorcartraderonline.com, Dealix, Discount Auto Parts, Dupont Registry, eClassics.com, General Parts (Carquest), Genuine/ NAPA, Hemmings, JC Whitney, Kragen, Kruse International, TraderOnline, Trader Publishing, Wal-Mart, newspaper classifieds, used car dealers, swap meets, car clubs

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

Clothing and Accessories: Abercrombie.com, AE.com, Amazon.com, Bluefly.com, Coldwater-Creek.com, Delias.com, Dockers.com, Eddie Bauer, The Gap, Gap Online sites, J. Crew, JCrew.com, LandsEnd.com, The Limited, LLBean.com, Macy s, The Men s Wearhouse, Overstock.com, Payless.com, Ross, Urbanq.com, VictoriasSecret.com, Walmart.com, Yoox.com

Computers & Consumer Electronics: Amazon.com, Best Buy, Buy.com, Circuit City, CNET, CompUSA, Dell, Electronics Boutique, Fry s Electronics, Gamestop, Gateway, The Good Guys, MicroWarehouse, PC Connection, Radio Shack, Ritz Camera, Tech Depot, Tiger Direct, Tweeter Home Entertainment, uBid, Computer Discount Warehouse, computer, consumer electronics and photography retailers

Home & Garden: IKEA, Crate & Barrel, Home Depot, Williams-Sonoma Inc. (Pottery Barn, Williams-Sonoma), Bed, Bath & Beyond, Lowes, Linens n Things, Pier One, Ethan Allen, Frontgate, Burpee.com

Jewelry: Bluenile.com, Diamond.com, Macy s

Pottery & Glass: Just Glass, Pottery Auction, Pottery Barn, Go Collect, Pier 1 Imports, Restoration Hardware

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

Tickets: Ticketmaster, Tickets.com, ticket brokers

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

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 commerce sites including: Amazon.com, BargainAndHaggle, Surplus Auction, uBid, Yahoo! Auctions and a large number of other regional and national companies engaged in consumer-to-consumer or business-to-consumer sales. Different aspects of our fixed-priced business compete with the major Internet portals (AOL, MSN, Yahoo! and comparable companies outside the U.S.) as well as Amazon.com and others.

Our international websites compete with similar online and offline channels in each of their vertical categories in most countries. In addition, they compete with general online e-commerce sites, such as Quello and Otto in Germany, Yahoo-Kimo in Taiwan, eSellpia in South Korea, El Corte Inglés in Spain, Kelkoo in Italy and Amazon in the U.K. and other countries. In some of these countries, there are online sites that have much larger customer bases and greater brand recognition than we do, and in each of these countries there are competitors that have a better understanding of local culture and commerce than we do.

The principal competitive factors for eBay include the following:

- ability to attract buyers and sellers;
- 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 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. In addition, certain offline competitors may encourage manufacturers to limit or cease distribution of their products to dealers who sell through online channels such as eBay. The adoption by manufacturers of anti-Internet policies could force eBay users to stop selling certain products on our site. Increased competition or anti-

Table of Contents

Internet distribution policies 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 a buyer protection program that generally insures items up to a value of $200, with a $25 deductible, for users with a non-negative feedback rating at no cost to the user. In addition, certain competitors may offer or continue to offer free shipping or other transaction related services, which could be impractical or inefficient for eBay users to match. New technologies may increase the competitive pressures by enabling our competitors to offer a lower cost service.

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, Internet browsers, or search engines, or Internet-based applications could promote our competitors, channel users to electronic commerce sites that compete with us, or charge us substantial fees for inclusion.

The market for PayPal s product is emerging, intensely competitive and characterized by rapid technological change. PayPal competes with existing on-line and off-line payment methods, including, among others:

Credit card merchant processors that offer their services to online merchants, including First Data, Concord EFS, iPayment, Paymentech, and Wells Fargo; and payment gateways, including VeriSign and Authorize.net;

MoneyZap and BidPay offered by Western Union, a subsidiary of First Data;

Yahoo! PayDirect offered by Yahoo! and HSBC;

c2it offered by Citigroup;

WebPay and Valid offered by CheckFree; and

U.S.P.S. SendMoney offered by the U.S. Postal Service.

Some of these competitors have longer operating histories, significantly greater financial, technical, marketing, customer service and other resources, greater name recognition or a larger base of customers in affiliated businesses than PayPal. For example, Citigroup s c2it has existing arrangements with AOL Time Warner and Microsoft. PayPal s competitors may respond to new or emerging technologies and changes in customer requirements faster and more effectively than PayPal. They may devote greater resources to the development, promotion and sale of products and services than PayPal, and they may offer lower prices. Some of these competitors have offered, and may continue to offer, their services for free in order to gain market share, and PayPal may be forced to lower its prices in response. Competing services tied to established banks and other financial institutions may offer greater liquidity and engender greater consumer confidence in the safety and efficacy of their services than PayPal. If these competitors acquired significant market share, this could result in PayPal losing market share.

PayPal also competes with providers of traditional payment methods, particularly credit cards, checks, money orders and ACH transactions. Associations of traditional financial institutions such as Visa, MasterCard and NACHA generally set the features of these payment methods. The associations have initiated programs to enhance the usability of these payment methods for online transactions and could lower fees charged to online merchants. Either of these changes could make it more difficult for PayPal to retain and attract customers.

Overseas, PayPal faces competition from similar channels and payment methods in most countries and from regional and national online and offline competitors in each country including First Gate and World Pay in the European Community, No Chex in the U.K., CertaPay and HyperWallet in Canada, and Paymate in

Table of Contents

Australia. In addition, in certain countries, such as Germany, electronic funds transfer (EFT) is a leading method of payment for both online and offline transactions. As in the U.S., established banks and other financial institutions that do not currently offer online payments could quickly and easily develop such a service.

Half.com competes directly with online and offline retailers in its product categories such as Amazon.com, as well as with traditional offline and online sellers of new and used books, videos and CDs, consumer electronics 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 backbone computers of the Internet have been the targets of such 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.

To succeed, online commerce and communications must provide a 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. PayPal s and Billpoint s users routinely provide credit card and other financial information. We rely on encryption and authentication technology licensed from third parties to provide the security and authentication technology to effect secure transmission of confidential information, including customer credit card numbers. Advances in computer capabilities, new discoveries in the field of cryptography or other developments may result in a compromise or breach of the technology used by us to protect customer transaction data. A number of websites have reported breaches of their security. Any compromise of our security could harm our reputation and, therefore, our business. In addition, a party who is able to circumvent our security measures could misappropriate proprietary information or cause interruptions in our operations. 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. Our users may also be targeted by parties attempting to misappropriate passwords, credit card numbers or other personal information by using fraudulent emails and websites appearing to be sent or operated by us. We actively pursue the parties responsible for these attempts at misappropriation and encourage our users to divulge sensitive information only after they have verified that they are on our legitimate websites, but we cannot entirely eliminate these types of activities.

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 caused in part 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 eBay s historical growth has been largely attributable to word of mouth. Both eBay and PayPal 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 services. Promoting and positioning our brand will depend largely on the success of our marketing efforts and our ability to provide high quality services. In order to promote our brand, we will need to increase our marketing budget and otherwise increase our financial commitment to creating and maintaining brand loyalty among users. Brand promotion activities may not yield increased revenues, and even if they do, any increased revenues may not offset the expenses we incurred in building our brand. If we do attract new users to our services, they may not conduct transactions over our services 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 trademarks, copyrights, patents, domain names, trade dress and trade secrets as critical to our success. We aggressively protect our intellectual property rights by relying on a combination of trademark, copyright, patent, trade dress and trade secret laws and through the domain name dispute resolution system. We also rely on 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 domain names, trademarks and service marks in the U.S. and internationally. Effective trademark, copyright, patent, trade dress, trade secret and domain name 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 trademarks, patents and domain names in an increasing number of jurisdictions, a process that is expensive and may not be successful in every location. We have licensed in the past, and expect to license in the future, certain of our proprietary rights, such as trademarks or copyrighted material, to third parties. These licensees may take actions that might diminish the value of our proprietary rights or harm our reputation.

We are subject to the risks of owning real property.

We own real property including land, buildings and interests in a partnership holding land and buildings, primarily related to our operations. We have little experience in managing real property. Ownership of this property subjects us to 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.

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

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

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 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 (loss), net of estimated tax.

Investments in both fixed rate and floating rate interest earning instruments carry varying degrees of interest rate risk. The fair market value of our fixed rate securities may be adversely impacted due to a rise in interest rates. In general, securities with longer maturities are subject to greater interest rate risk than those with shorter maturities. 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 March 31, 2003, our fixed income investments had an unrealized gain of $2.9 million with a pretax yield of approximately 1.7% and a weighted average maturity of 2 months. If interest rates were to instantaneously increase (decrease) by 100 basis points, the fair market value of the total investment portfolio could decrease (increase) by approximately $2.9 million. Assuming an average investment balance of $2.2 billion, if weighted average rates

Table of Contents

for the year were to increase (decrease) by 100 basis points, this would translate to an increase (decrease) in interest income of approximately $22 million annually.

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

Equity Price Risk

We are exposed to equity price risk on the marketable portion of equity investments we hold, typically as the result of strategic investments in third parties that are subject to considerable market risk due to their volatility. We typically do not attempt to reduce or eliminate our market exposure in these equity investments. As of March 31, 2003, we did not have any unrealized gains or losses associated with our equity investments. 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 marketable and non-marketable equity investments were other than temporary. Accordingly, we recorded impairment charges totaling $230,000 and $1.2 million during the three months ended March 31, 2003 and December 31, 2002, respectively, relating to the other-than-temporary impairment in the fair value of equity investments. At March 31, 2003, the total value of our equity investments was $43.2 million, including $3.1 million in marketable investments.

Foreign Currency Risk

International net revenues result from transactions by our foreign operations and are typically denominated in the local currency of each country. These operations also incur most of their expenses in the local currency. Accordingly, our foreign operations use the local currency as their functional currency. Our international operations are subject to risks typical of international operations, 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.

Foreign exchange rate fluctuations may adversely impact our financial position as well as our results of operations. Foreign exchange rate fluctuations may adversely impact our financial position as the assets and liabilities of our foreign operations are translated into U.S. dollars in preparing our consolidated balance sheet. The effect of foreign exchange rate fluctuations on eBay s financial position for the three months ended March 31, 2003, was a translation gain of approximately $51.3 million. This gain is recognized as an adjustment to stockholders equity through other comprehensive income. Additionally, foreign exchange rate fluctuations may adversely impact our results of operations as exchange rate fluctuations on transactions denominated in currencies other our functional currency create gains and losses which are reflected in our consolidated statement of income. Foreign exchange rate fluctuations had an immaterial impact on our results of operations for the three months ended March 31, 2003.

As of March 31, 2003, we had outstanding forward foreign exchange contracts with notional values equivalent to approximately $70 million with maturity dates within 92 days. The forward contracts are used to offset changes in the value of assets and liabilities denominated in foreign currencies as a result of currency fluctuations. Transaction gains and losses on the contracts and the assets and liabilities are recognized each period in our statement of income and generally are offsetting. As we purchased the forward contracts on March 31, 2003, the fair values of the forward contracts were immaterial as of this date.

Item 4: ***Controls and Procedures***

(a) *Evaluation of disclosure controls and procedures.* Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, we conducted an evaluation of our disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-14(c) and 15d-14(c)) as of a date, also referred to as the Evaluation Date, within 90 days before the filing date of this quarterly report. Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that as of the Evaluation Date, the design and operation of our disclosure controls and procedures were effective.

(b) *Changes in internal controls.* There were no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the Evaluation Date, including any corrective actions with regard to significant deficiencies and material weaknesses.

PART II: OTHER INFORMATION

Item 1: ***Legal Proceedings***

On April 25, 2001, our European subsidiaries, eBay GmbH and eBay International AG, were sued by Montres Rolex S.A. and certain Rolex affiliates, or Rolex, in the regional court of Cologne, Germany. The suit subsequently was transferred to the regional court in Dusseldorf, Germany. Rolex alleged that our subsidiaries were infringing Rolex s trademarks as a result of users selling counterfeit Rolex watches through our German website. The suit also alleges unfair competition. Rolex sought an order forbidding the sale of Rolex watches on the website as well as damages. In December 2002, a trial was held in the matter and the court ruled in favor of eBay on all causes of action. Rolex has appealed the ruling, but the appeal has not yet been briefed or heard.

On September 26, 2001, a complaint was filed by MercExchange LLC against us, our Half.com subsidiary and ReturnBuy, Inc. in the Eastern District of Virginia (No. 2:01-CV-736) alleging infringement of three patents (relating to online auction technology, multiple database searching and electronic consignment systems) and seeking a permanent injunction and damages (including treble damages for willful infringement). We answered the complaint, denying the allegations. In April 2002, we filed four motions for summary judgment relating to the three patents in suit. The court denied three of those motions and deferred ruling on the fourth motion. A Markman hearing was held in July 2002 to define certain disputed terms in the patents, and in October 2002 the court issued its claim construction findings. In October 2002, the court gave us leave to amend our answer to include a claim that MercExchange committed fraud on the patent office during the prosecution of one of the patents. On the same date, the court granted in part our pending summary judgment motion, effectively invalidating the patent related to online auction technology and rendering it unenforceable. This ruling also substantially reduced MercExchange s ability to claim damages. In November 2002, we filed two additional summary judgment motions regarding the patents. One motion was denied as moot; the other was denied because the court found there were triable issues of fact. In February 2003, we filed an additional summary judgment motion, which was subsequently denied. Only two patents remain in the case at this time. Trial of the matter began April 23, 2003. We believe we have meritorious defenses and will defend ourselves vigorously. However, even if successful, our defense against this action will be costly and could divert our management s time. If the plaintiff were to prevail on any of its claims, we might be forced to pay significant damages and licensing fees, modify our business practices or even be enjoined from conducting a significant part of our U.S. business. Any such results could materially harm our business. We are unable to determine what potential losses we may incur if this lawsuit were to have an unfavorable outcome.

On September 6, 2002, a complaint was filed by First USA Bank, N.A. against PayPal in the District of Delaware (No. 02-CV-1462) alleging infringement of two patents relating to assigning an alias to a credit card so as to eliminate the need for the physical presence of the card in a financial transaction and seeking a permanent injunction and damages. Factual discovery in the case is scheduled to end June 25, 2003, expert discovery is scheduled to take place from July to September 2003, and trial is scheduled for March 1, 2004. PayPal believes it has meritorious defenses and intends to defend itself vigorously. However, even if successful, our defense against this action will be costly and could divert management s time. If the plaintiff were to prevail on its claims, PayPal might be forced to pay significant damages and licensing fees or modify its business practices. Any such result could materially harm our business. We are unable to determine what potential losses we may incur if this suit were to have an unfavorable outcome.

On August 16, 2002, Charles E. Hill & Associates, Inc., or Hill, filed a lawsuit in the U.S. District Court for the Eastern District of Texas (No. 2:02-CV-186) alleging that we and 17 other companies, primarily large retailers, infringed three patents owned by Hill generally relating to electronic catalog systems and methods for transmitting and updating data at a remote computer. The suit seeks an injunction against continuing infringement, unspecified damages, including treble damages for willful infringement, and interest, costs, expenses and fees. In January 2003, the court granted the collective defendants motion to transfer the case from the court where it was filed in Marshall, Texas to the Federal District Court for the Southern District of Indiana. We believe that we have meritorious defenses and intend to defend ourselves vigorously.

On February 20, 2002, PayPal was sued in California state court in a purported class action alleging that its restriction of customer accounts and failure to promptly unrestrict legitimate accounts violates state consumer protection law and is an unfair business practice and a breach of PayPal s User Agreement. This action was refiled with a different named plaintiff on June 6, 2002, and a related action was filed in the U.S. District Court for the Northern District of California on the same day. On March 12, 2002, PayPal was sued in the U.S. District Court for the Northern District of California in a purported class action alleging that its restrictions of customer accounts and failure to promptly unrestrict legitimate accounts violates federal and state consumer protection and unfair business practice law. The federal court has denied PayPal s motion to compel individual arbitration as required by the PayPal User Agreement and has invalidated that provision of the User Agreement. PayPal has appealed that decision to the U.S. Court of Appeals for the Ninth Circuit. The two federal court actions have been consolidated into a single case. PayPal is defending itself vigorously, but if it is unable to prevail in these lawsuits, it may have to change its anti-fraud operations in a manner that will harm its business and pay substantial damages. Even if its defense is successful, the litigation could damage PayPal s reputation, could require significant management time, will be costly and could require changes to its customer service and operations that could increase its costs and decrease the effectiveness of its anti-fraud program.

Three purported class action complaints were filed following announcement of the PayPal merger in July 2002 in the court of Chancery in the State of Delaware in and for New Castle County by alleged stockholders of PayPal. Two additional purported class action complaints were filed in the Superior Court of the State of California, County of Santa Clara, by alleged PayPal stockholders. These complaints name as defendants PayPal and each member of its board of directors as well as eBay. The complaints are purported class actions that allege, among other things, that eBay controlled PayPal prior to the execution of their merger agreement, the defendants breached fiduciary duties they assertedly owed to PayPal s stockholders in connection with PayPal entering into the merger agreement and the exchange ratio in the merger is unfair and inadequate. The plaintiffs seek, among other things, an award of unspecified compensatory damages. We believe that each of the lawsuits was without merit and intend to defend ourselves vigorously.

Other third parties have from time to time claimed, and others may claim in the future that we have infringed their past, current or future intellectual property rights. We have in the past been forced to litigate such claims. 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 copyright and trademark infringement claims as the geographical reach of our services expands. We also expect that we will increasingly be subject to patent infringement claims as our services expand. In particular, we expect that patent infringement claims involving various aspects of our Payments business will continue to be made. We have been notified of several potential disputes and are subject to a suit by Tumbleweed Communications Corporation that is currently ongoing. 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.

Table of Contents

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

Item 2: ***Changes in Securities and Use of Proceeds***

Not applicable.

Item 3: ***Defaults Upon Senior Securities***

Not applicable.

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

Not applicable.

Item 5: ***Other Information***

Audit Committee Pre-Approvals of Non-Audit Engagements

Our Audit Committee has adopted a policy requiring the pre-approval of any non-audit engagement of PricewaterhouseCoopers LLP, or PwC, our independent auditor. In the event that we wish to engage PwC to perform accounting, technical, diligence or other permitted services not related to the services performed by PwC as our independent auditor, our internal finance personnel will prepare a summary of the proposed engagement, detailing the nature of the engagement, the reasons why PwC is the preferred provider of such services and the estimated duration and cost of the engagement. The report will be provided to our Audit Committee or a designated committee member, who will evaluate whether the proposed engagement will interfere with the independence of PwC in the performance of its auditing services. We intend to disclose all approved non-audit engagements in the appropriate quarterly report on Form 10-Q or annual report on Form 10-K.

Our Audit Committee approved the following non-audit engagements during the quarter ended March 31, 2003:

- the engagement by PayPal of PwC to provide general advisory services in connection with a research and development tax credit project;
- the engagement by PayPal of PwC to perform an analysis under Statement on Accounting Standards (SAS) No. 70 (*Service Organizations*) of PayPal s information technology processes and controls;
- the engagement of PwC to provide general advisory services to us in connection with an evaluation of our internal systems, processes and controls under Section 404 of the Sarbanes-Oxley Act; and
- the engagement of PwC to provide consultations on financial accounting and reporting matters.

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

(a) *Exhibits.*

10.24 Registrant s Amended and Restated 1998 Directors Stock Option Plan.

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

On March 31, 2003, eBay furnished a report on Form 8-K to report under Item 9 that it had filed its annual report on Form 10-K, and that accompanying such report were the certifications of eBay s Chief Executive Officer and Chief Financial Officer, as required by Section 906 of the Sarbanes-Oxley Act of 2002.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: May 14, 2003

eBay Inc.

Principal Executive Officer:

By: /s/ MARGARET C. WHITMAN

Margaret C. Whitman
President and Chief Executive Officer

Principal Financial Officer:

By:/s/ RAJIV DUTTA

Rajiv Dutta
Senior Vice President, Chief Financial Officer

Principal Accounting Officer:

By:/s/ MARK J. RUBASH

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

CERTIFICATIONS

I, Margaret C. Whitman, certify that:

1. I have reviewed this quarterly report on Form 10-Q of eBay Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant s other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant s auditors and the audit committee of registrant s board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant s ability to record, process, summarize and report financial data and have identified for the registrant s auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal controls; and

6. The registrant s other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 14, 2003

/s/ MARGARET C. WHITMAN

Margaret C. Whitman
President and Chief Executive Officer
(Principal Executive Officer)

Table of Contents

CERTIFICATIONS

I, Rajiv Dutta, certify that:

1. I have reviewed this quarterly report on Form 10-Q of eBay Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant s other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant s auditors and the audit committee of registrant s board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant s ability to record, process, summarize and report financial data and have identified for the registrant s auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal controls; and

6. The registrant s other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 14, 2003

/s/ RAJIV DUTTA

Rajiv Dutta
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

Table of Contents

INDEX TO EXHIBITS

Number	Description
10.24	Registrant s Amended and Restated 1998 Directors Stock Option Plan.

64