

EBAY INC  
Form 10-Q  
October 23, 2008

Table of Contents

**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 September 30, 2008**
- 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**

*(State or other jurisdiction of  
incorporation or organization)*

**2145 Hamilton Avenue**

**San Jose, California**

*(Address of principal executive offices)*

**74-0430924**

*(I.R.S. Employer  
Identification Number)*

**95125**

*(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 a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Edgar Filing: EBAY INC - Form 10-Q

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer (Do not check if a smaller reporting company) ☐

Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

As of October 16, 2008 there were 1,276,943,660 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**

**PART I: FINANCIAL INFORMATION**

Item 1: Financial Statements

eBay Inc. CONDENSED CONSOLIDATED BALANCE SHEET

eBay Inc. CONDENSED CONSOLIDATED STATEMENT OF (LOSS) INCOME

eBay Inc. CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE (LOSS) INCOME

eBay Inc. CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

eBay Inc. NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 -- The Company and Summary of Significant Accounting Policies

Note 2 -- Net (Loss) Income Per Share

Note 3 -- Business Combinations, Goodwill and Intangible Assets

Note 4 -- Segments

Note 5 -- Fair Value Measurement of Assets and Liabilities

Note 6 -- Commitments and Contingencies

Note 7 -- Stock Repurchase Programs

Note 8 -- Stock-Based Plans

Note 9 -- Income Taxes

Note 10 -- Subsequent Events

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

**FORWARD-LOOKING STATEMENTS**

Item 3: Quantitative and Qualitative Disclosures About Market Risk

Item 4: Controls and Procedures

**PART II: OTHER INFORMATION**

Item 1: Legal Proceedings

Item 1A: Risk Factors

Item 2: Unregistered Sales of Equity Securities and Use of Proceeds

Item 3: Defaults Upon Senior Securities

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

Item 5: Other Information

Item 6: Exhibits

**SIGNATURES**

**INDEX TO EXHIBITS**

EX-10.01

EX-10.02

EX-10.03

EX-12.01

EX-31.01

EX-31.02

EX-32.01

EX-32.02

---

Table of Contents**PART I: FINANCIAL INFORMATION****Item 1: Financial Statements****eBay Inc.****CONDENSED CONSOLIDATED BALANCE SHEET**

|                                                | December 31,<br>2007                                       | September 30,<br>2008 |
|------------------------------------------------|------------------------------------------------------------|-----------------------|
|                                                | (In thousands, except<br>par value amounts)<br>(Unaudited) |                       |
| ASSETS                                         |                                                            |                       |
| Current assets:                                |                                                            |                       |
| Cash and cash equivalents                      | \$ 4,221,191                                               | \$ 3,342,717          |
| Short-term investments                         | 676,264                                                    | 301,136               |
| Accounts receivable, net                       | 480,557                                                    | 436,456               |
| Funds receivable and customer accounts         | 1,513,578                                                  | 1,555,835             |
| Other current assets                           | 230,915                                                    | 372,202               |
| Total current assets                           | 7,122,505                                                  | 6,008,346             |
| Long-term investments                          | 138,237                                                    | 133,629               |
| Property and equipment, net                    | 1,120,452                                                  | 1,215,469             |
| Goodwill                                       | 6,257,153                                                  | 6,172,133             |
| Intangible assets, net                         | 596,038                                                    | 467,610               |
| Other assets                                   | 131,652                                                    | 242,970               |
| Total assets                                   | \$ 15,366,037                                              | \$ 14,240,157         |
| LIABILITIES AND STOCKHOLDERS EQUITY            |                                                            |                       |
| Current liabilities:                           |                                                            |                       |
| Accounts payable                               | \$ 156,613                                                 | \$ 217,272            |
| Funds payable and amounts due to customers     | 1,513,578                                                  | 1,555,835             |
| Accrued expenses and other current liabilities | 1,151,139                                                  | 804,634               |
| Deferred revenue and customer advances         | 166,495                                                    | 180,777               |
| Income taxes payable                           | 111,754                                                    | 96,215                |
| Total current liabilities                      | 3,099,579                                                  | 2,854,733             |
| Deferred and other tax liabilities, net        | 510,557                                                    | 639,926               |
| Other liabilities                              | 51,299                                                     | 51,803                |
| Total liabilities                              | 3,661,435                                                  | 3,546,462             |

# Edgar Filing: EBAY INC - Form 10-Q

## Stockholders' equity:

|                                                                                                          |               |               |
|----------------------------------------------------------------------------------------------------------|---------------|---------------|
| Common Stock, \$0.001 par value; 3,580,000 shares authorized; 1,350,219 and 1,276,843 shares outstanding | 1,458         | 1,465         |
| Additional paid-in capital                                                                               | 8,996,303     | 9,385,363     |
| Treasury stock at cost, 107,522 and 188,188 shares                                                       | (3,184,981)   | (5,377,070)   |
| Retained earnings                                                                                        | 4,190,546     | 5,602,828     |
| Accumulated other comprehensive income                                                                   | 1,701,276     | 1,081,109     |
| Total stockholders' equity                                                                               | 11,704,602    | 10,693,695    |
| Total liabilities and stockholders' equity                                                               | \$ 15,366,037 | \$ 14,240,157 |

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

**Table of Contents****eBay Inc.****CONDENSED CONSOLIDATED STATEMENT OF (LOSS) INCOME**

|                                            | <b>Three Months Ended<br/>September 30,</b>     |              | <b>Nine Months Ended<br/>September 30,</b> |              |
|--------------------------------------------|-------------------------------------------------|--------------|--------------------------------------------|--------------|
|                                            | <b>2007</b>                                     | <b>2008</b>  | <b>2007</b>                                | <b>2008</b>  |
|                                            | <b>(In thousands, except per share amounts)</b> |              |                                            |              |
|                                            | <b>(Unaudited)</b>                              |              |                                            |              |
| Net revenues                               | \$ 1,889,220                                    | \$ 2,117,531 | \$ 5,491,723                               | \$ 6,505,415 |
| Cost of net revenues                       | 446,521                                         | 560,963      | 1,256,999                                  | 1,648,478    |
| Gross profit                               | 1,442,699                                       | 1,556,568    | 4,234,724                                  | 4,856,937    |
| Operating expenses:                        |                                                 |              |                                            |              |
| Sales and marketing                        | 485,240                                         | 457,216      | 1,406,260                                  | 1,497,181    |
| Product development                        | 164,879                                         | 190,842      | 450,411                                    | 554,393      |
| General and administrative                 | 287,447                                         | 331,715      | 849,284                                    | 1,020,672    |
| Amortization of acquired intangible assets | 51,888                                          | 52,720       | 150,791                                    | 162,472      |
| Impairment of goodwill                     | 1,390,938                                       |              | 1,390,938                                  |              |
| Total operating expenses                   | 2,380,392                                       | 1,032,493    | 4,247,684                                  | 3,234,718    |
| (Loss) income from operations              | (937,693)                                       | 524,075      | (12,960)                                   | 1,622,219    |
| Interest and other income, net             | 38,363                                          | 38,556       | 102,350                                    | 91,551       |
| Interest expense                           | (2,728)                                         | 11           | (10,004)                                   | (3,474)      |
| (Loss) income before income taxes          | (902,058)                                       | 562,642      | 79,386                                     | 1,710,296    |
| Provision for income taxes                 | (33,577)                                        | (70,423)     | (262,021)                                  | (298,014)    |
| Net (loss) income                          | \$ (935,635)                                    | \$ 492,219   | \$ (182,635)                               | \$ 1,412,282 |
| Net (loss) income per share:               |                                                 |              |                                            |              |
| Basic                                      | \$ (0.69)                                       | \$ 0.38      | \$ (0.13)                                  | \$ 1.08      |
| Diluted                                    | \$ (0.69)                                       | \$ 0.38      | \$ (0.13)                                  | \$ 1.07      |
| Weighted average shares:                   |                                                 |              |                                            |              |
| Basic                                      | 1,354,786                                       | 1,288,937    | 1,360,830                                  | 1,311,501    |
| Diluted                                    | 1,354,786                                       | 1,297,484    | 1,360,830                                  | 1,322,126    |

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





Table of Contents**eBay Inc.****CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE (LOSS) INCOME**

|                                                             | <b>Three Months Ended<br/>September 30,</b> |              | <b>Nine Months Ended<br/>September 30,</b> |              |
|-------------------------------------------------------------|---------------------------------------------|--------------|--------------------------------------------|--------------|
|                                                             | <b>2007</b>                                 | <b>2008</b>  | <b>2007</b>                                | <b>2008</b>  |
|                                                             | <b>(In thousands)<br/>(Unaudited)</b>       |              |                                            |              |
| Net (loss) income                                           | \$ (935,635)                                | \$ 492,219   | \$ (182,635)                               | \$ 1,412,282 |
| Other comprehensive (loss) income:                          |                                             |              |                                            |              |
| Foreign currency translation                                | 301,135                                     | (597,518)    | 464,375                                    | (367,276)    |
| Unrealized gains (losses) on investments, net               | 285,756                                     | (114,953)    | 286,441                                    | (432,424)    |
| Unrealized (losses) gains on hedging activities             | (839)                                       | 19,022       | (1,319)                                    | 11,046       |
| Tax (provision) benefit on above items                      | (114,120)                                   | 44,974       | (114,200)                                  | 168,487      |
| Net change in accumulated other comprehensive (loss) income | 471,932                                     | (648,475)    | 635,297                                    | (620,167)    |
| Comprehensive (loss) income                                 | \$ (463,703)                                | \$ (156,256) | \$ 452,662                                 | \$ 792,115   |

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

Table of Contents**eBay Inc.****CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS**

|                                                                | <b>Nine Months Ended<br/>September 30,</b> |              |
|----------------------------------------------------------------|--------------------------------------------|--------------|
|                                                                | <b>2007</b>                                | <b>2008</b>  |
|                                                                | <b>(In thousands)</b>                      |              |
|                                                                | <b>(Unaudited)</b>                         |              |
| Cash flows from operating activities:                          |                                            |              |
| Net (loss) income                                              | \$ (182,635)                               | \$ 1,412,282 |
| Adjustments:                                                   |                                            |              |
| Provision for doubtful accounts and authorized credits         | 66,848                                     | 92,234       |
| Provision for transaction losses                               | 100,848                                    | 118,197      |
| Depreciation and amortization                                  | 441,891                                    | 517,917      |
| Impairment of goodwill                                         | 1,390,938                                  |              |
| Stock-based compensation                                       | 232,160                                    | 269,481      |
| Deferred income taxes                                          | (68,934)                                   | (110,947)    |
| Tax benefits from stock-based compensation                     | 112,883                                    | 38,220       |
| Excess tax benefits from stock-based compensation              | (69,026)                                   | (4,670)      |
| Changes in assets and liabilities, net of acquisition effects: |                                            |              |
| Accounts receivable                                            | (86,316)                                   | (47,612)     |
| Funds receivable and customer accounts                         | (420,817)                                  | (42,256)     |
| Other current assets                                           | (179,927)                                  | (112,098)    |
| Other non-current assets                                       | (79,069)                                   | (26,242)     |
| Accounts payable                                               | 12,707                                     | 33,300       |
| Funds payable and amounts due to customers                     | 420,817                                    | 42,256       |
| Accrued expenses and other liabilities                         | 5,642                                      | (105,124)    |
| Deferred revenue and customer advances                         | 27,477                                     | 12,480       |
| Income taxes payable and other tax liabilities                 | 123,076                                    | 110,854      |
| Net cash provided by operating activities                      | 1,848,563                                  | 2,198,272    |
| Cash flows from investing activities:                          |                                            |              |
| Purchases of property and equipment, net                       | (326,035)                                  | (406,739)    |
| Purchases of investments                                       | (205,298)                                  | (107,990)    |
| Maturities and sales of investments                            | 783,816                                    | 42,248       |
| Acquisitions, net of cash acquired                             | (320,195)                                  | (159,064)    |
| Other                                                          | 5,523                                      | (51,369)     |
| Net cash used in investing activities                          | (62,189)                                   | (682,914)    |
| Cash flows from financing activities:                          |                                            |              |
| Proceeds from issuance of common stock, net                    | 365,199                                    | 98,727       |
| Repurchases of common stock, net                               | (1,170,699)                                | (2,179,552)  |
| Excess tax benefits from stock-based compensation              | 69,026                                     | 4,670        |

Edgar Filing: EBAY INC - Form 10-Q

|                                                              |              |              |
|--------------------------------------------------------------|--------------|--------------|
| Repayment of borrowings                                      |              | (200,220)    |
| Net cash used in financing activities                        | (736,474)    | (2,276,375)  |
| Effect of exchange rate changes on cash and cash equivalents | 199,899      | (117,457)    |
| Net increase (decrease) in cash and cash equivalents         | 1,249,799    | (878,474)    |
| Cash and cash equivalents at beginning of period             | 2,662,792    | 4,221,191    |
| Cash and cash equivalents at end of period                   | \$ 3,912,591 | \$ 3,342,717 |
| Supplemental cash flow disclosures:                          |              |              |
| Cash paid for interest                                       | \$ 6,381     | \$ 1,257     |
| Cash paid for income taxes                                   | \$ 281,657   | \$ 329,160   |
| Non-cash investing activities:                               |              |              |
| Common stock options assumed pursuant to acquisition         | \$ 10,361    | \$ 4,398     |

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. eBay's purpose is to pioneer new communities around the world, built on commerce, sustained by trust and inspired by opportunity. eBay connects hundreds of millions of people around the world every day, empowering them to explore new opportunities and innovate together. eBay Inc. does this by providing Internet platforms for global commerce, payments and communications. Since its inception, eBay Inc. has expanded to include eBay, PayPal, Skype, Shopping.com, StubHub and others.

eBay has three operating segments: Marketplaces, Payments and Communications. The Marketplaces segment enables online commerce through a variety of platforms, including the Marketplaces site comprising auction-style and fixed price formats, our classifieds websites, our comparison shopping site, Shopping.com, our secondary tickets platform, StubHub, our fixed price media marketplace, Half.com and our apartment listing service platform, Rent.com. The Payments segment, which consists of our PayPal, Inc. ( PayPal ) business, enables individuals and businesses to securely, easily and quickly send and receive payments online. The Communications segment, which consists of our Skype Technologies SA ( Skype ) business, enables Voice over Internet Protocol ( VoIP ) communications between Skype users, and provides low-cost connectivity to traditional fixed-line and mobile telephones.

When we refer to we, our, us or eBay in this document, we mean the current Delaware corporation (eBay Inc.) and California predecessor, as well as all of our consolidated subsidiaries.

***Use of estimates***

The preparation of condensed consolidated financial statements in conformity with U.S. 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 as of the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. We evaluate our estimates on an ongoing basis, including those related to provisions for doubtful accounts and authorized credits, the provision for transaction losses, legal contingencies, income taxes, marketing services and other revenues, stock-based compensation expense and goodwill and intangible assets. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results could differ from those estimates.

***Principles of consolidation and basis of presentation***

The accompanying financial statements are consolidated and include the financial statements of eBay and our majority-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

These unaudited interim financial statements reflect our condensed consolidated balance sheet as of December 31, 2007 and September 30, 2008. These statements also show our condensed consolidated statement of (loss) income and

## Edgar Filing: EBAY INC - Form 10-Q

condensed consolidated statement of comprehensive (loss) income for the three and nine months ended September 30, 2007 and 2008 and our condensed consolidated statement of cash flows for the nine months ended September 30, 2007 and 2008. These statements include all normal recurring adjustments that we believe are necessary to fairly state our financial position, operating results and cash flows. Because all of the disclosures required by U.S. generally accepted accounting principles for annual consolidated financial statements are not included herein, these interim financial statements should be read in conjunction with the audited financial statements and the notes thereto for the year ended December 31, 2007 included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission ( SEC ) on February 29, 2008. The condensed consolidated

**Table of Contents**

**eBay Inc.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

balance sheet as of December 31, 2007 was derived from our audited financial statements for the year ended December 31, 2007, but does not include all disclosures required by U.S. generally accepted accounting principles. The condensed consolidated statements of (loss) income, comprehensive (loss) income and cash flows for the periods presented are not necessarily indicative of results that we expect for any future period.

Certain prior period balances have been reclassified to conform to the current period presentation. Customer accounts were reclassified from other current assets to funds receivable and customer accounts.

***Recent accounting pronouncements***

In December 2007, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( FAS ) No. 141 (Revised 2007), Business Combinations ( FAS 141(R) ). FAS 141(R) establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, liabilities assumed, and any noncontrolling interests in the acquiree, as well as the goodwill acquired. Significant changes from current practice resulting from FAS 141(R) include the expansion of the definitions of a business and a business combination. For all business combinations (whether partial, full or step acquisitions), the acquirer will record 100% of all assets and liabilities of the acquired business, including goodwill, generally at their fair values; contingent consideration will be recognized at its fair value on the acquisition date and, for certain arrangements, changes in fair value will be recognized in earnings until settlement; and acquisition-related transaction and restructuring costs will be expensed rather than treated as part of the cost of the acquisition. FAS 141(R) also establishes disclosure requirements to enable users to evaluate the nature and financial effects of the business combination. FAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. FAS 141(R) may have an impact on our consolidated financial statements. The nature and magnitude of the specific impact will depend upon the nature, terms, and size of the acquisitions consummated after the effective date.

In December 2007, the FASB issued FAS No. 160, Noncontrolling Interests in Consolidated Financial Statements An amendment of ARB No. 51 ( FAS 160 ). FAS 160 amends Accounting Research Bulletin 51, Consolidated Financial Statements, to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary, which is sometimes referred to as minority interest, is a third-party ownership interest in the consolidated entity that should be reported as a component of equity in the consolidated financial statements. Among other requirements, FAS 160 requires the consolidated statement of income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. FAS 160 also requires disclosure on the face of the consolidated statement of income of the amounts of consolidated net income attributable to the parent and to the noncontrolling interest. FAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier adoption is not permitted. We are currently evaluating the potential impact of this statement.

In February 2008, the FASB issued FASB Staff Position FAS 157-2, Effective Date of FASB Statement No. 157 ( FSP 157-2 ), to partially defer FASB Statement No. 157, Fair Value Measurements ( FAS 157 ). FSP 157-2 defers the effective date of FAS 157 for nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), to fiscal years, and interim periods within those fiscal years, beginning after November 15, 2008. We are currently evaluating the impact of adopting the provisions of FAS 157 as it relates to non-financial assets and liabilities.

In March 2008, the FASB issued FAS No. 161, Disclosures about Derivative Instruments and Hedging Activities ( FAS 161 ). FAS 161 amends and expands the disclosure requirements of FAS 133, Accounting for Derivative Instruments and Hedging Activities and requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. This statement is

Table of Contents**eBay Inc.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

effective for financial statements issued for fiscal periods beginning after November 15, 2008. Earlier adoption is not permitted. We do not believe the adoption of FAS 161 will have a material impact on our consolidated financial statements.

In April 2008, the FASB issued FASB Staff Position FAS 142-3, Determination of Useful Life of Intangible Assets ( FSP 142-3 ). FSP 142-3 amends the factors that should be considered in developing the renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FAS 142, Goodwill and Other Intangible Assets. FSP 142-3 also requires expanded disclosure regarding the determination of intangible asset useful lives. FSP 142-3 is effective for fiscal years beginning after December 15, 2008. Earlier adoption is not permitted. We are currently evaluating the potential impact the adoption of FSP 142-3 will have on our consolidated financial statements.

In October 2008, the FASB issued FASB Staff Position FAS 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active ( FSP 157-3 ). FSP 157-3 clarified the application of FAS 157. FSP 157-3 demonstrated how the fair value of a financial asset is determined when the market for that financial asset is inactive. FSP 157-3 was effective upon issuance, including prior periods for which financial statements had not been issued. The implementation of this standard did not have an impact on our consolidated financial statements.

**Note 2 Net (Loss) Income Per Share**

Basic net (loss) income per share is computed by dividing the net (loss) income for the period by the weighted average number of common shares outstanding during the period. Diluted net (loss) income per share is computed by dividing the net (loss) income for the period by the weighted average number of shares of common stock and potentially dilutive common stock outstanding during the period. The dilutive effect of outstanding options and restricted stock is reflected in diluted earnings per share by application of the treasury stock method. The calculation of diluted net (loss) income per share excludes all anti-dilutive shares. The following table sets forth the computation of basic and diluted net (loss) income per share for the periods indicated (in thousands, except per share amounts):

|                                           | <b>Three Months Ended<br/>September 30,<br/>2007</b> |           | <b>September 30,<br/>2008</b> |           | <b>Nine Months Ended<br/>September 30,<br/>2007</b> |           | <b>2008</b> |           |
|-------------------------------------------|------------------------------------------------------|-----------|-------------------------------|-----------|-----------------------------------------------------|-----------|-------------|-----------|
| Numerator:                                |                                                      |           |                               |           |                                                     |           |             |           |
| Net (loss) income                         | \$                                                   | (935,635) | \$                            | 492,219   | \$                                                  | (182,635) | \$          | 1,412,282 |
| Denominator:                              |                                                      |           |                               |           |                                                     |           |             |           |
| Weighted average common shares basic      |                                                      | 1,354,786 |                               | 1,288,937 |                                                     | 1,360,830 |             | 1,311,501 |
| Dilutive effect of equity incentive plans |                                                      |           |                               | 8,547     |                                                     |           |             | 10,625    |
| Weighted average common shares diluted    |                                                      | 1,354,786 |                               | 1,297,484 |                                                     | 1,360,830 |             | 1,322,126 |
| Net (loss) income per share:              |                                                      |           |                               |           |                                                     |           |             |           |
| Basic                                     | \$                                                   | (0.69)    | \$                            | 0.38      | \$                                                  | (0.13)    | \$          | 1.08      |



Edgar Filing: EBAY INC - Form 10-Q

|         |    |        |    |      |    |        |    |      |
|---------|----|--------|----|------|----|--------|----|------|
| Diluted | \$ | (0.69) | \$ | 0.38 | \$ | (0.13) | \$ | 1.07 |
|---------|----|--------|----|------|----|--------|----|------|

Common stock equivalents excluded from (loss)  
income per diluted share because their effect  
would have been anti-dilutive

|         |         |         |        |
|---------|---------|---------|--------|
| 139,590 | 102,322 | 142,403 | 94,978 |
|---------|---------|---------|--------|

Table of Contents**eBay Inc.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 3 Business Combinations, Goodwill and Intangible Assets*****Acquisition of Fraud Sciences Ltd.***

On January 30, 2008, we acquired all of the outstanding shares of Fraud Sciences Ltd. ( Fraud Sciences ) for a total aggregate purchase price of approximately \$153.6 million. The purchase price consisted of cash totaling \$148.3 million, \$0.9 million in estimated acquisition-related expenses and the assumption of Fraud Sciences outstanding common stock options, valued at approximately \$4.4 million. The fair value of Fraud Sciences stock options that were assumed was determined using a Black-Scholes model. Fraud Sciences provides online risk tools and is included within our Payments segment. Fraud Sciences is expected to enhance PayPal's proprietary fraud management systems and accelerate our development of next generation fraud detection tools.

We accounted for the acquisition as a taxable purchase transaction and, accordingly, the purchase price has been allocated to the tangible assets, liabilities assumed and identifiable intangible assets acquired based on their estimated fair values on the acquisition date. The excess of the purchase price over the aggregate fair values was recorded as goodwill. The fair value assigned to identifiable intangible assets acquired is determined using the income approach, which discounts expected future cash flows to present value using estimates and assumptions determined by management. Purchased intangible assets are amortized on a straight-line basis over the respective useful lives. Our preliminary allocation of the purchase price is summarized below (in thousands):

|                                                        |            |
|--------------------------------------------------------|------------|
| Net liabilities assumed, net of cash acquired of \$198 | \$ (5,117) |
| Goodwill                                               | 135,477    |
| Developed technology                                   | 23,200     |
| Total                                                  | \$ 153,560 |

The estimated useful economic life of the acquired developed technology is two years. The allocation of the purchase price for the acquisition has been prepared on a preliminary basis and changes to that allocation may occur as additional information becomes available.

The results of operations for the acquired business have been included in our condensed consolidated statement of income for the period subsequent to our acquisition of Fraud Sciences. Fraud Sciences results of operations for periods prior to this acquisition were not material to our condensed consolidated statement of income and, accordingly, pro forma financial information has not been presented.

***Goodwill***

The following table presents goodwill balances and the movements for each of our reportable segments during the nine months ended September 30, 2008 (in thousands):

|                      | <b>December 31,<br/>2007</b> | <b>Goodwill<br/>Acquired</b> | <b>Adjustments</b> | <b>September 30,<br/>2008</b> |
|----------------------|------------------------------|------------------------------|--------------------|-------------------------------|
| Reportable segments: |                              |                              |                    |                               |
| Marketplaces         | \$ 3,016,799                 | \$ 7,435                     | \$ (183,576)       | \$ 2,840,658                  |
| Payments             | 1,348,373                    | 135,477                      | (173)              | 1,483,677                     |
| Communications       | 1,919,341                    |                              | (44,183)           | 1,875,158                     |
|                      | \$ 6,284,513                 | \$ 142,912                   | \$ (227,932)       | \$ 6,199,493                  |

Investments accounted for under the equity method of accounting are classified on our balance sheet as long-term investments. Such investments include identifiable intangible assets, deferred tax liabilities and goodwill. As

Table of Contents**eBay Inc.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

of December 31, 2007 and September 30, 2008, the goodwill related to our equity investments, included above, was approximately \$27.4 million.

The changes in goodwill during the nine months ended September 30, 2008 were due primarily to the acquisition of Fraud Sciences and foreign currency translation adjustments.

In accordance with Statement of FAS No. 142, Goodwill and Other Intangible Assets, goodwill is subject to at least an annual assessment for impairment, applying a fair-value based test. We conducted our annual impairment test as of August 31, 2008 and determined there was no impairment. There were no events or circumstances from that date through September 30, 2008 indicating that a further assessment was necessary.

***Intangible Assets***

The components of identifiable intangible assets are as follows (in thousands, except years):

|                              | December 31, 2007           |                             |                           |                                                  | September 30, 2008          |                             |                           |                                                  |
|------------------------------|-----------------------------|-----------------------------|---------------------------|--------------------------------------------------|-----------------------------|-----------------------------|---------------------------|--------------------------------------------------|
|                              | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net<br>Carrying<br>Amount | Weighted<br>Average<br>Useful<br>Life<br>(Years) | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net<br>Carrying<br>Amount | Weighted<br>Average<br>Useful<br>Life<br>(Years) |
| Intangible assets:           |                             |                             |                           |                                                  |                             |                             |                           |                                                  |
| Customer lists and user base | \$ 588,714                  | \$ (334,864)                | \$ 253,850                | 6                                                | \$ 569,793                  | \$ (393,851)                | \$ 175,942                | 6                                                |
| Trademarks and trade names   | 572,918                     | (292,854)                   | 280,064                   | 5                                                | 559,360                     | (368,513)                   | 190,847                   | 5                                                |
| Developed technologies       | 125,504                     | (85,441)                    | 40,063                    | 4                                                | 147,876                     | (102,921)                   | 44,955                    | 4                                                |
| All other                    | 62,052                      | (38,546)                    | 23,506                    | 4                                                | 114,792                     | (58,166)                    | 56,626                    | 4                                                |
|                              | \$ 1,349,188                | \$ (751,705)                | \$ 597,483                |                                                  | \$ 1,391,821                | \$ (923,451)                | \$ 468,370                |                                                  |

As of December 31, 2007 and September 30, 2008, the net carrying amount of intangible assets related to our equity investments included above was approximately \$1.4 million and \$0.8 million, respectively. All of our identifiable intangible assets are subject to amortization. Aggregate amortization expense for intangible assets was \$56.7 million and \$66.3 million for the three months ended September 30, 2007 and 2008, respectively. Aggregate amortization expense for intangible assets was \$167.6 million and \$195.2 million for the nine months ended September 30, 2007 and 2008, respectively.

Table of Contents**eBay Inc.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 4 Segments**

Operating segments are based upon our organization structure, the manner in which our operations are managed, the criteria used by our Chief Executive Officer, who is our chief decision maker for segment reporting purposes, to evaluate segment performance and the availability of separate financial information. We have three operating segments: Marketplaces, Payments and Communications.

The following tables summarize the financial performance of our operating segments (in thousands):

|                                                       | <b>Three Months Ended September 30, 2007</b> |                 |                       |                     |
|-------------------------------------------------------|----------------------------------------------|-----------------|-----------------------|---------------------|
|                                                       | <b>Marketplaces</b>                          | <b>Payments</b> | <b>Communications</b> | <b>Consolidated</b> |
| Net revenues from external customers                  | \$ 1,320,632                                 | \$ 470,396      | \$ 98,192             | \$ 1,889,220        |
| Direct costs                                          | 760,918                                      | 386,474         | 83,758                | 1,231,150           |
| Direct contribution                                   | \$ 559,714                                   | \$ 83,922       | \$ 14,434             | 658,070             |
| Operating expenses and indirect costs of net revenues |                                              |                 |                       | 1,595,763           |
| Loss from operations                                  |                                              |                 |                       | (937,693)           |
| Interest and other income, net                        |                                              |                 |                       | 38,363              |
| Interest expense                                      |                                              |                 |                       | (2,728)             |
| Loss before income taxes                              |                                              |                 |                       | \$ (902,058)        |

|                                                       | <b>Three Months Ended September 30, 2008</b> |                 |                       |                     |
|-------------------------------------------------------|----------------------------------------------|-----------------|-----------------------|---------------------|
|                                                       | <b>Marketplaces</b>                          | <b>Payments</b> | <b>Communications</b> | <b>Consolidated</b> |
| Net revenues from external customers                  | \$ 1,376,853                                 | \$ 597,211      | \$ 143,467            | \$ 2,117,531        |
| Direct costs                                          | 789,109                                      | 483,713         | 105,766               | 1,378,588           |
| Direct contribution                                   | \$ 587,744                                   | \$ 113,498      | \$ 37,701             | 738,943             |
| Operating expenses and indirect costs of net revenues |                                              |                 |                       | 214,868             |
| Income from operations                                |                                              |                 |                       | 524,075             |
| Interest and other income, net                        |                                              |                 |                       | 38,556              |
| Interest expense                                      |                                              |                 |                       | 11                  |

Income before income taxes \$ 562,642

|                                                       | <b>Nine Months Ended September 30, 2007</b> |                 |                       |                     |
|-------------------------------------------------------|---------------------------------------------|-----------------|-----------------------|---------------------|
|                                                       | <b>Marketplaces</b>                         | <b>Payments</b> | <b>Communications</b> | <b>Consolidated</b> |
| Net revenues from external customers                  | \$ 3,861,384                                | \$ 1,363,904    | \$ 266,435            | \$ 5,491,723        |
| Direct costs                                          | 2,180,678                                   | 1,104,055       | 239,429               | 3,524,162           |
| Direct contribution                                   | \$ 1,680,706                                | \$ 259,849      | \$ 27,006             | 1,967,561           |
| Operating expenses and indirect costs of net revenues |                                             |                 |                       | 1,980,521           |
| Loss from operations                                  |                                             |                 |                       | (12,960)            |
| Interest and other income, net                        |                                             |                 |                       | 102,350             |
| Interest expense                                      |                                             |                 |                       | (10,004)            |
| Income before income taxes                            |                                             |                 |                       | \$ 79,386           |

Table of Contents**eBay Inc.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

|                                                       | <b>Nine Months Ended September 30, 2008</b> |                 |                       |                     |
|-------------------------------------------------------|---------------------------------------------|-----------------|-----------------------|---------------------|
|                                                       | <b>Marketplaces</b>                         | <b>Payments</b> | <b>Communications</b> | <b>Consolidated</b> |
| Net revenues from external customers                  | \$ 4,319,201                                | \$ 1,780,585    | \$ 405,629            | \$ 6,505,415        |
| Direct costs                                          | 2,440,797                                   | 1,417,231       | 322,880               | 4,180,908           |
| Direct contribution                                   | \$ 1,878,404                                | \$ 363,354      | \$ 82,749             | 2,324,507           |
| Operating expenses and indirect costs of net revenues |                                             |                 |                       | 702,288             |
| Income from operations                                |                                             |                 |                       | 1,622,219           |
| Interest and other income, net                        |                                             |                 |                       | 91,551              |
| Interest expense                                      |                                             |                 |                       | (3,474)             |
| Income before income taxes                            |                                             |                 |                       | \$ 1,710,296        |

Direct costs of operating segments include specific costs of net revenues, sales and marketing expenses, product development 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, site operations expenses, billing operations, certain technology and facilities expenses, transaction expenses, provisions for doubtful accounts, authorized credits and transaction losses. Segment managers do not have discretionary control over expenses such as our corporate center costs (consisting of costs related to corporate management, human resources, finance and legal), amortization of intangible assets, stock-based compensation expenses and impairment of goodwill as they are not evaluated in the measurement of segment performance.

**Note 5 Fair Value Measurement of Assets and Liabilities**

The following table summarizes our financial assets and liabilities measured at fair value on a recurring basis in accordance with FAS 157 as of September 30, 2008 (in thousands):

| <b>Description</b> | <b>Balance as of<br/>September 30,<br/>2008</b> | <b>Quoted Prices in<br/>Active Markets<br/>for<br/>Identical Assets<br/>(Level 1)</b> | <b>Significant Other<br/>Observable<br/>Inputs<br/>(Level 2)</b> |
|--------------------|-------------------------------------------------|---------------------------------------------------------------------------------------|------------------------------------------------------------------|
|                    |                                                 |                                                                                       |                                                                  |

**Assets:**

Cash and cash equivalents:

Edgar Filing: EBAY INC - Form 10-Q

|                                      |    |           |    |           |    |         |
|--------------------------------------|----|-----------|----|-----------|----|---------|
| Bank deposits and money market funds | \$ | 2,720,693 | \$ | 2,720,693 | \$ |         |
| Commercial paper                     |    | 622,024   |    |           |    | 622,024 |
| Total cash and cash equivalents      |    | 3,342,717 |    | 2,720,693 |    | 622,024 |
| Short-term investments:              |    |           |    |           |    |         |
| Restricted cash                      |    | 22,216    |    | 22,216    |    |         |
| Equity instruments                   |    | 165,365   |    | 165,365   |    |         |
| Time deposits                        |    | 97,303    |    |           |    | 97,303  |
| Corporate debt securities            |    | 16,252    |    |           |    | 16,252  |
| Total short-term investments         |    | 301,136   |    | 187,581   |    | 113,555 |
| Long-term restricted cash            |    | 6,854     |    | 6,854     |    |         |
| Derivatives                          |    | 18,995    |    |           |    | 18,995  |
| Total financial assets               | \$ | 3,669,702 | \$ | 2,915,128 | \$ | 754,574 |
| <b>Liabilities:</b>                  |    |           |    |           |    |         |
| Derivatives                          | \$ | 8,532     | \$ |           | \$ | 8,532   |



**Table of Contents**

**eBay Inc.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Our financial assets and liabilities are valued using market prices on both active markets (level 1) and less active markets (level 2). Level 1 instrument valuations are obtained from real-time quotes for transactions in active exchange markets involving identical assets. Level 2 instrument valuations are obtained from readily-available pricing sources for comparable instruments. As of September 30, 2008, we did not have any assets or liabilities without observable market values that would require a high level of judgment to determine fair value (level 3 assets). Our derivative instruments are valued using pricing models that take into account the contract terms as well as multiple inputs where applicable, such as equity prices, interest rate yield curve, option volatility and currency rates. Our derivative instruments are short-term in nature, typically one month to one year in duration.

We incurred a reduction in unrealized gains of \$115.0 million and \$432.4 million for the three and nine months ended September 30, 2008, respectively. These reductions in unrealized gains are due primarily to the difference in value of our investment in MercadoLibre at the beginning and end of the period and are excluded from earnings and reported as a component of accumulated other comprehensive income. At September 30, 2008, our investment in MercadoLibre had an aggregate unrealized gain of \$156.9 million. We do not anticipate any significant realized losses associated with this investment as our historical cost basis is not significant.

In addition to the long-term restricted cash, noted above, we had approximately \$126.8 million of cost and equity method investments at September 30, 2008, classified within long-term investments on the condensed consolidated balance sheet.

As of September 30, 2008, we held no direct investments in auction rate securities, collateralized debt obligations, structured investment vehicles or mortgage-backed securities.

In Europe, we have a cash pooling arrangement with a financial institution for cash management purposes. This arrangement allows for cash withdrawals from this financial institution based upon our aggregate operating cash balances held in Europe within the same financial institution ( Aggregate Cash Deposits ). This arrangement also allows us to withdraw amounts exceeding the Aggregate Cash Deposits up to an agreed-upon limit. The net balance of the withdrawals and the Aggregate Cash Deposits are used by the financial institution as a basis for calculating our net interest expense or income. As of September 30, 2008, we had a total of \$1.8 billion in cash withdrawals offsetting our \$1.9 billion in Aggregate Cash Deposits held within the same financial institution under this cash pooling arrangement.

**Note 6 Commitments and Contingencies**

***Litigation and Other Legal Matters***

In April 2001, two of our European subsidiaries, eBay GmbH and eBay International AG, were sued by Montres Rolex S.A. and certain of its affiliates. 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 enjoining the sale of Rolex-branded watches on the website as well as damages. The matter was eventually decided by the German Supreme Court which in 2007 held, following a 2004 precedent in the matter of *Rolex v Ricardo*, that eBay must take reasonable measures to prevent recurrence once it is informed of clearly identified infringement, and that eBay may in certain circumstances be liable upon first notice of infringement. The court referred the case back to the Higher Regional Court to determine whether, in some circumstances, a low

starting listing price was sufficient to indicate that a listing was infringing. In July 2007, the German Federal Supreme Court extended the reach of the *Rolex* decision in *IVD v. eBay*. The court held that (i) in certain circumstances, a duty of care could be found to exist to competitors requiring eBay to take reasonable measures to prevent illegal items from being listed (even where the competitors were not directly harmed) and (ii) such duty would extend to listings by the same seller in the same category (not just identical listings). We expect that this ruling will likely result in increased costs and litigation against us in Germany although we do not currently believe that it will require a major change in our business practices.

**Table of Contents**

**eBay Inc.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In August 2006, Louis Vuitton Malletier and Christian Dior Couture filed two lawsuits in the Paris Court of Commerce against eBay Inc. and eBay International AG. Among other things, the complaint alleges that we violated French tort law by negligently broadcasting listings posted by third parties offering counterfeit items bearing plaintiffs trademarks, and by purchasing certain advertising keywords. Around September 2006, Parfums Christian Dior, Kenzo Parfums, Parfums Givenchy, and Guerlain Société also filed a lawsuit in the Paris Court of Commerce against eBay Inc. and eBay International AG. The complaint alleges that we have interfered with the selective distribution network the plaintiffs established in France and the European Union by allowing third parties to post listings offering genuine perfumes and cosmetics for sale on our websites. In June 2008, the Paris Court of Commerce ruled that eBay and eBay International AG were liable for failing to prevent the sale of counterfeit items on its websites that traded on plaintiffs brand names and for interfering with the plaintiffs selective distribution network. The court awarded plaintiffs approximately EUR 38.6 million in damages and issued an injunction prohibiting all sales of perfumes and cosmetics bearing the Dior, Guerlain, Givenchy and Kenzo brands over all worldwide eBay sites to the extent that they are accessible from France. We have taken measures to comply with the injunction and have appealed these rulings. However, these and similar suits may force us to modify our business practices, which could lower our revenue, increase our costs, or make our websites less convenient to our customers. Any such results could materially harm our business. Other luxury brand owners have also filed suit against us or have threatened to do so, seeking to hold us liable for, among other things, alleged counterfeit items listed on our websites by third parties, for tester and other not for resale consumer products listed on our websites by third parties, for the alleged misuse of trademarks in listings, for alleged violations of selective distribution channel laws, for alleged non-compliance of consumer protection laws or in connection with paid search advertisements. We continue to believe that we have meritorious defenses to these suits and intend to defend ourselves vigorously.

In June 2006, Net2Phone, Inc. filed a lawsuit in the U.S. District Court for the District of New Jersey (No. 06-2469) alleging that eBay Inc., Skype Technologies S.A., and Skype Inc. infringed five patents owned by Net2Phone relating to point-to-point Internet protocol. The suit seeks an injunction against continuing infringement, unspecified damages, including treble damages for willful infringement, and interest, costs, and fees. We have filed an answer and counterclaims asserting that the patents are invalid, unenforceable, and were not infringed. The parties have completed claim construction briefing and most of fact discovery and are conducting expert discovery. The pretrial conference is scheduled for November 2008. We believe that we have meritorious defenses and intend to defend ourselves vigorously.

In March 2007, a plaintiff filed a purported antitrust class action lawsuit against eBay in the Western District of Texas alleging that eBay and its wholly owned subsidiary PayPal monopolized markets through various anticompetitive acts and tying arrangements. The plaintiff alleges claims under sections 1 and 2 of the Sherman Act, as well as related state law claims. The complaint seeks treble damages and an injunction. In April 2007, the plaintiff re-filed the complaint in the U.S. District Court for the Northern District of California (No. 07-CV-01882-RS), and dismissed the Texas action. In May 2007, the case was consolidated with other similar lawsuits (No. 07-CV-01882JF). In June 2007, we filed a motion to dismiss the class action complaint. In March 2008, the court granted the motion to dismiss the tying claims with leave to amend and denied the motion with respect to the monopolization claims. Plaintiffs subsequently decided not to refile the tying claims. The class certification motion is scheduled for January 2009. We believe that we have meritorious defenses and intend to defend ourselves vigorously.

In May 2007, Netcraft Corporation filed a lawsuit in the Western District of Wisconsin (No. 07-C-0254C) alleging that eBay and PayPal infringed two of its patents entitled Internet billing methods. The suit seeks an injunction against

continuing infringement, unspecified damages, and interest, costs, and fees. In September 2007, we filed a motion for summary judgment of noninfringement on both patents. In December 2007, the U.S. District Court for the Western District of Wisconsin entered a judgment granting our motion for summary judgment of non-infringement on both of the patents that Netcraft asserted against eBay and PayPal. Netcraft Corporation has appealed the judgment. Both sides have filed their appeal briefs, and oral argument took place in October 2008 before the Court of Appeals for the Federal Circuit.

**Table of Contents**

**eBay Inc.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In October 2007, PartsRiver filed a lawsuit in the Eastern District of Texas (No. 2-07CV-440-DF) alleging that eBay, Microsoft, Yahoo!, Shopzilla, PriceGrabber and PriceRunner infringed its patent relating to search methods. The suit seeks an injunction against continuing infringement, unspecified damages, and interest, costs, and fees. The defendants have moved to transfer venue and the parties are conducting discovery. Fact discovery cutoff is scheduled for July 2009, and trial is scheduled for October 2009. We believe that we have meritorious defenses and intend to defend ourselves vigorously.

eBay's Korean subsidiary, IAC, has notified a majority of its approximately 20 million users of a data breach involving personally identifiable information including name, address, resident registration number and some transaction and refund data (but not including credit card information or real time banking information). Approximately 139,000 users have sued IAC over this breach in several lawsuits and we expect more to do so in the future. There is some precedent in Korea for a court to grant consolation money for data breaches without a specific finding of harm from the breach. Such precedents have involved payments of up to approximately \$200 per user. IAC intends to vigorously defend itself in this lawsuit.

Other third parties have from time to time claimed, and others may claim in the future, that we have infringed their intellectual property rights. We are subject to additional patent disputes, and expect that we will increasingly be subject to patent infringement claims as our services expand in scope and complexity. In particular, we expect that we may face additional patent infringement claims involving various aspects of our Marketplaces, Payments and Communications businesses. We have in the past been forced to litigate such claims. We may also become more vulnerable to third-party claims as laws such as the Digital Millennium Copyright Act, the Lanham Act and the Communications Decency Act are interpreted by the courts, and as we become subject to laws in jurisdictions where the underlying laws with respect to the potential liability of online intermediaries like ourselves are either unclear or less favorable. We believe that additional lawsuits alleging that we have violated copyright or trademark laws will be filed against us. Intellectual property claims, whether meritorious or not, are time consuming and costly to resolve, could require expensive changes in our methods of doing business, or could require us to enter into costly royalty or licensing agreements.

From time to time, we are involved in other disputes or regulatory inquiries that arise in the ordinary course of business. The number and significance of these disputes and inquiries are increasing as our business expands and our company grows larger. Any claims or regulatory actions against us, whether meritorious or not, could be time consuming, result in costly litigation, require significant amounts of management time, and result in the diversion of significant operational resources.

***Credit Agreement***

Lehman Brothers Commercial Bank was a participating lender in our \$2.0 billion credit agreement. As a result of the bankruptcy of its parent company, our available line of credit has been reduced by its commitment of \$160 million. As of September 30, 2008, we had no outstanding borrowings under this credit agreement. As of September 30, 2008, we were in compliance with the financial covenants associated with the credit agreement. See Note 10 Subsequent Events for discussion of activity related to the line of credit after September 30, 2008.

***Indemnification Provisions***

In the ordinary course of business, we have included limited indemnification provisions in certain of our agreements with parties with which we have commercial relations, including our standard marketing, promotions and application-programming-interface license agreements. Under these contracts, we generally indemnify, hold harmless, and agree to reimburse the indemnified party for losses suffered or incurred by the indemnified party in connection with claims by a third party with respect to domain names, trademarks, logos and other branding elements to the extent that such marks are applicable to our performance under the subject agreement. In a limited number of agreements, we have provided an indemnity for other types of third-party claims, which are indemnities mainly related to copyrights, trademarks, and patents. In our PayPal business, we have provided an indemnity to our

**Table of Contents****eBay Inc.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

payment processors in the event of certain third-party claims or card network fines against the processor arising out of conduct by PayPal or PayPal's customers. It is not possible to determine the maximum potential loss under these indemnification provisions due to our limited history of prior indemnification claims and the unique facts and circumstances involved in each particular provision. To date, no significant costs have been incurred, either individually or collectively, in connection with our indemnification provisions.

**Note 7 Stock Repurchase Programs**

In January 2008, our Board authorized a stock repurchase program to provide for the repurchase of up to \$2.0 billion of our common stock, excluding broker commissions, with no expiration from the date of authorization. This program is in addition to our previously announced stock repurchase program. The stock repurchase activity under the stock repurchase programs during the first nine months of 2008 is summarized as follows (in thousands, except per share amounts):

|                                           | <b>Shares<br/>Repurchased</b> | <b>Average<br/>Price per<br/>Share</b> | <b>Value of<br/>Shares<br/>Repurchased</b> | <b>Remaining<br/>Amount<br/>Authorized</b> |
|-------------------------------------------|-------------------------------|----------------------------------------|--------------------------------------------|--------------------------------------------|
| Balance at January 1, 2008                | 99,084                        | \$ 31.84                               | \$ 3,154,682                               | \$ 845,318                                 |
| Authorization of new plan in January 2008 |                               |                                        |                                            | 2,000,000                                  |
| Repurchase of common stock                | 80,608                        | 27.15                                  | 2,188,818                                  | (2,188,818)                                |
| Balance at September 30, 2008             | 179,692                       | \$ 29.74                               | \$ 5,343,500                               | \$ 656,500                                 |

These repurchased shares are recorded as treasury stock and are accounted for under the cost method. No repurchased shares have been retired or reissued.

From time to time, we enter into structured equity hedging transactions. According to the terms of these transactions, if the market price of our common stock exceeds a pre-determined price on the maturity date, we have the option to settle these transactions in cash or by repurchasing shares of our common stock. If the market price of our common stock is below that pre-determined price on the maturity date, we are required to settle these transactions by repurchasing shares of our common stock. The number of shares repurchased through the use of structured equity hedging transactions are included in the table above. The structured equity hedging transactions that settled in cash during the nine months ended September 30, 2008, resulted in premiums of approximately \$12.3 million, which were recorded as additional paid-in capital.

**Note 8 Stock-Based Plans*****Stock Options***

The following table summarizes stock option activity for the nine-month period ended September 30, 2008 (in thousands):

|                                   | <b>Shares</b> |
|-----------------------------------|---------------|
| Outstanding at January 1, 2008    | 117,862       |
| Granted and assumed               | 10,875        |
| Exercised                         | (4,730)       |
| Forfeited/expired/cancelled       | (11,238)      |
| Outstanding at September 30, 2008 | 112,769       |

Stock options granted under our equity incentive plans generally vest 25% one year from the date of grant (for new hires) and 12.5% six months from the date of grant (for existing employees) and the remainder generally vest at a rate of 2.08% per month thereafter, in either case based on the optionee's continuing service to eBay, and generally expire



Table of Contents**eBay Inc.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

seven to ten years from the date of grant. The weighted average exercise price of stock options granted and assumed during the period was \$25.13 per share and the related weighted average grant date fair value was \$7.56 per share.

***Restricted Stock Units and Performance-Based Restricted Stock Units***

The following table summarizes restricted stock unit activity for the nine-month period ended September 30, 2008 (in thousands):

|                                   | <b>Units</b> |
|-----------------------------------|--------------|
| Outstanding at January 1, 2008    | 8,833        |
| Awarded                           | 19,492       |
| Vested                            | (1,943)      |
| Forfeited                         | (2,042)      |
| Outstanding at September 30, 2008 | 24,340       |

In general, restricted stock units vest over three to five years and are subject to the recipient's continuing service to eBay. The cost of restricted stock units is determined using the fair value of our common stock on the date of grant. The weighted average grant date fair value for restricted stock units awarded during the period was \$25.97 per share.

During the first nine months of 2008, we awarded 86,550 restricted stock units (which are included in the restricted stock unit activity table above) under the performance-based restricted stock unit plan in accordance with the satisfaction of performance conditions related to such performance-based restricted stock units.

***Stock-based Compensation Expense***

The impact on our results of operations of recording stock-based compensation expense for the three and nine months ended September 30, 2007 and 2008 was as follows (in thousands):

|                                        | <b>Three Months Ended<br/>September 30,<br/>2007</b> |             | <b>Nine Months Ended<br/>September 30,<br/>2007</b> |             |
|----------------------------------------|------------------------------------------------------|-------------|-----------------------------------------------------|-------------|
|                                        |                                                      | <b>2008</b> |                                                     | <b>2008</b> |
| Cost of net revenues                   | \$ 9,132                                             | \$ 10,395   | \$ 27,543                                           | \$ 31,908   |
| Sales and marketing                    | 22,192                                               | 23,745      | 64,501                                              | 72,096      |
| Product development                    | 21,374                                               | 23,458      | 56,751                                              | 71,627      |
| General and administrative             | 27,891                                               | 32,653      | 83,365                                              | 93,850      |
| Total stock-based compensation expense | \$ 80,589                                            | \$ 90,251   | \$ 232,160                                          | \$ 269,481  |

Total stock-based compensation expense included in capitalized development costs was \$2.2 million and \$3.4 million for the three months ended September 30, 2007 and 2008, respectively. Total stock-based compensation expense included in capitalized development costs was \$6.4 million and \$8.2 million for the nine months ended September 30, 2007 and 2008, respectively.

Table of Contents**eBay Inc.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Valuation Assumptions***

We calculated the fair value of each option award on the date of grant using the Black-Scholes option pricing model. The following weighted average assumptions were used for the three and nine months ended September 30, 2007 and 2008:

|                           | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|---------------------------|---------------------------------------------|-------------|--------------------------------------------|-------------|
|                           | <b>2007</b>                                 | <b>2008</b> | <b>2007</b>                                | <b>2008</b> |
| Risk-free interest rates  | 4.5%                                        | 2.9%        | 4.5%                                       | 2.3%        |
| Expected lives (in years) | 3.4                                         | 3.9         | 3.5                                        | 3.8         |
| Dividend yield            | 0%                                          | 0%          | 0%                                         | 0%          |
| Expected volatility       | 40%                                         | 40%         | 36%                                        | 34%         |

Our computation of expected volatility is based on a combination of historical and market-based implied volatility from traded options on our common stock. Our computation of expected life was determined based on historical experience of similar awards, giving consideration to the contractual terms of the stock-based awards, vesting schedules and expectations of future employee behavior. The interest rate for periods within the contractual life of the award is based on the U.S. Treasury yield curve in effect at the time of grant.

**Note 9 Income Taxes**

The following table reflects changes in unrecognized tax benefits for the nine-month period ended September 30, 2008 (in thousands):

|                                                                                                   |            |
|---------------------------------------------------------------------------------------------------|------------|
| Gross amounts of unrecognized tax benefits as of January 1, 2008                                  | \$ 494,253 |
| Gross amounts of increases in unrecognized tax benefits for tax positions taken during the period | 116,042    |
| Gross amounts of unrecognized tax benefits as of September 30, 2008                               | \$ 610,295 |

As of September 30, 2008, our liabilities for unrecognized tax benefits were included in deferred and other tax liabilities, net. The total liabilities for unrecognized tax benefits and the increase for the current period of these liabilities relate primarily to the allocations of revenue and costs among our global operations. Over the next twelve months, our existing tax positions will continue to generate an increase in liabilities for unrecognized tax benefits. We recognize interest and/or penalties related to uncertain tax positions in income tax expense. The amount of interest and penalties accrued at September 30, 2008 was approximately \$29.6 million.

We are subject to taxation in the U.S. and various states and foreign jurisdictions. We are under examination by certain tax authorities for the 2003 tax year. The material jurisdictions that are subject to potential examination by tax authorities for tax years after 2002 include, among others, the U.S., California, France, Germany, Italy, Switzerland

and Singapore.

**Note 10 Subsequent Events**

On October 3, 2008 we entered into a definitive agreement to acquire all of the equity securities of Bill Me Later for approximately \$820 million in cash and \$125 million worth of outstanding options, net of option exercise proceeds. Bill Me Later has expertise in deferred payments and promotional financing services. The transaction is expected to close in the fourth quarter of 2008.

On October 6, 2008 we completed the acquisition of all of the equity securities of Den Blå Avis and Bilbasen, and certain other related companies, for a purchase price of approximately \$390 million in cash. Den Blå Avis and Bilbasen are two leading online classifieds sites in Denmark. The total purchase price will be allocated to the

**Table of Contents**

**eBay Inc.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values as of the acquisition date.

On October 6, 2008, we announced an initiative to simplify and streamline our organization, improve our cost structure and strengthen the overall competitiveness of our existing businesses through a reduction in our global workforce. As a result of this initiative, we expect to incur aggregate costs of approximately \$70-\$80 million, with the charges predominantly recorded in the fourth quarter of 2008.

On October 16, 2008, we drew down an aggregate amount of \$1.0 billion under our revolving credit facility pursuant to the Credit Agreement. We expect that the funds will be used for general corporate purposes, including financing the acquisition of Bill Me Later, Inc. and its associated receivables. See Note 6 Commitments and Contingencies for further information on the Credit Agreement.

**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 within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including statements that involve expectations, plans or intentions (such as those relating to future business or financial results, new features or services, or management strategies). You can identify these forward-looking statements by words such as may, will, should, could, expect, anticipate, believe, estimate, intend, plan and other similar expressions. These forward-looking statements involve risks and uncertainties that could cause our actual results to differ materially from those expressed or implied in our forward-looking statements. Such risks and uncertainties include, among others, those discussed in Part II Item 1A: Risk Factors, of this Quarterly Report on Form 10-Q as well as our consolidated financial statements, related notes, and the other financial information appearing elsewhere in this report and our other filings with the Securities and Exchange Commission, or the SEC. We do not intend, and undertake no obligation, to update any of our forward-looking statements after the date of this report to reflect actual results or future events or circumstances. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.*

You should read the following Management's Discussion and Analysis of Financial Condition and Results of Operations in conjunction with the unaudited condensed consolidated financial statements and the related notes that appear elsewhere in this report.

**Our Business**

We operate three primary business segments: Marketplaces, Payments and Communications. The Marketplaces segment enables online commerce through a variety of different platforms, including the Marketplaces site comprising auction-style and fixed priced formats, our classifieds websites, our comparison shopping site, Shopping.com, our secondary tickets platform, StubHub, our fixed price media marketplace, Half.com, and our apartment listing service platform, Rent.com. Our Payments segment, which consists of PayPal, enables individuals and businesses to securely, easily and quickly send and receive payments online. Our Communications segment, which consists of Skype, enables VoIP communications between Skype users and also provides Skype users low-cost connectivity to traditional fixed-line and mobile telephones.

**Key Operating Metrics and Financial Performance**

Members of our senior management team regularly review key operating metrics such as active users, sold items, listings, Gross Merchandise Volume ( GMV ), net Total Payment Volume ( TPV ), transaction loss rates, Skype registered users and SkypeOut minutes. Members of our senior management team also regularly review key financial information including net revenues, operating margins, earnings per share, cash flows and financial metrics that exclude certain non-cash items. These financial measures allow us to monitor the profitability of our business and to evaluate the effectiveness of investments that we have made (and continue to make) in the areas of marketing, product development, international expansion, customer support and site operations. We believe that an understanding of these key operating and financial measures and how they change over time is important to investors, analysts and other parties analyzing our business results and future market opportunities.

**Financial Summary**

Net revenues for the three months ended September 30, 2008 were \$2.1 billion, representing an increase of 12% compared to the same period of the prior year. Our revenue growth continues to be driven by PayPal merchant services, global classifieds, advertising and Skype as well as a weaker U.S. dollar relative to other currencies (primarily the Euro). Our revenue growth, particularly in our Marketplaces and Payments segments, was negatively impacted by the difficult global economic environment as buyers reduced their spending. Operating income for the three months ended September 30, 2008 was \$524.1 million, or 25% of net revenues, compared to an operating loss of \$937.7 million, or (50%) of net revenues, in the same period of the prior year. The year over year change in operating margin (which is operating income as a percentage of net revenues) was due to the goodwill impairment

**Table of Contents**

charge in 2007 as well as margins improving in all three of our business segments offset by the continued faster growth of our lower margin businesses, primarily PayPal and Skype. Net income for the three months ended September 30, 2008 was \$492.2 million, or \$0.38 earnings per diluted share, compared to a net loss of \$935.6 million, or \$0.69 loss per diluted share for the same period of the prior year. The change in earnings per diluted share was due primarily to the goodwill impairment charge in 2007 and our lower weighted average share count as a result of shares of our common stock repurchased over the last year. During the third quarter of 2008, we repurchased 24.8 million shares of our common stock under our repurchase program for an aggregate purchase price of \$622.8 million.

*Our expectations*

For the remainder of 2008, compared to the same period in 2007, we expect that our net revenues and earnings per diluted share will decrease primarily as a result of the slowing growth in our core Marketplace business, uncertain global consumer spending environment, the strengthening of the U.S. dollar, the impact of our previously announced acquisitions of Den Blå Avis and Bilbasen, and agreement to acquire Bill Me Later, and a charge associated with our global reduction in workforce. Our global reduction in workforce is intended to simplify and streamline our organization, improve our cost structure and strengthen the overall competitiveness of our existing businesses. The reduction is expected to result in pretax restructuring charges of approximately \$70 to \$80 million, with charges predominantly recorded in the fourth quarter of 2008. Additionally, we expect to continue to make significant investments in all three of our business segments that are designed to enhance our business fundamentals and enable us to provide a better overall experience for our customers, and we expect to benefit from these investments over time.

*Seasonality*

The following table sets forth, for the periods presented, our total net revenues and the sequential quarterly growth of these net revenues:

|                                   | <b>March 31</b>                           | <b>Three Months Ended</b> |                     | <b>December 31</b> |
|-----------------------------------|-------------------------------------------|---------------------------|---------------------|--------------------|
|                                   |                                           | <b>June 30</b>            | <b>September 30</b> |                    |
|                                   | <b>(In thousands, except percentages)</b> |                           |                     |                    |
| <b>2006</b>                       |                                           |                           |                     |                    |
| Net revenues                      | \$ 1,390,419                              | \$ 1,410,784              | \$ 1,448,637        | \$ 1,719,901       |
| Percent change from prior quarter | 5%                                        | 1%                        | 3%                  | 19%                |
| <b>2007</b>                       |                                           |                           |                     |                    |
| Net revenues                      | \$ 1,768,074                              | \$ 1,834,429              | \$ 1,889,220        | \$ 2,180,606       |
| Percent change from prior quarter | 3%                                        | 4%                        | 3%                  | 15%                |
| <b>2008</b>                       |                                           |                           |                     |                    |
| Net revenues                      | \$ 2,192,223                              | \$ 2,195,661              | \$ 2,117,531        | N/A                |
| Percent change from prior quarter | 1%                                        | 0%                        | (4)%                |                    |

We expect transaction activity patterns in our businesses to increasingly mirror general consumer buying patterns, both online and offline, as our business expands, with the strongest sequential growth usually occurring in the fourth quarter. Our revenue growth in the third quarter of 2008 was negatively impacted by the broader economic environment as well as a strengthening U.S. dollar. We saw a considerable slowdown across virtually all of our businesses beginning in mid-August. The uncertain global consumer spending environment and strengthening of the U.S. dollar, noted above, is expected to result in less than 3% sequential growth in the fourth quarter of 2008.

**Results of Operations**



Beginning with the first quarter of 2008, we reclassified revenue generated primarily from our Marketplaces non-GMV based businesses (which include Shopping.com, Rent.com and our classified websites) from Net Transaction Revenues to Marketing Services and Other Revenues in order to more closely align our net transaction revenue presentation with our key operating metrics. Marketing Services and Other Revenues also includes amounts previously reflected under Advertising and Other Revenue. Prior period amounts have been reclassified to conform to the current presentation. Consolidated net revenues, as well as total segment revenues, are unchanged.

**Table of Contents**

Our net transaction revenues from our Marketplaces segment are derived primarily from listing and final value fees paid by sellers. For our Payments segment, net transaction revenues are generated primarily by fees from payment processing services. Our Communications segment net transaction revenues are generated primarily from fees charged to users to connect Skype's VoIP product to traditional telecommunication networks. These fees are charged on a per minute basis or on a subscription basis, and we refer to these minutes as SkypeOut minutes.

Our Marketing Services and Other Revenues are derived principally from the sale of advertisements, revenue sharing arrangements, classifieds fees, lead referral fees and other revenues. Other revenues are derived principally from contractual arrangements with third parties that provide services to eBay and PayPal users and interest earned from banks on certain PayPal customer account balances.

Revenues are attributed to U.S. and international geographies primarily based upon the country in which the seller, payment recipient, Skype user's Internet protocol address, online property that generates advertising, or other service provider, as the case may be, is located. Because we generate the majority of our revenue internationally, fluctuations in foreign currency exchange rates will impact our results of operations.

The following table sets forth, for the periods presented, the breakdown of net revenues by type, segment and geography. In addition, we have provided a table of certain key operating metrics that we believe are significant factors affecting our net revenues.

|                                             | Three Months Ended |                    |                | Nine Months Ended  |                    |                |
|---------------------------------------------|--------------------|--------------------|----------------|--------------------|--------------------|----------------|
|                                             | September 30, 2007 | September 30, 2008 | Percent Change | September 30, 2007 | September 30, 2008 | Percent Change |
| (In thousands, except percent changes)      |                    |                    |                |                    |                    |                |
| <b>Net Revenues by Type:</b>                |                    |                    |                |                    |                    |                |
| Net transaction revenues                    |                    |                    |                |                    |                    |                |
| Marketplaces                                | \$ 1,155,886       | \$ 1,163,890       | 1%             | \$ 3,400,535       | \$ 3,664,830       | 8%             |
| Payments                                    | 447,952            | 576,302            | 29%            | 1,299,238          | 1,716,309          | 32%            |
| Communications                              | 93,823             | 137,201            | 46%            | 254,198            | 387,143            | 52%            |
| Total net transaction revenues              | 1,697,661          | 1,877,393          | 11%            | 4,953,971          | 5,768,282          | 16%            |
| Marketing services and other revenues       |                    |                    |                |                    |                    |                |
| Marketplaces                                | 164,746            | 212,963            | 29%            | 460,851            | 654,371            | 42%            |
| Payments                                    | 22,444             | 20,909             | (7)%           | 64,666             | 64,276             | (1)%           |
| Communications                              | 4,369              | 6,266              | 43%            | 12,235             | 18,486             | 51%            |
| Total marketing services and other revenues | 191,559            | 240,138            | 25%            | 537,752            | 737,133            | 37%            |
| Total net revenues                          | \$ 1,889,220       | \$ 2,117,531       | 12%            | \$ 5,491,723       | \$ 6,505,415       | 18%            |
| <b>Net Revenues by Segment:</b>             |                    |                    |                |                    |                    |                |
| Marketplaces                                | \$ 1,320,632       | \$ 1,376,853       | 4%             | \$ 3,861,384       | \$ 4,319,201       | 12%            |
| Payments                                    | 470,396            | 597,211            | 27%            | 1,363,904          | 1,780,585          | 31%            |
| Communications                              | 98,192             | 143,467            | 46%            | 266,435            | 405,629            | 52%            |

Edgar Filing: EBAY INC - Form 10-Q

|                                   |              |              |     |              |              |     |
|-----------------------------------|--------------|--------------|-----|--------------|--------------|-----|
| Total net revenues                | \$ 1,889,220 | \$ 2,117,531 | 12% | \$ 5,491,723 | \$ 6,505,415 | 18% |
| <b>Net Revenues by Geography:</b> |              |              |     |              |              |     |
| U.S.                              | \$ 929,605   | \$ 1,001,637 | 8%  | \$ 2,710,334 | \$ 3,028,098 | 12% |
| International                     | 959,615      | 1,115,894    | 16% | 2,781,389    | 3,477,317    | 25% |
| Total net revenues                | \$ 1,889,220 | \$ 2,117,531 | 12% | \$ 5,491,723 | \$ 6,505,415 | 18% |

**Table of Contents**

|                                       | Three Months Ended |                    |                | Nine Months Ended  |                    |                |
|---------------------------------------|--------------------|--------------------|----------------|--------------------|--------------------|----------------|
|                                       | September 30, 2007 | September 30, 2008 | Percent Change | September 30, 2007 | September 30, 2008 | Percent Change |
| (In millions, except percent changes) |                    |                    |                |                    |                    |                |
| <b>Supplemental Operating Data:</b>   |                    |                    |                |                    |                    |                |
| <i>Marketplaces Segment:(1)</i>       |                    |                    |                |                    |                    |                |
| Active users(2)                       | 83.0               | 85.7               | 3%             | 83.0               | 85.7               | 3%             |
| Number of new listings(3)             | 555.6              | 700.2              | 26%            | 1,703.1            | 2,014.6            | 18%            |
| Gross merchandise volume(4)           | \$ 14,395          | \$ 14,284          | (1)%           | \$ 43,140          | \$ 46,004          | 7%             |
| <i>Payments Segment:</i>              |                    |                    |                |                    |                    |                |
| Active registered accounts(5)         | 54.8               | 65.3               | 19%            | 54.8               | 65.3               | 19%            |
| Net total payment volume(6)           | \$ 11,569          | \$ 14,812          | 28%            | \$ 33,426          | \$ 44,159          | 32%            |
| <i>Communications Segment:</i>        |                    |                    |                |                    |                    |                |
| Registered users(7)                   | 245.7              | 370.2              | 51%            | 245.7              | 370.2              | 51%            |

- (1) Rent.com, Shopping.com and our classifieds websites are not included in these metrics.
- (2) All users, excluding users of Half.com, StubHub and Internet Auction Co., our Korean subsidiary, who bid on, bought or listed an item within the previous 12-month period. Users may register more than once and as a result, may have more than one account.
- (3) Listings on eBay Marketplaces trading platforms during the period, regardless of whether the listing subsequently closed successfully.
- (4) Total value of all successfully closed items between users on eBay Marketplaces trading platforms during the period, regardless of whether the buyer and seller actually consummated the transaction.
- (5) All registered accounts that successfully sent or received at least one payment or payment reversal through the PayPal system within the previous 12-month period.
- (6) Total dollar volume of payments, net of payment reversals, successfully completed through the PayPal system during the period, excluding the payment gateway business.
- (7) Cumulative number of unique user accounts, which includes users who may have registered via non-Skype based websites, as of the end of the period. Users may register more than once and, as a result, may have more than one account.

***Marketplaces Net Transaction Revenues***

Total net transaction revenues from Marketplaces increased 1% and 8% during the third quarter and first nine months of 2008, respectively, compared to the same periods of the prior year. The slight increase in net transaction revenues for the third quarter of 2008 was primarily due to an increase in take rate resulting from a change in category mix offset by a 1% decline in total GMV due to slowing growth in our core Marketplaces business and as a result of slowing consumer spending in an uncertain economic environment more than offset the growth of listings. The increase in net transaction revenues for the first nine months of 2008 was due primarily to a 7% year-over-year growth in GMV with clothing, consumer electronics, home and garden, tickets, parts and accessories and sports having the

most significant dollar impact, partially offset by a decrease in vehicles GMV. Marketplaces net transaction revenue growth rate year-over-year was negatively impacted by an increase in buyer and seller incentive programs, some of which are recorded as contra-revenue.

Marketplaces net transaction revenues earned internationally were \$601.1 million and \$2.0 billion during the third quarter and first nine months of 2008, respectively, and represented 52% and 54% of total Marketplaces net transaction revenues during those periods, respectively. Marketplaces net transaction revenues earned internationally were \$599.3 million and \$1.8 billion during the third quarter and first nine months of 2007, respectively, and represented 52% of total Marketplaces net transaction revenues during both periods. Based on changes in foreign currency rates year over year, Marketplaces net revenues were positively impacted by foreign currency translation of approximately \$51.7 million and \$244.6 million during the third quarter and first nine months of 2008,

## **Table of Contents**

respectively, as compared to net revenues that would have been recorded had foreign currency rates remained constant. Changes in foreign currency rates will impact our operating results and, to the extent that the U.S. dollar strengthens, our foreign currency denominated net revenues will be negatively impacted.

We expect our Marketplaces net transaction revenues for the remainder of 2008, compared to the same period in 2007, to decrease as a result of the slowing growth in our core Marketplaces business, the uncertain global consumer spending environment, strengthening dollar and our continued use of buyer and seller incentives (some of which are recorded as contra revenue).

### ***Payments Net Transaction Revenues***

Payments net transaction revenues increased 29% and 32% during the third quarter and first nine months of 2008 respectively, compared to the same periods of the prior year. The increase in net transaction revenues was consistent with our 28% and 32% growth in TPV during the third quarter and first nine months of 2008, respectively, compared to the same periods of the prior year. TPV increased due to growth in PayPal's merchant services business and continued penetration of eBay Marketplaces transactions. However, TPV growth was negatively impacted by the difficult global economic environment.

TPV for PayPal's merchant services business was approximately \$7.5 billion and \$21.4 billion in the third quarter and first nine months of 2008, respectively, which represented an increase of 49% and 56% compared to the same periods of the prior year, respectively. PayPal's merchant services business accounted for approximately 51% and 49% of PayPal's TPV in the third quarter and first nine months of 2008, respectively, compared to 44% and 41% in the same periods of the prior year, respectively. The increase in PayPal's merchant services business was primarily the result of more online merchants, both domestically and internationally, adding PayPal as a payment option, as well as increased usage of PayPal by customers of our existing merchant services clients. Our Payments net transaction revenues as a percentage of TPV was 3.9% for all periods presented.

Payments net transaction revenues earned internationally were \$256.6 million and \$753.8 million during the third quarter and first nine months of 2008, respectively, and represented 45% and 44% of total Payments net transaction revenues in the third quarter and first nine months of 2008, respectively. Payments net transaction revenues earned internationally were \$191.1 million and \$543.5 million during the third quarter and first nine months of 2007, respectively, and represented 43% and 42% of total Payments net transaction revenues during those periods, respectively. International growth in our Payments segment continues to benefit from the expansion of our international operations and the number of currencies supported by PayPal over the last 12 months. Based on changes in foreign currency rates year over year, Payments net revenues were positively impacted by foreign currency translation of approximately \$0.9 million and \$4.6 million during the third quarter and first nine months of 2008, respectively, as compared to net revenues that would have been recorded had foreign currency rates remained constant.

We expect our Payments net transaction revenues for the remainder of 2008, compared to the same period in 2007, to continue to grow based upon growth in our merchant services business resulting from an increased number of merchants integrating PayPal on their websites, continued penetration on Marketplaces transactions and the expected completion of our acquisition of Bill Me Later in the fourth quarter of 2008. Our growth rate will continue to be impacted by the uncertain global consumer spending environment.

### ***Communications Net Transaction Revenues***

Communications net transaction revenues increased 46% and 52% during the third quarter and first nine months of 2008, respectively, compared to the same periods of the prior year. The increase in net transaction revenues was due

primarily to an increase in SkypeOut minutes to 2.2 billion and 5.8 billion during the third quarter and first nine months of 2008, respectively, compared to 1.4 billion and 4.4 billion in the same periods of the prior year, or year-over-year growth of 54% and 30%, respectively. The cumulative number of Skype registered users increased to 370.2 million at September 30, 2008 from 245.7 million at September 30, 2007. The growth in Skype registered users was due primarily to its marketing activities and strategic partnership initiatives, such as Skype's collaboration with MySpace.

**Table of Contents**

Communications net transaction revenues earned internationally were \$113.0 million and \$321.6 million in the third quarter and first nine months of 2008, respectively, and represented 82% and 83% of total Communications net transaction revenues during those periods, respectively. Communications net transaction revenues earned internationally were \$78.3 million and \$214.8 million in the third quarter and first nine months of 2007, respectively, and represented 83% and 85% of total Communications net transaction revenues during those periods, respectively. Based on changes in foreign currency rates year over year, Communications net revenues were positively impacted by foreign currency translation of approximately \$12.3 million and \$46.6 million during the third quarter and first nine months of 2008, respectively, as compared to net revenues that would have been recorded had foreign currency rates remained constant.

We expect our Communications net transaction revenues for the remainder of 2008, compared to the same period in 2007, to continue to grow as we focus on increasing user activity, growing our registered user base and expanding our calling plans and products.

***Marketing Services and Other Revenues***

Marketing services and other revenues was \$240.1 million and \$737.1 million in the third quarter and first nine months of 2008, respectively, representing an increase of 25% and 37%, respectively, compared to the same periods in the prior year. Marketing services and other revenues represented 11% of total net revenues during both the third quarter and first nine months of 2008, respectively, compared to 10% of total net revenues during both the third quarter and first nine months of 2007. Marketing services and other revenues increased during the third quarter and first nine months of 2008 compared to the same periods of the prior year due primarily to the advertising initiatives in our Marketplaces segment, primarily internationally, as well as growth in our classifieds business partially offset by a decline in Shopping.com business and interest earned from banks on certain U.S. PayPal customer account balances.

We expect marketing services and other revenues for the remainder of 2008, compared to the same period in 2007, to continue to grow as advertising revenue generated from all of Marketplaces platforms increases along with our classifieds business.

***Cost of Net Revenues***

|                                    | Three Months Ended    |                       |                   | Nine Months Ended     |                       |                   |
|------------------------------------|-----------------------|-----------------------|-------------------|-----------------------|-----------------------|-------------------|
|                                    | September 30,<br>2007 | September 30,<br>2008 | Percent<br>Change | September 30,<br>2007 | September 30,<br>2008 | Percent<br>Change |
| (In thousands, except percentages) |                       |                       |                   |                       |                       |                   |
| Cost of net revenues               | \$ 446,521            | \$ 560,963            | 26%               | \$ 1,256,999          | \$ 1,648,478          | 31%               |
| As a percentage of net revenues    | 23.6%                 | 26.5%                 |                   | 22.9%                 | 25.3%                 |                   |

Cost of net revenues consists primarily of costs associated with payment processing, customer support and site operations, and Skype telecommunications costs. Significant cost components include bank transaction fees, credit card interchange, assessments, other payment processing costs, employee compensation, contractor costs, facilities costs for our customer support and site operations, depreciation of equipment, amortization of capitalized product development costs and amortization of acquired developed technology.

The increase in cost of net revenues in the third quarter and first nine months of 2008 of \$114.4 million and \$391.5 million, respectively, compared to the same periods in the prior year was due primarily to an increase in



customer support and site operations costs, payment processing costs and Skype telecommunications costs. Aggregate customer support and site operations costs increased \$57.4 million and \$162.8 million during the third quarter and first nine months of 2008, respectively, compared to the same periods of the prior year. The increase was due primarily to our increased focus on customer care initiatives and the development and expansion of our customer support and site operations infrastructure as a result of our growth in transaction volume. Payment processing costs increased \$29.0 million and \$120.8 million during the third quarter and first nine months of 2008, respectively, compared to the same periods of the prior year. Payment processing costs were driven primarily by an increase in PayPal TPV driven by Marketplaces and PayPal's merchant services activity. Skype telecommunications costs increased \$13.9 million and \$50.0 million during the third quarter and first nine months of 2008,

**Table of Contents**

respectively, compared to the same periods of the prior year due primarily to an increase in SkypeOut minutes. Cost of net revenues increased as a percentage of net revenues during the third quarter and first nine months of 2008, compared to the same periods of the prior year, primarily as a result of the relative growth of our lower gross margin businesses, PayPal and Skype.

For the remainder of 2008, compared to the same period in 2007, we expect our Payments and Communications segments to grow at a faster rate than our Marketplaces segment, which will increase our cost of net revenues as a percentage of net revenues.

***Sales and Marketing***

|                                    | Three Months Ended                 |                       |                   | Nine Months Ended     |                       |                   |
|------------------------------------|------------------------------------|-----------------------|-------------------|-----------------------|-----------------------|-------------------|
|                                    | September 30,<br>2007              | September 30,<br>2008 | Percent<br>Change | September 30,<br>2007 | September 30,<br>2008 | Percent<br>Change |
|                                    | (In thousands, except percentages) |                       |                   |                       |                       |                   |
| Sales and marketing                | \$ 485,240                         | \$ 457,216            | (6)%              | \$ 1,406,260          | \$ 1,497,181          | 6%                |
| As a percentage of net<br>revenues | 25.7%                              | 21.6%                 |                   | 25.6%                 | 23.0%                 |                   |

Sales and marketing expense consists primarily of advertising costs, marketing programs, contractor costs and employee compensation for sales and marketing staff.

Sales and marketing expense decreased in the third quarter of 2008 by \$28.0 million, compared to the same period in the prior year. Sales and marketing expense increased in the first nine months of 2008 by \$90.9 million, compared to the same period in the prior year. Employee-related costs, including the use of contractors, facilities and equipment, increased \$26.4 million and \$90.8 million in the third quarter and first nine months of 2008, respectively, compared to the same periods in the prior year due primarily to an increase in staffing. We direct customers to our websites primarily through a number of online marketing channels such as sponsored search, portal advertising, email campaigns and other initiatives. Combined advertising and marketing costs decreased \$50.3 million and \$14.0 million during the third quarter and first nine months of 2008 compared to the same periods in the prior year. Advertising and marketing costs are decreasing as a percentage of net revenues as we increase the use of buyer and seller incentives (for which certain associated expenses are recorded as contra-revenue instead of sales and marketing expense) as opposed to online and offline marketing programs in an effort to improve user loyalty and retention, as well as to more efficiently incur marketing expenditures by our Marketplaces segment.

For the remainder of 2008, compared to the same period in 2007, we expect sales and marketing expense to decrease in total and as a percentage of revenues due to improved sales and marketing expense leverage in our Marketplaces segment, the relative growth in our Payments and Communications segments (each of which generally has lower relative sales and marketing expense as a percentage of net revenues than our Marketplaces segment), and our increased use of buyer and seller incentives (for which certain associated expenses are recorded as contra-revenue instead of sales and marketing expense).

***Product Development***

| Three Months Ended |               |         | Nine Months Ended |               |         |
|--------------------|---------------|---------|-------------------|---------------|---------|
| September 30,      | September 30, | Percent | September 30,     | September 30, | Percent |

Edgar Filing: EBAY INC - Form 10-Q

|                                 | 2007                               | 2008       | Change | 2007       | 2008       | Change |
|---------------------------------|------------------------------------|------------|--------|------------|------------|--------|
|                                 | (In thousands, except percentages) |            |        |            |            |        |
| Product development             | \$ 164,879                         | \$ 190,842 | 16%    | \$ 450,411 | \$ 554,393 | 23%    |
| As a percentage of net revenues | 8.7%                               | 9.0%       |        | 8.2%       | 8.5%       |        |

Product development expense consists primarily of employee compensation, contractor costs, facilities cost and depreciation on equipment. Product development expense is net of required capitalization of major site and other product development efforts, including the development of our next-generation platform architecture, migration of certain platforms, seller tools and Payments services projects. Capitalized site and product development costs were \$32.9 million and \$85.5 million in the third quarter and first nine months of 2008, respectively, compared to \$22.3 million and \$61.2 million in the third quarter and first nine months of 2007, respectively.

**Table of Contents**

Capitalized site and product development costs are reflected as a cost of net revenues when amortized in future periods.

The increase in product development expense in the third quarter and first nine months of 2008 of \$26.0 million and \$104.0 million, respectively, compared to the same periods in the prior year was due primarily to an increase in employee related and contractor costs, including stock-based compensation expense, to support several platform development initiatives to enhance the user experience and expand our existing product offerings.

For the remainder of 2008, compared to the same period in 2007, we expect product development expense will continue to increase in total and increase slightly as a percentage of net revenues as we develop new site features and functionality and continue to expand our existing product offerings.

***General and Administrative***

|                                 | <b>Three Months Ended</b>                 |                               |                           | <b>Nine Months Ended</b>      |                               |                           |
|---------------------------------|-------------------------------------------|-------------------------------|---------------------------|-------------------------------|-------------------------------|---------------------------|
|                                 | <b>September 30,<br/>2007</b>             | <b>September 30,<br/>2008</b> | <b>Percent<br/>Change</b> | <b>September 30,<br/>2007</b> | <b>September 30,<br/>2008</b> | <b>Percent<br/>Change</b> |
|                                 | <b>(In thousands, except percentages)</b> |                               |                           |                               |                               |                           |
| General and administrative      | \$ 287,447                                | \$ 331,715                    | 15%                       | \$ 849,284                    | \$ 1,020,672                  | 20%                       |
| As a percentage of net revenues | 15.2%                                     | 15.7%                         |                           | 15.5%                         | 15.7%                         |                           |

General and administrative expense consists primarily of employee compensation, contractor costs, provisions for transaction losses associated with PayPal, facilities costs, depreciation of equipment, provision for doubtful accounts, payroll taxes on employee stock options, insurance, professional fees and legal related costs.

General and administrative expense increased by \$44.3 million and \$171.4 million in the third quarter and first nine months of 2008, respectively, compared to the same periods of the prior year due to higher employee related costs, legal costs, provision for doubtful accounts and authorized credits, and provision for transaction losses.

Employee-related costs, including the cost of using contractors, facilities and equipment, increased by \$14.3 million and \$67.2 million in the third quarter and first nine months of 2008, respectively, to support our global growth. Legal-related costs increased by \$9.1 million and \$53.1 million in the third quarter and first nine months of 2008, respectively, relating primarily to various ongoing litigation. These costs may fluctuate from period to period. Provision for doubtful accounts and authorized credits increased by \$10.0 million and \$25.4 million in the third quarter and first nine months of 2008, respectively, due to higher revenue and the current market conditions.

PayPal's provision for transaction losses increased by \$12.6 million and \$17.3 million for the third quarter and first nine months of 2008, respectively, compared to the same periods of the prior year, due primarily to higher TPV. PayPal's transaction loss rate, which is the transaction loss expense as a percentage of PayPal's TPV, was 0.29% and 0.26% during the third quarter and first nine months of 2008, respectively, compared to 0.27% and 0.30% during the third quarter and first nine months of 2007, respectively. The increase in the transaction loss rate for the third quarter compared to the same period in the prior year is due primarily to a reduction in transaction losses in the third quarter of 2007 as a result of a refinement in our estimate. The decrease in our transaction loss rate for the first nine months compared to the same period in the prior year is due to our continued enhancement of our fraud detection models based on our historical experiences.

For the remainder of 2008, compared to the same period in 2007, we expect general and administrative expense to increase in total and as a percentage of net revenues due to our continued investment across all areas of our business and related corporate functions. In addition, we expect our transaction loss rate to fluctuate depending on many factors such as the increase in protection coverage, product and credit policy changes, historical loss experience, TPV, macroeconomic factors and proportion of payments made with credit cards.

**Table of Contents*****Amortization of Acquired Intangible Assets***

|                                            | <b>Three Months Ended</b>                 |                      |                |    | <b>Nine Months Ended</b> |                      |                |
|--------------------------------------------|-------------------------------------------|----------------------|----------------|----|--------------------------|----------------------|----------------|
|                                            | <b>September 30,</b>                      | <b>September 30,</b> | <b>Percent</b> |    | <b>September 30,</b>     | <b>September 30,</b> | <b>Percent</b> |
|                                            | <b>2007</b>                               | <b>2008</b>          | <b>Change</b>  |    | <b>2007</b>              | <b>2008</b>          | <b>Change</b>  |
|                                            | <b>(In thousands, except percentages)</b> |                      |                |    |                          |                      |                |
| Amortization of acquired intangible assets | \$ 51,888                                 | \$ 52,720            | 2%             | \$ | 150,791                  | \$ 162,472           | 8%             |
| As a percentage of net revenues            | 2.7%                                      | 2.5%                 |                |    | 2.7%                     | 2.5%                 |                |

From time to time we have purchased, and we expect to continue to purchase, assets or businesses to accelerate category and geographic expansion, increase the features, functions and formats available to our users and maintain a leading role in ecommerce, payments and communications. These purchase transactions generally result in the creation of acquired intangible assets with finite lives and lead to a corresponding increase in our amortization expense in future periods. We amortize intangible assets over the period of estimated benefit using the straight-line method and estimated useful lives ranging from one to eight years. The increase in amortization of acquired intangibles during the third quarter and first nine months of 2008 as compared to the same periods of the prior year is due primarily to the business acquisitions we consummated during 2007 and 2008. Significant acquisitions completed during the first nine months of 2008 include the acquisition of Fraud Sciences.

For the remainder of 2008, compared to the same period of 2007, we expect amortization of acquired intangible assets to increase due to the acquisitions of Den Blå Avis and Bilbasen and the anticipated acquisition of Bill Me Later.

***Impairment of Goodwill***

There were no goodwill impairment charges in the three and nine months ended September 30, 2008 as compared to the \$1.4 billion impairment of goodwill related to our Communications segment in the three and nine months ended September 30, 2007, which was the result of our annual impairment test of goodwill as of August 31, 2007.

***Interest and Other Income, Net***

|                                 | <b>Three Months Ended</b>                 |                      |                |    | <b>Nine Months Ended</b> |                      |                |
|---------------------------------|-------------------------------------------|----------------------|----------------|----|--------------------------|----------------------|----------------|
|                                 | <b>September 30,</b>                      | <b>September 30,</b> | <b>Percent</b> |    | <b>September 30,</b>     | <b>September 30,</b> | <b>Percent</b> |
|                                 | <b>2007</b>                               | <b>2008</b>          | <b>Change</b>  |    | <b>2007</b>              | <b>2008</b>          | <b>Change</b>  |
|                                 | <b>(In thousands, except percentages)</b> |                      |                |    |                          |                      |                |
| Interest and other income, net  | \$ 38,363                                 | \$ 38,556            | 1%             | \$ | 102,350                  | \$ 91,551            | (11)%          |
| As a percentage of net revenues | 2.0%                                      | 1.8%                 |                |    | 1.9%                     | 1.4%                 |                |

Interest and other income, net, consists of interest earned on cash, cash equivalents and investments, as well as foreign exchange transaction gains and losses, our portion of unconsolidated joint venture and minority equity investment results and other miscellaneous transactions not related to our primary operations.

Interest and other income, net, increased slightly during the third quarter of 2008 as compared to the same periods of the prior year. Interest and other income, net, decreased 11% during the first nine months of 2008 due to lower interest income generated by lower interest rates earned on lower average cash, cash equivalents and investments balances.

For the remainder of 2008, compared to the same period in 2007, we expect interest and other income, net, to decrease based primarily on lower interest rates and level of invested assets.

**Table of Contents*****Interest Expense***

|                                 | <b>Three Months Ended</b>                 |                      |                | <b>Nine Months Ended</b> |                      |                |
|---------------------------------|-------------------------------------------|----------------------|----------------|--------------------------|----------------------|----------------|
|                                 | <b>September 30,</b>                      | <b>September 30,</b> | <b>Percent</b> | <b>September 30,</b>     | <b>September 30,</b> | <b>Percent</b> |
|                                 | <b>2007</b>                               | <b>2008</b>          | <b>Change</b>  | <b>2007</b>              | <b>2008</b>          | <b>Change</b>  |
|                                 | <b>(In thousands, except percentages)</b> |                      |                |                          |                      |                |
| Interest expense                | \$ 2,728                                  | \$ (11)              | (100)%         | \$ 10,004                | \$ 3,474             | (65)%          |
| As a percentage of net revenues | 0.1%                                      | 0.0%                 |                | 0.2%                     | 0.1%                 |                |

Interest expense consists primarily of interest charges on the amount drawn under our existing credit agreement and certain accrued contingencies. The decrease in interest expense in the third quarter and first nine months of 2008 compared to the same periods of the prior year is due primarily to decreased interest charges associated with lower outstanding balances under our credit agreement and certain accrued contingencies.

For the remainder of 2008, compared to the same period in 2007, we expect interest expense to increase as we borrowed against our line of credit in October 2008.

***Provision for Income Taxes***

|                                 | <b>Three Months Ended</b>                 |                      |                | <b>Nine Months Ended</b> |                      |                |
|---------------------------------|-------------------------------------------|----------------------|----------------|--------------------------|----------------------|----------------|
|                                 | <b>September 30,</b>                      | <b>September 30,</b> | <b>Percent</b> | <b>September 30,</b>     | <b>September 30,</b> | <b>Percent</b> |
|                                 | <b>2007</b>                               | <b>2008</b>          | <b>Change</b>  | <b>2007</b>              | <b>2008</b>          | <b>Change</b>  |
|                                 | <b>(In thousands, except percentages)</b> |                      |                |                          |                      |                |
| Provision for income taxes      | \$ 33,577                                 | \$ 70,423            | 110%           | \$ 262,021               | \$ 298,014           | 14%            |
| As a percentage of net revenues | 1.8%                                      | 3.3%                 |                | 4.8%                     | 4.6%                 |                |
| Effective tax rate              | (4)%                                      | 13%                  |                | (330)%                   | 17%                  |                |

The provision for income taxes differs from the amount computed by applying the statutory U.S. federal rate principally due to foreign income with lower tax rates and from tax credits that lower the effective tax rate, offset by state taxes and subsidiary losses for which we have not provided a benefit and other factors that impact the effective tax rate.

The increase in the effective tax rate for the third quarter and first nine months of 2008 compared to the same period of the prior year primarily resulted from the goodwill impairment charge recorded in the three and nine months ended September 30, 2007, which is non-deductible for tax purposes. In addition, the effective tax rate for the three and nine months ended September 30, 2007 was favorably impacted by a tax benefit from a ruling issued by a tax authority related to prior periods. During fiscal 2008, the expansion of our international operations has resulted in favorable changes to our geographic earnings mix.

For the remainder of 2008, we are projecting an effective tax rate slightly higher than our effective tax rate in the first nine months of 2008.



**Liquidity and Capital Resources*****Cash Flows***

|                                                       | <b>Nine Months Ended<br/>September 30,</b> |              |
|-------------------------------------------------------|--------------------------------------------|--------------|
|                                                       | <b>2007</b>                                | <b>2008</b>  |
|                                                       | <b>(In thousands)</b>                      |              |
| Net cash provided by (used in):                       |                                            |              |
| Operating activities                                  | \$ 1,848,563                               | \$ 2,198,272 |
| Investing activities                                  | (62,189)                                   | (682,914)    |
| Financing activities                                  | (736,474)                                  | (2,276,375)  |
| Effect of exchange rates on cash and cash equivalents | 199,899                                    | (117,457)    |
| Net increase (decrease) in cash and cash equivalents  | \$ 1,249,799                               | \$ (878,474) |

## **Table of Contents**

We generated cash from operating activities in amounts greater than net income in the nine months ended September 30, 2007 and 2008 due primarily to non-cash charges to earnings and tax benefits from stock-based compensation. Non-cash charges to earnings included depreciation and amortization on our long-term assets, impairment of goodwill, stock-based compensation, provision for doubtful accounts and authorized credits, the provision for transaction losses and deferred income taxes. We continue to expect net cash provided by operating activities to be lower for the remainder of 2008, compared to the same period of 2007, due primarily to lower net income.

Net cash used in investing activities of \$682.9 million during the first nine months of 2008 consisted primarily of cash paid for acquisitions, primarily Fraud Sciences, totaling \$159.1 million, and the purchase of fixed assets to support our site operations, customer support and international expansion totaling \$406.7 million. The purchase of fixed assets consisted primarily of computer equipment, software, and leasehold improvements for our offices and buildings. Net cash used in investing activities during the first nine months of 2007 consisted primarily of cash paid to acquire businesses totaling \$320.2 million, and the purchase of fixed assets for \$326.0 million, offset by net cash provided by our investment activity of \$783.8 million. In the fourth quarter of fiscal 2008, we announced an acquisition for \$390 million and the entry into another acquisition agreement for an aggregate transaction value of \$945 million. Both transactions involve the use of cash. In addition, we expect to continue to purchase property and equipment for cash and we may acquire other businesses for cash.

Net cash flows used in financing activities of \$2.3 billion during the first nine months of 2008 were due primarily to the repurchase of approximately 80.6 million shares of common stock for an aggregate purchase price of approximately \$2.2 billion and the repayment of our line of credit of \$200.2 million, offset in part by net proceeds from the issuance of common stock of \$98.7 million. The net cash flows used in financing activities during the first nine months of 2007 were due primarily to the repurchase of approximately 35.3 million shares of common stock for an aggregate purchase price of approximately \$1.2 billion, offset in part by net proceeds from the issuance of common stock of \$365.2 million. For the remainder of 2008, we may continue to repurchase our common stock for cash. On October 16, 2008, we drew down an aggregate amount of \$1.0 billion under our revolving credit facility.

The negative effect of exchange rates on cash and cash equivalents of \$117.5 million during the first nine months of 2008 was due to the strength of the U.S. dollar during the period against other foreign currencies, primarily the Euro. At September 30, 2008, we held balances in cash and cash equivalents outside the U.S. in certain of our foreign operations totaling approximately \$2.9 billion. If these cash and cash equivalents were distributed to the U.S. in the form of dividends or otherwise, we would be subject to additional U.S. income taxes (subject to adjustment for foreign tax credits) and foreign withholding taxes.

At September 30, 2008, we had cash and cash equivalents of \$3.3 billion. Our available cash and cash equivalents are held in bank deposits, money market funds and commercial paper. We actively monitor the third-party depository institutions that hold our cash and cash equivalents. Our emphasis is primarily on safety of principal while secondarily maximizing yield on those funds. We diversify our cash and cash equivalents among counterparties to minimize exposure to any one of these entities. To date, we have experienced no material loss or lack of access to our invested cash or cash equivalents; however, we can provide no assurances that access to our invested cash and cash equivalents will not be impacted by adverse conditions in the financial markets.

At any point in time we have funds in our operating accounts and customer accounts that are with third party financial institutions. These balances in the U.S. may exceed the Federal Deposit Insurance Corporation ( FDIC ) insurance limits. While we monitor the cash balances in our operating accounts and adjusts the cash balances as appropriate, these cash balances could be impacted if the underlying financial institutions fail or could be subject to other adverse conditions in the financial markets.

***Credit Agreement***

Lehman Brothers Commercial Bank was a participating lender in our \$2.0 billion credit agreement. As a result of the bankruptcy of its parent company, our available line of credit has been reduced by its commitment of \$160 million. As of September 30, 2008, we had no outstanding borrowings under our credit agreement of \$1.8 billion. As of September 30, 2008, we were in compliance with the financial covenants associated with the

## **Table of Contents**

credit agreement. On October 16, 2008, we drew down an aggregate amount of \$1.0 billion under our revolving credit facility pursuant to the Credit Agreement. We expect that the funds will be used for general corporate purposes, including financing the acquisition of Bill Me Later, Inc. and its associated receivables. Additionally, we are not aware of any lack of access to the remaining \$840M under the line of credit; however, we can provide no assurance that access to the remaining available line of credit will not be impacted by adverse conditions in the financial markets. Our line of credit is not reliant upon a single bank.

### ***Stock Repurchases***

In January 2008, our Board authorized, and we announced, a stock repurchase program of up to \$2.0 billion of our common stock. This program is in addition to our previously announced stock repurchase program. During the third quarter and first nine months of 2008, we repurchased approximately \$622.8 million and \$2.2 billion of our common stock, respectively. As of September 30, 2008, we have repurchased approximately \$5.3 billion of our common stock (\$4.0 billion of which completed the previously announced and expanded stock repurchase program) and we have the ability to repurchase up to \$656.5 million of our common stock under our stock repurchase program authorized by our Board in January 2008.

### ***Off-Balance Sheet Arrangements and Customer Accounts***

As of September 30, 2008, we had no off-balance sheet arrangements that have, or are reasonably likely to have, a current or future material effect on our condensed consolidated financial condition, results of operations, liquidity, capital expenditures or capital resources. As of September 30, 2008, we had a total of \$1.8 billion in cash withdrawals offsetting our \$1.9 billion in cash deposits held within the same financial institution under our cash pooling arrangement. See Note 5 Fair Value Measurement of Assets and Liabilities for further discussion.

Customer balances held as direct claims against us, primarily PayPal, are included on our condensed consolidated balance sheet in funds receivable and customer accounts with an offsetting current liability in funds payable and amounts due to customers, and totaled approximately \$1.1 billion as of December 31, 2007 and \$1.0 billion as of September 30, 2008. Customer funds held by PayPal as an agent or custodian on behalf of our customers are not reflected in our condensed consolidated balance sheets. These funds include funds held on behalf of U.S. customers that are deposited in bank accounts insured up to certain limits by the FDIC and funds that U.S. customers choose to invest in the PayPal Money Market Fund, and totaled approximately \$1.8 billion and \$2.0 billion as of December 31, 2007 and September 30, 2008, respectively. The assets of the PayPal Money Market Fund are invested in a portfolio managed by Barclays Global Fund Advisors.

### ***Indemnification Provisions***

In the ordinary course of business, we have included limited indemnification provisions in certain of our agreements with parties with which we have commercial relations, including our standard marketing, promotions and application-programming-interface license agreements. Under these contracts, we generally indemnify, hold harmless, and agree to reimburse the indemnified party for losses suffered or incurred by the indemnified party in connection with claims by a third party with respect to our domain names, trademarks, logos and other branding elements to the extent that such marks are applicable to our performance under the subject agreement. In a limited number of agreements, we have provided an indemnity for other types of third-party claims, which are indemnities mainly related to various intellectual property rights. In our PayPal business, we have provided an indemnity to our payment processors in the event of certain third-party claims or card network fines against the processor arising out of conduct by PayPal or PayPal customers. It is not possible to determine the maximum potential loss under these indemnification provisions due to our limited history of prior indemnification claims and the unique facts and circumstances involved in each particular provision. To date, no significant costs have been incurred, either

individually or collectively, in connection with our indemnification provisions.

**Table of Contents**

***Liquidity and Capital Resource Requirements***

We believe that existing cash, cash equivalents and investments of approximately \$3.8 billion, together with cash generated from operations and available borrowings under our credit facility, will be sufficient to fund our operating activities, capital expenditures and other obligations for the foreseeable future.

***Recent Accounting Pronouncements***

See Note 1 The Company and Summary of Significant Accounting Policies to the condensed consolidated financial statements, regarding the effect of certain recent accounting pronouncements on our condensed consolidated financial statements.

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

The information in this section should be read in connection with the information on financial market risk related to changes in interest rates and non-U.S. currency exchange rates in Part II, Item 7A, Quantitative and Qualitative Disclosures About Market Risk, in our Annual Report on Form 10-K for the year ended December 31, 2007. Our market risk profile has not changed significantly during the first nine months of 2008.

**Interest Rate Risk**

We actively monitor the third-party depository institutions that hold our cash and cash equivalents. We diversify our cash and cash equivalents among counterparties to minimize exposure to any one of these entities. Our emphasis is primarily on safety of principal while secondarily maximizing yield on those funds. To achieve this objective, we maintain our portfolio of cash equivalents and short-term and long-term investments in a variety of securities, including government and corporate securities and money market funds. These investments are generally classified as available-for-sale and consequently are recorded on the balance sheet at fair value with unrealized gains or losses reported as a separate component of accumulated other comprehensive income, net of estimated tax.

**Investment Risk**

As of September 30, 2008, the carrying value of our cash and cash equivalents approximated their fair value and represented approximately 88% of our total cash, cash equivalents and investment portfolio, which was held primarily in bank deposits, commercial paper and money market funds. As of September 30, 2008, we held no direct investments in auction rate securities, collateralized debt obligations, structured investment vehicles or mortgage-backed securities.

**Foreign Currency Risk**

We are a growing company, with an increasing proportion of our operations conducted outside the U.S. Our foreign currency exposure continues to evolve as we grow internationally. Our exposure to foreign currency transaction gains and losses is the result of certain net receivables due from our foreign subsidiaries and customers being denominated in currencies other than the U.S. dollar, primarily the Euro, British pound, Korean won and Australian dollar in which our revenues and profits are denominated. A portion of these risks is hedged, but fluctuations could impact our results of operations, financial position, and cash flows.

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

(a) *Evaluation of disclosure controls and procedures.* Based on the evaluation of our disclosure controls and procedures (as defined in Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) required by Securities Exchange Act Rules 13a-15(b) or 15d-15(b), our Chief Executive Officer and our Chief Financial Officer have concluded that as of the end of the period covered by this report, our disclosure controls and procedures were effective.

(b) *Changes in internal controls.* There were no changes in our internal control over financial reporting that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents**

**PART II: OTHER INFORMATION**

**Item 1: *Legal Proceedings***

In April 2001, two of our European subsidiaries, eBay GmbH and eBay International AG, were sued by Montres Rolex S.A. and certain of its affiliates. 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 enjoining the sale of Rolex-branded watches on the website as well as damages. The matter was eventually decided by the German Supreme Court which in 2007 held, following a 2004 precedent in the matter of *Rolex v Ricardo*, that eBay must take reasonable measures to prevent recurrence once it is informed of clearly identified infringement, and that eBay may in certain circumstances be liable upon first notice of infringement. The court referred the case back to the Higher Regional Court to determine whether, in some circumstances, a low starting listing price was sufficient to indicate that a listing was infringing. In July 2007, the German Federal Supreme Court extended the reach of the *Rolex* decision in *IVD v. eBay*. The court held that (i) in certain circumstances, a duty of care could be found to exist to competitors requiring eBay to take reasonable measures to prevent illegal items from being listed (even where the competitors were not directly harmed) and (ii) such duty would extend to listings by the same seller in the same category (not just identical listings). We expect that this ruling will likely result in increased costs and litigation against us in Germany although we do not currently believe that it will require a major change in our business practices.

In August 2006, Louis Vuitton Malletier and Christian Dior Couture filed two lawsuits in the Paris Court of Commerce against eBay Inc. and eBay International AG. Among other things, the complaint alleges that we violated French tort law by negligently broadcasting listings posted by third parties offering counterfeit items bearing plaintiffs' trademarks, and by purchasing certain advertising keywords. Around September 2006, Parfums Christian Dior, Kenzo Parfums, Parfums Givenchy, and Guerlain Société also filed a lawsuit in the Paris Court of Commerce against eBay Inc. and eBay International AG. The complaint alleges that we have interfered with the selective distribution network the plaintiffs established in France and the European Union by allowing third parties to post listings offering genuine perfumes and cosmetics for sale on our websites. In June 2008, the Paris Court of Commerce ruled that eBay and eBay International AG were liable for failing to prevent the sale of counterfeit items on its websites that traded on plaintiffs' brand names and for interfering with the plaintiffs' selective distribution network. The court awarded plaintiffs approximately EUR 38.6 million in damages and issued an injunction prohibiting all sales of perfumes and cosmetics bearing the Dior, Guerlain, Givenchy and Kenzo brands over all worldwide eBay sites to the extent that they are accessible from France. We have taken measures to comply with the injunction and have appealed these rulings. However, these and similar suits may force us to modify our business practices, which could lower our revenue, increase our costs, or make our websites less convenient to our customers. Any such results could materially harm our business. Other luxury brand owners have also filed suit against us or have threatened to do so, seeking to hold us liable for, among other things, alleged counterfeit items listed on our websites by third parties, for tester and other not for resale consumer products listed on our websites by third parties, for the alleged misuse of trademarks in listings, for alleged violations of selective distribution channel laws, for alleged non-compliance of consumer protection laws or in connection with paid search advertisements. We continue to believe that we have meritorious defenses to these suits and intend to defend ourselves vigorously.

In June 2006, Net2Phone, Inc. filed a lawsuit in the U.S. District Court for the District of New Jersey (No. 06-2469) alleging that eBay Inc., Skype Technologies S.A., and Skype Inc. infringed five patents owned by Net2Phone relating to point-to-point Internet protocol. The suit seeks an injunction against continuing infringement, unspecified damages, including treble damages for willful infringement, and interest, costs, and fees. We have filed an answer and counterclaims asserting that the patents are invalid, unenforceable, and were not infringed. The parties have completed claim construction briefing and most of fact discovery and are conducting expert discovery. The pretrial conference is



scheduled for November 2008. We believe that we have meritorious defenses and intend to defend ourselves vigorously.

In March 2007, a plaintiff filed a purported antitrust class action lawsuit against eBay in the Western District of Texas alleging that eBay and its wholly owned subsidiary PayPal monopolized markets through various anticompetitive acts and tying arrangements. The plaintiff alleges claims under sections 1 and 2 of the Sherman Act, as well as

## **Table of Contents**

related state law claims. The complaint seeks treble damages and an injunction. In April 2007, the plaintiff re-filed the complaint in the U.S. District Court for the Northern District of California (No. 07-CV-01882-RS), and dismissed the Texas action. In May 2007, the case was consolidated with other similar lawsuits (No. 07-CV-01882JF). In June 2007, we filed a motion to dismiss the class action complaint. In March 2008, the court granted the motion to dismiss the tying claims with leave to amend and denied the motion with respect to the monopolization claims. Plaintiffs subsequently decided not to refile the tying claims. The class certification motion is scheduled for January 2009. We believe that we have meritorious defenses and intend to defend ourselves vigorously.

In May 2007, Netcraft Corporation filed a lawsuit in the Western District of Wisconsin (No. 07-C-0254C) alleging that eBay and PayPal infringed two of its patents entitled "Internet billing methods." The suit seeks an injunction against continuing infringement, unspecified damages, and interest, costs, and fees. In September 2007, we filed a motion for summary judgment of noninfringement on both patents. In December 2007, the U.S. District Court for the Western District of Wisconsin entered a judgment granting our motion for summary judgment of non-infringement on both of the patents that Netcraft asserted against eBay and PayPal. Netcraft Corporation has appealed the judgment. Both sides have filed their appeal briefs, and oral argument took place in October 2008 before the Court of Appeals for the Federal Circuit.

In October 2007, PartsRiver filed a lawsuit in the Eastern District of Texas (No. 2-07CV-440-DF) alleging that eBay, Microsoft, Yahoo!, Shopzilla, PriceGrabber and PriceRunner infringed its patent relating to search methods. The suit seeks an injunction against continuing infringement, unspecified damages, and interest, costs, and fees. The defendants have moved to transfer venue and the parties are conducting discovery. Fact discovery cutoff is scheduled for July 2009, and trial is scheduled for October 2009. We believe that we have meritorious defenses and intend to defend ourselves vigorously.

eBay's Korean subsidiary, IAC, has notified a majority of its approximately 20 million users of a data breach involving personally identifiable information including name, address, resident registration number and some transaction and refund data (but not including credit card information or real time banking information). Approximately 139,000 users have sued IAC over this breach in several lawsuits and we expect more to do so in the future. There is some precedent in Korea for a court to grant consolation money for data breaches without a specific finding of harm from the breach. Such precedents have involved payments of up to approximately \$200 per user. IAC intends to vigorously defend itself in this lawsuit.

Other third parties have from time to time claimed, and others may claim in the future, that we have infringed their intellectual property rights. We are subject to additional patent disputes, and expect that we will increasingly be subject to patent infringement claims as our services expand in scope and complexity. In particular, we expect that we may face additional patent infringement claims involving various aspects of our Marketplaces, Payments and Communications businesses. We have in the past been forced to litigate such claims. We may also become more vulnerable to third-party claims as laws such as the Digital Millennium Copyright Act, the Lanham Act and the Communications Decency Act are interpreted by the courts, and as we become subject to laws in jurisdictions where the underlying laws with respect to the potential liability of online intermediaries like ourselves are either unclear or less favorable. We believe that additional lawsuits alleging that we have violated copyright or trademark laws will be filed against us. Intellectual property claims, whether meritorious or not, are time consuming and costly to resolve, could require expensive changes in our methods of doing business, or could require us to enter into costly royalty or licensing agreements.

From time to time, we are involved in other disputes or regulatory inquiries that arise in the ordinary course of business. The number and significance of these disputes and inquiries are increasing as our business expands and our company grows larger. Any claims or regulatory actions against us, whether meritorious or not, could be time consuming, result in costly litigation, require significant amounts of management time, and result in the diversion of

significant operational resources.

**Table of Contents**

**Item 1A: Risk Factors**

**Risk Factors That May Affect Results of Operations and Financial Condition**

*The risks and uncertainties described below are not the only ones facing us. Other events that we do not currently anticipate or that we currently deem immaterial also may affect our results of operations and financial condition.*

***Our operating results may decline.***

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 operating results include the following:

our ability to retain an active user base, attract new users, and encourage existing users to list items for sale, purchase items through our websites, or use our payment service or communication software and products;

our ability to increase activity of the users of our Marketplaces business, especially with respect to our top buyers and sellers, in our most mature geographies, especially the U.S., Germany and the U.K.;

general economic conditions, including the possibility of a severe recession in the U.S. and a worldwide economic slowdown; recent disruptions to the credit and financial markets in the U.S. and worldwide; and those economic conditions specific to the Internet, ecommerce and payments industries;

our ability to successfully integrate and manage businesses that we acquire, including new needs to manage credit risks and bad debts upon completion of our announced acquisition of Bill Me Later;

the volume, size, timing, monetization, and completion rates of transactions using our websites or technology;

the amount and timing of operating costs and capital expenditures relating to the maintenance and expansion of our businesses, operations, and infrastructure;

the effect of recently announced and possible future changes to our pricing, products and policies, including, among other changes: a reduced emphasis on upfront fees (e.g., insertion fees for listings) and corresponding increases in success-based fees (e.g., final value fees for sold items); new algorithms for determining which listings appear at the top of searches (Best Match); changes to buyer and seller feedback criteria; tighter seller standards, which may restrict some sellers from selling on our websites even if they have been able to do so historically; new restrictions or holds on payments made to certain sellers or in connection with certain categories of higher-risk transactions; new incentives and rewards for top PowerSellers; increased protection for buyers who pay for eligible transactions on eBay.com using PayPal, as well as improved seller protection for U.S. eBay sellers against claims, chargebacks and reversals; lower insertion fees for, and extended duration of, listings of fixed-price items; shipping and handling limits on certain categories of items (e.g., media); and, beginning in October 2008, no longer allowing paper forms of payment, including checks and money orders, to be used on eBay.com in the U.S. for most categories of items;

regulatory and legal actions imposing obligations on our businesses or our users, including the injunction related to certain cosmetic and perfume brands (see Item 1 Legal Proceedings above);

new laws or regulations, or interpretations of existing laws or regulations, that impose liability on us for actions of our users or otherwise harm our business models or restrict the Internet, electronic commerce, online payments, or online communications;

the actions of our competitors, including the introduction of new sites, services, and products;

consumer confidence in the safety and security of transactions using our websites or technology and our ability to manage the costs of our user protection programs;

our ability to manage PayPal's transaction loss rate and payment funding mix;

**Table of Contents**

the costs and results of litigation that involves us;

our ability to develop product enhancements, programs, and features at a reasonable cost and in a timely manner;

our ability to upgrade and develop our systems, infrastructure, and customer service capabilities to accommodate growth and to improve our websites at a reasonable cost while maintaining 24/7 operations;

technical difficulties or service interruptions involving our websites or services provided to us or our users by third parties;

our ability to comply with the requirements of entities whose services are required for our operations, such as credit card networks and banks;

our ability to increase the acceptance of PayPal by online merchants outside of our Marketplaces platforms, which may require long implementation cycles and incentives to merchants that are initially dilutive;

our ability to manage, profitably expand and effectively monetize the Skype business;

our ability to manage our businesses following recently announced reductions in our workforce;

the effect of recently announced management changes;

the cost and availability of online and traditional advertising, and the success of our brand building and marketing campaigns;

our ability to attract new personnel in a timely and effective manner and to retain key employees;

the continued healthy operation of our technology suppliers and other parties with which we have commercial relations;

continued consumer acceptance of the Internet as a medium for commerce and communication in the face of increasing publicity about fraud, spoofing, phishing, viruses, spyware, and other dangers of the Internet; and

macroeconomic and geopolitical events such as recession, commodity inflation, war, threat of war, or terrorist actions.

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. In view of the rapidly evolving nature of our business, 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 invest heavily in marketing and promotion, customer support, and further development of the operating infrastructure for our core and non-core operations. Some of this investment entails long-term contractual commitments. 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. Growth rates of our Marketplaces businesses in our most established markets, such as the U.S., Germany and the U.K., have continued to decline. Despite our efforts to stem these declines, growth rates in these and other markets may continue to decline. As our penetration in established markets grows, we will increasingly need to focus on keeping existing users, especially our top buyers and sellers, active and increasing their activity level on our sites in order to continue to grow our business. In addition, our Marketplaces business is facing increased competitive pressure. If we are unable to change our services in ways that reflect the changing demands of the ecommerce marketplace, particularly the higher growth of sales of fixed-price items, our business will suffer.

In January and June 2008, we announced significant changes to our Marketplaces business in four major areas: fee structure, seller incentives, standards and buyer and seller feedback and increased buyer and seller protections in

**Table of Contents**

the U.S. In August 2008, we announced a series of pricing, shipping and other changes for our Marketplaces business in our three largest markets: the U.S., Germany and the U.K. We may make further changes in these or other areas in the future. Some of the changes that we have announced to date have been controversial with, and led to dissatisfaction among, a number of our sellers, and additional changes that we announce in the future may also be negatively received by a number of our sellers. Given the number of recent changes that we have made to our policies and pricing, it may take a number of our sellers some time to fully assess and adjust to these changes, and sellers may elect to reduce volume while making such assessments and adjustments. If any of these changes cause sellers to move their business (in whole or in part) away from our websites or otherwise fail to improve gross merchandise volume or the number of successful listings, our operating results and profitability will be harmed.

In addition, because a large percentage of PayPal transactions originate on the eBay platform, declines in growth rates in major Marketplaces markets also adversely affect PayPal's growth rate. The expected future growth of our PayPal, Skype, StubHub, and other lower margin businesses may also cause downward pressure on our profit margins because those businesses have lower gross margins than our Marketplaces platforms.

***An economic recession could harm our business.***

Our Marketplaces and Payments businesses are dependent on consumer purchases. An economic downturn would likely reduce the volume of purchases on our Marketplaces platforms and the volume of transactions paid for using our PayPal payment service and adversely affect our business. In addition, an economic downturn would likely require us to increase our reserves for bad debt and PayPal transaction loss.

***We are exposed to fluctuations in currency exchange rates and interest rates.***

Because we conduct a significant and growing portion of our business outside the United States but report our results in U.S. dollars, we face exposure to adverse movements in currency exchange rates. In connection with its multi-currency service, PayPal fixes exchange rates twice per day, and may face financial exposure if it incorrectly fixes the exchange rate or if exposure reports are delayed. PayPal also holds some corporate and customer funds in non-U.S. currencies, and thus its financial results are affected by the translation of these non-U.S. currencies into U.S. dollars. In addition, the results of operations of many 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. If the U.S. dollar weakens against foreign currencies, the translation of these foreign currency denominated transactions will result in increased net revenues, operating expenses, and net income. Similarly, our net revenues, operating expenses, and net income will be negatively impacted if the U.S. dollar strengthens against foreign currencies, as has happened recently. Based on changes in foreign currency rates year over year, net revenues in the three months ended September 30, 2008 were positively impacted by foreign currency translation of \$64.9 million, compared to the same period of the prior fiscal year. Based on changes in foreign currency rates year over year, operating income for the three months ended September 30, 2008 was positively impacted by foreign currency translation of \$43.6 million, compared to the same period of the prior fiscal year. 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, British pound, Australian dollar, and Canadian dollar, our foreign revenues and profits will be reduced as a result of these translation adjustments. While from time to time we enter into transactions to hedge portions of our foreign currency translation exposure, it is impossible to perfectly predict or completely eliminate the effects of this exposure. In addition, to the extent the U.S. dollar strengthens against the Euro, the British pound, the Australian dollar, and the Canadian dollar, cross-border trade related to purchases of dollar-denominated goods by non-U.S. purchasers will likely decrease, and that decrease will likely not be offset by a corresponding increase in cross-border trade involving purchases by U.S. buyers of goods denominated in other currencies, adversely affecting our business.



In addition, we face exposure to fluctuations in interest rates. For example, reductions in interest rates reduce our investment income, which in turn would lower our net interest income.

**Table of Contents**

***The listing or sale by our users of pirated or counterfeit items may harm our business.***

We have received in the past, and we anticipate receiving in the future, communications alleging that certain items listed or sold through our service by our users infringe third-party copyrights, trademarks and trade names, or other intellectual property rights. Although we have sought to work actively with the owners of intellectual property rights to eliminate listings offering infringing items on our websites, some rights owners have expressed the view that our efforts are insufficient. Content owners and other intellectual property rights owners have been active in asserting their purported rights against online companies, including eBay. Allegations of infringement of intellectual property rights have resulted in threats of litigation and actual litigation against us from time to time, including litigation brought by Tiffany & Co. in the U.S., Rolex S.A. in Germany, Louis Vuitton Malletier and Christian Dior Couture in France, L'Oréal SA, Lancôme Parfums et Beauté & Cie, and Laboratoire Garnier & Cie in several European countries, and a number of others. The plaintiffs in these cases seek to hold eBay liable for alleged counterfeit items listed on our sites by third parties, for tester and other not for resale consumer products listed on our sites by third parties, for the alleged misuse of trademarks or copyrights in listings or otherwise on our sites, or in connection with paid search advertisements, or for alleged violations of selective distribution channel laws or parallel import laws for listings of authentic items. Such plaintiffs seek, among other things, injunctive relief and damages. In the aggregate, these suits could result in significant damage awards and could adversely affect our business. Other luxury brand owners have also filed suit against us or have threatened to do so. In June 2008, the Paris Court of Commerce ruled in the *Louis Vuitton Malletier* and *Christian Dior Couture* cases that eBay and eBay International AG were liable for failing to prevent the sale of counterfeit items on its websites that traded on plaintiffs' brand names and for interfering with the plaintiffs' selective distribution network. The court awarded the plaintiffs approximately EUR 38.6 million in damages and issued an injunction prohibiting all sales of perfumes and cosmetics bearing the Dior, Guerlain, Givenchy and Kenzo brands over all worldwide eBay sites to the extent they are accessible from France. We have taken measures to comply with the injunction and have appealed these rulings. However, these and similar suits may force us to modify our business practices, which could lower our revenue, increase our costs or make our websites less convenient to our customers. Any such results could materially harm our business.

In addition to litigation from rights owners, we may be subject to regulatory, civil or criminal proceedings and penalties if the authorities feel we have aided in the sale of counterfeit goods. While we have had some early success in defending against such litigation, more recent cases have been based, at least in part, on different legal theories than those of earlier cases, and there is no guarantee that we will continue to be successful in defending against such litigation. For example, the German Federal Supreme Court has ruled against us in the *Rolex* and *IVD* cases. Plaintiffs in recent cases have argued that we are not entitled to safe harbors under the Digital Millennium Copyright Act in the U.S. or as a hosting provider in the European Union because of the alleged active nature of our involvement with our sellers, and that, whether or not such safe harbors are available, we should be found liable because we supposedly have not adequately removed counterfeit listings or effectively suspended users who have created such listings. We are constantly improving and modifying our efforts to eliminate counterfeit and pirated items. These improvements are in response to ongoing business initiatives designed to reduce bad buyer experiences and improve customer satisfaction as well as in response to new patterns we are seeing among counterfeiters and others committing fraud on our users. Notwithstanding these efforts, we believe that the legal climate, especially in Europe, is becoming more adverse to our arguments, which may require us to take actions which could lower our revenues, increase our costs, or make our websites less convenient to our customers. This may materially harm our business.

Content owners and other intellectual property rights owners may also seek to bring legal action against entities that are peripherally involved in the sale of infringing items, such as payment companies. To the extent that intellectual property rights owners bring legal action against PayPal based upon the use of PayPal's payment services in a transaction involving the sale of infringing items, including on our websites, our business could be harmed.

Litigation and negative publicity has increased as our websites gain prominence in markets outside of the U.S., where the laws may be unsettled or less favorable to us. Such litigation is costly for us, could result in damage awards, injunctive relief, or 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. In addition, a public perception that counterfeit or pirated items are commonplace on our site, even if factually incorrect, could damage our reputation and our business.

**Table of Contents**

***We are subject to patent litigation.***

We have repeatedly been sued for allegedly infringing other parties' patents. Some of these ongoing suits are described under the heading "Item 1 Legal Proceedings," above. We are a defendant in other patent suits and we have been notified of several other potential patent disputes, and expect that we will increasingly be subject to patent infringement claims as our services expand in scope and complexity. In particular, we expect that we may face additional patent infringement claims involving various aspects of our Marketplaces, Payments and Communications segments. These claims, whether meritorious or not, are time consuming and costly to resolve, and could require expensive changes in our methods of doing business, could require us to enter into costly royalty or licensing agreements, or could require us to cease conducting certain operations.

***Use of our services for illegal purposes could harm our business.***

The law relating to the liability of providers of online services for the activities of their users on their service is often challenged in the U.S. and internationally. In violation of our policies, unlawful goods and stolen goods have been listed and traded on our services. We may be unable to prevent our users from selling unlawful or stolen goods or unlawful services or selling goods or services in an unlawful manner, and we may be subject to allegations of civil or criminal liability for unlawful activities carried out by users through our services. We have been subject to several lawsuits based upon such allegations. In December 2004, an executive of Baazee.com, our Indian subsidiary, was arrested (and later released) in connection with a user's listing of a pornographic video clip on that website. We continue to contest the charges related to this arrest. Similarly, our Korean subsidiary and one of its employees were found criminally liable for listings on the Korean subsidiary's website. The German Federal Supreme Court has ruled that we may have a duty to take reasonable measures to prevent prohibited DVDs from being sold on our site to minors and that competitors may be able to enforce this duty. In a number of circumstances, third parties have alleged that our services aid and abet certain violations of certain laws, including antiscaling laws with respect to the resale of tickets, laws regarding the sale of counterfeit items, the fencing of stolen goods, and restrictive distribution laws and distance selling laws.

Although we have prohibited the listing of stolen goods and certain high-risk items and implemented other protective measures, we may be required to spend substantial resources to take additional protective measures or discontinue certain service offerings, any of which could harm our business. Any costs incurred as a result of potential liability relating to the alleged 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 and stolen goods using our services. This negative publicity, even if factually incorrect, could damage our reputation and diminish the value of our brand names. It also could make users reluctant to use our services.

PayPal's payment system is also 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, piracy of software and other intellectual property, money laundering, bank fraud, child pornography trafficking, prohibited sales of alcoholic beverages or tobacco products, and online securities fraud. Recent changes in law have increased the penalties for intermediaries providing payment services for certain illegal activities. Despite measures PayPal has taken to detect and lessen the risk of this kind of conduct, including PayPal's ability to take legal action to recover its losses for certain violations of its acceptable use policy, illegal activities could still be funded using PayPal. Any resulting claims or liabilities could adversely affect our business.

***Current or future anti-money laundering laws could increase PayPal's costs or require it to change its processes.***

PayPal is subject to anti-money laundering and counter-terrorist financing laws and regulations that prohibit, among other things, its involvement in transferring the proceeds of criminal activities. Although PayPal has adopted a

program to comply with these laws and regulations, any errors or failure to implement the program properly could lead to lawsuits, administrative action, and prosecution by the government. In July 2003, PayPal agreed with the U.S. Attorney for the Eastern District of Missouri that it would pay \$10 million as a civil forfeiture to settle allegations that its provision of services to online gambling merchants violated provisions of the USA PATRIOT Act and further agreed to have its compliance program reviewed by an independent audit firm. PayPal is also subject to

## **Table of Contents**

regulations that require it to report suspicious activities involving transactions of \$2,000 or more and may be required 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 uses to verify the identity of its customers and to monitor international transactions more closely. As PayPal localizes its service in other countries, additional verification and reporting requirements may apply, which in some cases are more stringent. Several countries, including Australia, Canada and Luxembourg, are in the process of implementing new anti-money laundering and counter-terrorist financing laws and regulations, and the impact of these laws and regulations on PayPal's business is uncertain. 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 customers and to monitor its customers' activities more closely. These requirements, as well as any additional restrictions imposed by credit card networks, could raise PayPal's costs significantly and reduce the attractiveness of its product. Failure to comply with federal, state or foreign country money laundering and counter-terrorist financing laws could result in significant criminal and civil lawsuits, penalties, and forfeiture of significant assets.

### ***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 often 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, domestic and foreign legislation has been proposed that would prohibit or impose liability for 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. Several court decisions arguably have narrowed the scope of the immunity provided to Internet service providers like us under the Communications Decency Act. For example, the Ninth Circuit recently held that certain immunity provisions under the Communications Decency Act might not apply to the extent that a website owner materially contributes to the development of unlawful content on its website. In addition, the Paris Court of Commerce has ruled in the *Louis Vuitton Malletier* and *Christian Dior Couture* cases that applicable laws protecting passive internet hosts from liability are inapplicable to eBay given that the content in question was provided by users under eBay's control and authority. This trend, if continued, may increase our potential liability to third parties for the user-provided content on our sites. Our liability for such claims may be higher in jurisdictions outside the U.S. where laws governing Internet transactions are unsettled. 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 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 potential liability could harm our business.

### ***Government inquiries may lead to charges or penalties.***

A large number of transactions occur on our websites. Government regulators have received a significant 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, from time to time we have been contacted by various foreign and domestic governmental regulatory agencies that have questions about our operations and the steps we take to protect our users from fraud. PayPal has received inquiries regarding its restriction and disclosure practices from the Federal Trade Commission and regarding these and other business practices from the attorneys general of a number of states. In

September 2006, PayPal entered into a settlement agreement with the attorneys general of a number of states under which it agreed to pay \$1.7 million to the attorneys general, shorten and streamline its user agreement, increase educational messaging to users about funding choices, and communicate more information

## **Table of Contents**

regarding protection programs to users. We currently face inquiries from government regulators in various jurisdictions related to actions that we have taken that are designed to improve the safety of transactions on our websites, most notably by requiring PayPal to be offered and/or used for certain high-risk transactions or by certain sellers in certain jurisdictions, and we may face similar inquiries from other government regulators in the future. We are likely to receive other 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, operating procedures and disclosures. If one or more of these agencies is not satisfied with our response to current or future inquiries, we could be subject to enforcement actions, fines or other penalties, or forced to change our operating practices in ways that could harm our business.

### ***We are subject to general litigation and regulatory disputes.***

From time to time, we are involved in other disputes or regulatory inquiries that arise in the ordinary course of business. The number and significance of these disputes and inquiries are increasing as our business expands and our company grows larger. We have in the past been forced to litigate such claims. We may also become more vulnerable to third-party claims as laws such as the Digital Millennium Copyright Act, the Lanham Act and the Communications Decency Act are interpreted by the courts and as we expand geographically into jurisdictions where the underlying laws with respect to the potential liability of online intermediaries such as ourselves are either unclear or less favorable. In Germany, the German Federal Supreme Court has ruled that we may owe duties, under certain circumstances, to content owners and competitors relating to taking reasonable steps to prevent the listing of illegal, counterfeit, and pirated items. In June 2008, the Paris Court of Commerce ruled in the *Louis Vuitton Malletier* and *Christian Dior Couture* cases that eBay and eBay International AG were liable for failing to prevent the sale of counterfeit items on its websites that traded on plaintiffs' brand names and for interfering with the plaintiffs' selective distribution network. The scope of these duties is being defined by the courts, including appellate courts, and the ultimate impact on us is uncertain, but may require us to increase our level of filtering and review for these items, thereby increasing our costs. Any claims or regulatory actions against us, whether meritorious or not, could be time consuming, result in costly litigation, require significant amounts of management time, and result in the diversion of significant operational resources.

### ***Failure to deal effectively with fraudulent transactions and customer disputes would increase our loss rate and harm our business.***

In June 2008, we announced that beginning in the fall of 2008, buyers who pay for transactions on eBay.com with PayPal will be protected on eligible transactions for the full amount of an item's purchase price if the buyer does not receive the goods they purchased or if the goods differ significantly from what was described by the seller. Furthermore, U.S. sellers on eBay.com will receive improved seller protection for eligible transactions in which the seller is paid with PayPal, in that they will be covered against payment reversals due to buyer claims of an unauthorized payment or an item that was not received, so long as the seller delivers to the address that the buyer provided to PayPal. We will also offer enhanced buyer and seller protections in some eBay international marketplaces. The recently announced changes to PayPal's buyer protection program could result in future increases and fluctuations in PayPal's transaction loss rate. For the full year ended December 31, 2007 and the nine months ended September 30, 2008, PayPal's transaction loss (including both direct losses and buyer protection payouts) totaled \$139.3 million and \$117.0 million, representing 0.29% and 0.26% of PayPal's TPV in each period, respectively.

PayPal's highly automated and liquid payment service makes PayPal an attractive target for fraud. In configuring its service, PayPal continually strives to maintain the right balance of appropriate measures to promote both convenience and security for customers. Identity thieves and those committing fraud using stolen credit card or bank account numbers can potentially steal large amounts of money from businesses such as PayPal. We believe 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. While PayPal uses advanced anti-fraud technologies, we expect that technically knowledgeable criminals will continue to attempt to circumvent PayPal's anti-fraud systems. In addition, PayPal's service could be subject to employee fraud or other internal security breaches, and PayPal may be required to reimburse customers for any funds stolen as a result of

**Table of Contents**

such breaches. Merchants could also request reimbursement, or stop using PayPal, if they are affected by buyer fraud.

PayPal incurs substantial losses from merchant fraud, including claims from customers that merchants have not performed or that their goods or services do not match the merchant's description. PayPal also incurs losses from claims that the customer did not authorize the purchase, from buyer fraud, from erroneous transmissions, and from customers who have closed bank accounts or have insufficient funds in them to satisfy payments. In addition to the direct costs of such losses, if they are related to credit card transactions and become excessive, they 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 further suffer. PayPal was assessed substantial fines for excess chargebacks in 2001, and excessive chargebacks may arise in the future. PayPal has taken measures to detect and reduce the risk of fraud, but these measures need to be continually improved and may not be effective against new forms of fraud or in connection with new product offerings. If these measures do not succeed, our business will suffer.

eBay faces similar risks with respect to fraudulent activities on its websites. eBay periodically receives complaints from users who may not have received the goods that they had purchased. In some cases individuals have been arrested and convicted for fraudulent activities using our websites. eBay also receives complaints from sellers who have not received payment for the goods that a buyer had contracted to purchase. Non-payment may occur because of miscommunication, because a buyer has changed his or her mind and decided not to honor the contract to purchase the item, or because the buyer bid on the item maliciously in order to harm either the seller or eBay. In some European and Asian jurisdictions, buyers may also have the right to withdraw from a sale made by a professional seller within a specified time period. While sometimes eBay can suspend the accounts of users who fail to fulfill their payment or delivery obligations to other users, eBay does not have the ability to require users to make payment or deliver goods, or otherwise make users whole other than through our limited buyer protection programs. Other than through these programs, eBay does not compensate users who believe they have been defrauded by other users, although users who pay through PayPal may have reimbursement rights from their credit card company or bank, which in turn will seek reimbursement from PayPal. eBay also periodically receives complaints from buyers as to the quality of the goods purchased. 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 in some jurisdictions and may be higher in some non-U.S. jurisdictions than it is in the U.S. Litigation involving liability for third-party actions could be costly for us, divert management attention, result in increased costs of doing business, lead to adverse judgments, or otherwise harm our business. In addition, affected users will likely complain to regulatory agencies that could take action against us, including imposing fines or seeking injunctions.

Negative publicity and user sentiment generated as a result of fraudulent or deceptive conduct by users of our eBay and PayPal services could damage our reputation, reduce our ability to attract new users or retain our current users, and diminish the value of our brand names. We believe that negative user experiences are one of the primary reasons users stop using our services.

***Any factors which reduce cross-border trade could harm our business.***

Cross-border transactions using our websites generally provide higher revenues and gross margins than similar transactions that take place within a single country due to higher transaction fees we earn for those transactions. Cross-border trade has become an increasingly important source of both revenue and profits for us. To the extent that any factors result in a net reduction in cross-border trade, including, among other factors, fluctuations in exchange rates, the application of specific national or regional laws (e.g., selective distribution channel laws) to users in other countries, or any other factors impose restrictions on, or increase the costs of, shipping goods across national borders, our business would suffer. We believe that recent increases in the relative value of the U.S. dollar versus other

currencies have reduced cross-border trade between U.S. sellers and foreign buyers, without a corresponding increase in cross-border traffic in the other direction, adversely affecting our business.

**Table of Contents**

***Our business is subject to online security risks, including security breaches and identity theft.***

To succeed, online commerce and communications must provide a secure transmission of confidential information over public networks. Our security measures may not detect or prevent security breaches that 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 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 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 transaction data. In addition, any party who is able to illicitly obtain a user's password could access the user's transaction data. An increasing number of websites have reported breaches of their security. Any compromise of our security could harm our reputation and, therefore, our business, and could result in a violation of applicable privacy and other laws. In addition, a party that is able to circumvent our security measures could misappropriate proprietary information, cause interruption in our operations, damage our computers or those of our users, or otherwise damage our reputation and business. Under credit card rules and our contract with our card processors, if there is a breach of credit card information that we store, or that is stored by PayPal's direct credit card processing customers, we could be liable to the credit card issuing banks for their cost of issuing new cards and related expenses. In addition, if we fail to follow credit card industry security standards, even if there is no compromise of customer information, we could incur significant fines or lose our ability to give customers the option of using credit cards to fund their payments or pay their fees. If we were unable to accept credit cards, our business would be seriously damaged.

eBay's Korean subsidiary, IAC, has notified a majority of its approximately 20 million users of a data breach involving personally identifiable information including name, address, resident registration number and some transaction and refund data (but not including credit card information or real time banking information). Approximately 139,000 users have sued IAC over this breach in several lawsuits and we expect more to do so in the future. There is some precedent in Korea for a court to grant consolation money for data breaches without a specific finding of harm from the breach. Such precedents have involved payments of up to approximately \$200 per user. IAC intends to vigorously defend itself in this lawsuit.

Our servers are also vulnerable to computer viruses, physical or electronic break-ins, and similar disruptions, and we have experienced denial-of-service type attacks on our system that have made all or portions of our websites unavailable for periods of time. We may need to expend significant resources to protect against security breaches or to address problems caused by breaches. These issues are likely to become more difficult as we expand the number of places where we operate. Security breaches, including any breach that results in the release of our users' personal information, 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.

Our users, as well as those of other prominent Internet companies, have been and will continue to be targeted by parties using fraudulent spoof and phishing emails to misappropriate passwords, credit card numbers, or other personal information or to introduce viruses through trojan horse programs to our users' computers. These emails appear to be legitimate emails sent by eBay, PayPal, Skype, or a user of one of those businesses, but direct recipients to fake websites operated by the sender of the email or request that the recipient send a password or other confidential information via email or download a program. Despite our efforts to mitigate spoof and phishing emails through product improvements and user education, spoof and phishing remain a serious problem that may damage our brands, discourage use of our websites, and increase our costs.

***Changes in regulations or user concerns regarding privacy and protection of user data could adversely affect our business.***

We are subject to laws relating to the collection, use, retention, security and transfer of personally identifiable information about our users, especially for financial information and for users located outside of the U.S. In many cases, these laws apply not only to third-party transactions but also to transfers of information between ourselves and our subsidiaries, and between ourselves, our subsidiaries, and other parties with which we have commercial

**Table of Contents**

relations. New laws in this area have been passed by several jurisdictions, and other jurisdictions are considering imposing additional restrictions. The interpretation and application of user data protection laws are in a state of flux. These laws may be interpreted and applied inconsistently from country to country and our current data protection policies and practices may not be consistent with those interpretations and applications. Complying with these varying international requirements could cause us to incur substantial costs or require us to change our business practices in a manner adverse to our business. In addition, we have and post on our websites our own privacy policies and practices concerning the collection, use and disclosure of user data. Any failure, or perceived failure, by us to comply with our posted privacy policies or with any regulatory requirements or orders or other federal, state or international privacy or consumer protection-related laws and regulations could result in proceedings or actions against us by governmental entities or others, subject us to significant penalties and negative publicity and adversely affect us. In addition, as noted above, we are subject to the possibility of security breaches, which themselves may result in a violation of these laws.

***Our revenue from advertising is subject to factors beyond our control.***

We derive an increasing portion of our revenues from advertising on our websites. Revenues from online advertising are sensitive to events and trends that affect advertising expenditures, such as general changes in the economy and changes in consumer spending, as well as the effectiveness of online advertising versus offline advertising media and the value our websites provide to advertisers relative to other websites. In addition, major search engine operators have the ability to change from time to time, at their sole discretion, the rules and search algorithms governing the pricing, availability, and placement of online advertising. Any changes in these rules or search algorithms may potentially reduce the value of online advertising to our businesses. If we experience a reduction in our advertising revenues due to economic, competitive, technological or other factors, including a reduction in consumer spending due to a recession in the U.S. and a worldwide economic slowdown or if we are unable to provide value to our advertisers, our business and financial results would suffer.

***Our growth will depend on our ability to develop our brands, and these efforts may be costly.***

We believe that continuing to strengthen our brands will be critical to achieving widespread acceptance of our services, and will require a continued focus on active marketing efforts across all of our brands. The demand for and cost of online and traditional advertising have been increasing, and may continue to increase. Accordingly, we will need to continue to spend substantial amounts of money on, and devote substantial resources to, advertising, marketing, and other efforts to create and maintain brand loyalty among users. Since 2004, we have significantly increased the number of brands we are supporting, adding Rent.com, Shopping.com, Kijiji, StubHub, and Skype, among others. Each of these brands requires its own resources, increasing the costs of our branding efforts. Brand promotion activities may not yield increased revenues, and even if they do, any increased revenues may not offset the expenses incurred in building our brands. Also, major search engine operators that we use to advertise our brands have frequently-changing rules that govern their pricing, availability and placement of online advertisement (e.g., paid search, keywords), and changes to these rules could negatively affect our use of online advertising to promote our brands. If we do attract new users to our services, they may not conduct transactions using our services on a regular basis. If we fail to promote and maintain our brands, or if we incur substantial expenses in an unsuccessful attempt to promote and maintain our brands, our business would be harmed.

***New and existing regulations could harm our business.***

We are subject to the same foreign and domestic laws as other companies conducting business on and off the Internet. It is not always clear how existing laws governing issues such as property ownership, copyrights, trademarks and other intellectual property issues, parallel imports and distribution controls, taxation, libel and defamation, obscenity, and personal privacy apply to online businesses such as ours. The 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 Directive on Distance Selling and Electronic Commerce, are being interpreted by the courts, but their applicability and scope remain uncertain. Furthermore, as our activities and the types of goods and services listed on our websites expand, including through acquisitions such

## **Table of Contents**

as our acquisition of StubHub, an online ticket marketplace, in February 2007, regulatory agencies or courts may claim or hold that we or our users are either subject to licensure or prohibited from conducting our business in their jurisdiction, either with respect to our services in general, or with respect the sale of certain items, such as real estate, event tickets, cultural goods, boats, and automobiles.

Our success and increased visibility has driven some existing businesses that perceive our business model to be a threat to their business to raise concerns about our business models to policymakers and regulators, particularly in the U.S. and Europe. These established businesses and their trade association groups employ significant resources in their efforts to shape the legal and regulatory regimes in countries where we have significant operations. They may employ these resources in an effort to change the legal and regulatory regimes in ways intended to reduce the effectiveness of our businesses and the ability of users to use our products and services. In particular, these established businesses have raised concerns relating to pricing, parallel imports, professional seller obligations, stolen goods, copyrights, trademarks and other intellectual property rights, and the liability of the provider of an Internet marketplace for the conduct of its users related to those and other issues. Success in changing the legal or regulatory regimes in a manner that would increase our liability for third-party listings could negatively impact our business.

Over the last few years some large retailers and their trade associations have sought legislation in a number of states and the U.S. Congress that would make eBay liable for the sale of stolen property or would ban certain categories of goods from sale on our platform, including gift cards and health and beauty products. No such legislation has passed. Nonetheless, the proponents continue to seek passage of such legislation, and if any of these laws are adopted it could harm our business.

Numerous states and foreign jurisdictions, including the State of California, where our headquarters are located, have regulations regarding auctions and the handling of property by secondhand dealers or pawnbrokers. Several states and some foreign jurisdictions, including France, have attempted, and may attempt in the future, to impose such regulations upon us or our users. Attempted enforcement of these laws against some of our users appears to be increasing and such attempted enforcements could harm our business. In France, we have been sued by Conseil des Ventes, the French auction regulatory authority. The agency alleges that sales on our French website constitute illegal auctions that cannot be performed without its consent. A lawsuit alleging similar claims has been brought against us by two associations of French antique dealers. We intend to vigorously defend against these lawsuits. However, this and other regulatory and licensure claims could result in costly litigation and, if successful, could require us to change the way we or our users do business in ways that increase costs or reduce revenues (for example, by forcing us to prohibit listings of certain items for some locations). We could also be subject to fines or other penalties, and any of these outcomes could harm our business.

A number of the lawsuits against us relating to trademark issues seek to have our websites subject to unfavorable local laws. For example, trademark exhaustion principles provide trademark owners with certain rights to control the sale of a branded authentic product until it has been placed on the market by the trademark holder or with the holder's consent. The application of trademark exhaustion principles is largely unsettled in the context of the Internet, and if trademark owners are able to force us to prohibit listings of certain items in one or more locations, our business could be harmed.

As we expand and localize our international activities, we become obligated to comply with the laws of the countries in which we operate. In addition, because our services are accessible worldwide, and we facilitate sales of goods to users worldwide, one or more jurisdictions may claim that we or our users are required to comply with their laws based on the location of our servers or one or more of our users, or the location of the product or service being sold or provided in an ecommerce transaction. For example, we were found liable in the recent Louis Vuitton Malletier litigation for transactions on our websites worldwide, including in China. Laws regulating Internet and ecommerce companies outside of the U.S. may be less favorable than those in the U.S., giving greater rights to consumers, content owners, competitors, users and other third parties. Compliance may be more costly or may require us to change our



business practices or restrict our service offerings, and the imposition of any regulations on our users may harm our business. In addition, we may be subject to overlapping legal or regulatory regimes that impose conflicting requirements on us. Our alleged failure to comply with foreign laws could subject us to penalties ranging from criminal prosecution to significant fines to bans on our services.

**Table of Contents**

***If PayPal were found to be subject to or in violation of any U.S. laws or regulations governing banking, money transmission, or electronic funds transfers, it could be subject to liability and forced to change its business practices.***

Nearly all U.S. states and territories have enacted legislation regulating money transmitters. To date, PayPal has obtained licenses in 42 of these jurisdictions and interpretations in six states that licensing is not required under their existing statutes, and is applying for a license in one additional state. The remaining U.S. states and territories do not currently regulate money transmitters. 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 were found to be in violation of money services laws or regulations, PayPal could be subject to liability, forced to cease doing business with residents of certain states, or forced to change its business practices. 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, which would further harm our business. Even if PayPal is not forced to change its business practices, it could be required to obtain additional licenses or regulatory approvals that could impose a substantial cost on PayPal.

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 reimburse consumers for losses above \$50 from transactions not authorized by the consumer. PayPal currently voluntarily reimburses consumers for all financial losses from transactions not authorized by the consumer, not just losses above \$50. PayPal seeks to pass most of these losses on to the relevant merchants, but PayPal incurs losses if the merchant does not have sufficient funds in its PayPal account. In addition, PayPal is subject to the financial privacy provisions of the Gramm-Leach-Bliley Act, state financial privacy laws, and related regulations. As a result, some customer financial information that PayPal receives is subject to limitations on reuse and disclosure. 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. Even technical violations of these laws can result in penalties of up to \$1,000 for each non-compliant transaction. PayPal processed an average of approximately 2.33 million transactions per day during the quarter ended September 30, 2008, and any violations could expose PayPal to significant liability. Any negative change in the public's perception of PayPal's compliance with privacy laws and policies could also negatively impact PayPal's business.

***PayPal is subject to regulation as a bank in Luxembourg, and its status under banking or financial services laws or other laws in markets outside the U.S. is unclear.***

PayPal currently allows its customers with credit cards to send payments from 190 markets, and allows its customers to receive payments in 65 of those markets (including the U.S.). Customers can only withdraw funds electronically to local bank accounts in 40 of these 65 markets. In 20 of these 65 markets customers can withdraw funds electronically to their credit or debit card. In two of these 65 markets customers can only withdraw funds locally by receiving a bank draft in the mail, and in another three of these 65 markets, customers cannot withdraw locally and can only withdraw funds if they have a U.S. bank account. These limitations affect PayPal's ability to grow in these markets. PayPal also offers customers the ability to send or receive payments denominated in 19 currencies. Of the 190 markets whose residents can use the PayPal service, 31 (27 countries plus four French overseas departments) are members of the European Union. As of July 2007, PayPal provides localized versions of its service to customers in the EU through PayPal (Europe) S.A.R.L. et Cie, SCA., a wholly-owned subsidiary of PayPal that is licensed as a bank in Luxembourg. Accordingly, PayPal (Europe) is subject to significant fines or other enforcement action if it violates the disclosure, reporting, anti-money laundering, capitalization, funds management, corporate governance or other requirements imposed on Luxembourg banks. PayPal has limited experience in operating as a bank, and any fines or other enforcement actions imposed by the Luxembourg regulator could adversely affect PayPal's business. PayPal

(Europe) implements its localized services in EU countries through an expedited passport notification process through the Luxembourg regulator to regulators in other EU member states pursuant to EU Directives, and has completed the passport notice process in all EU member countries. The regulators in these countries could notify PayPal (Europe) of local consumer protection laws that will apply to its business, in addition to Luxembourg consumer protection law. The regulators in these countries could

## **Table of Contents**

also seek to persuade the Luxembourg regulator to order PayPal (Europe) to conduct its activities in the local country through a branch office. Any such responses from these regulators could increase the cost of, or delay, PayPal's plans for expanding its business.

In markets other than the U.S., EU, Australia and China, PayPal serves its customers through PayPal Singapore Private Ltd., a wholly-owned subsidiary of PayPal that is based in Singapore. In many of these markets, it is not clear whether PayPal's Singapore-based service is subject to local law or, if it is subject to local law, whether such local law requires a payment processor like PayPal to be licensed as a bank or financial institution or otherwise. Even if PayPal is not currently required to obtain a license in those countries, future localization or targeted marketing of PayPal's service in those countries could require licensure. 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. Delay or failure to receive such a license would require PayPal to change its business practices or features in ways that would adversely affect PayPal's international expansion plans and could require PayPal to suspend providing services to customers in one or more countries. PayPal may also be subject to other laws and regulations of one or more countries in which it serves its customers, such as data protection and anti-money laundering laws, which vary from country to country and are subject to change. In some cases, these laws may require expensive changes to PayPal's current business practices. 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 providing services to customers in one or more countries.

In addition, if PayPal were to seek to expand the financial products that it offers outside of the U.S., either alone, through a commercial alliance, or through an acquisition, PayPal could become subject to additional licensure requirements, additional laws and regulations, or increased regulatory scrutiny, which could impose substantial costs and delay the introduction of any new products.

### ***Changes to credit card networks or bank fees, rules, or practices could harm PayPal's business.***

PayPal does not belong to or directly access credit card networks, such as Visa and MasterCard. As a result, PayPal must rely on banks or other payment processors to process transactions, and must pay a fee for this service. From time to time, credit card networks have increased, and may increase in the future, the interchange fees and assessments that they charge for each transaction using one of their cards. PayPal's credit card processors have the right to pass any increases in interchange fees and assessments on to PayPal as well as increase their own fees for processing. These increased fees increase PayPal's operating costs and reduce its profit margins. PayPal is also required by its processors to comply with credit card network operating rules, and PayPal has agreed to reimburse its processors for any fines they are assessed by credit card networks as a result of any rule violations by PayPal or PayPal's customers. The credit card networks set and interpret the credit card rules. Credit card networks could adopt new operating rules or re-interpret existing rules that PayPal or its processors might find difficult or even impossible to follow. As a result, 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, the velocity of trade on eBay could decrease and our business would further suffer.

PayPal is required to comply with credit card networks' special operating rules for Internet payment services. PayPal and its credit card processors have implemented specific business processes for merchant customers in order to comply with these rules, but any failure to comply could result in fines, the amount of which would be within the credit card networks' discretion. PayPal also could be subject to fines from credit card networks if it fails to detect that merchants are engaging in activities that are illegal or that are considered high risk, primarily the sale of certain types of digital content. For high risk merchants, PayPal must either prevent such merchants from using PayPal or register such merchants with credit card networks and conduct additional monitoring with respect to such merchants. PayPal has incurred fines from its credit card processor relating to PayPal's failure to detect the use of its service by high risk

merchants. The amount of these fines has not been material, but any additional fines in the future would likely be for larger amounts, could become material, and could result in a termination of PayPal's ability to accept credit cards or changes in PayPal's process for registering new customers, which would seriously damage PayPal's business.

**Table of Contents**

***Changes in PayPal's funding mix could adversely affect PayPal's results.***

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 or use buyer credit issued by GE Money Bank. Senders fund a significant portion of PayPal's payment volume using credit cards, and PayPal's financial success will remain highly sensitive to changes in the rate at which its senders fund payments using credit cards. Senders may prefer funding using credit cards rather than bank account transfers for a number of reasons, including the ability to dispute and reverse charges directly with their credit card provider if merchandise is not delivered or is not as described, the ability to earn frequent flier miles or other incentives offered by credit card issuers, the ability to defer payment, or a reluctance to provide bank account information to PayPal. The proportion of PayPal's payment volume funded using credit cards has increased over time. In addition, some of PayPal's newer offerings, including the ability to make a limited number of payments without opening an account, have a higher rate of credit card funding than PayPal's basic product offering. In September 2006, PayPal entered into a settlement agreement with the attorneys general of a number of states under which it agreed to pay \$1.7 million to the attorneys general, shorten and streamline its user agreement, and communicate more information regarding protection programs to users. Also in September 2006, PayPal announced that it had reached a preliminary settlement agreement under which it agreed to pay approximately \$3.5 million into a settlement fund for the benefit of a class represented by plaintiffs in a suit that alleged, among other things, that PayPal's disclosure regarding the effects of users' choice of funding mechanism was deceptive. This settlement has now been approved by the court. Although PayPal did not admit any liability for any of the allegations in the two cases, changes to our disclosure practices could result in increased use of credit card funding, which could harm PayPal's business.

***PayPal's failure to manage customer funds properly would harm its business.***

PayPal's ability to manage and account accurately for customer funds requires a high level of internal controls. In some of the markets that PayPal serves and currencies that PayPal offers, PayPal has a limited operating history and limited management experience in managing 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.

***System failures could harm our business.***

We have experienced system failures from time to time, and any interruption in the availability of our websites will reduce our current revenues and profits, could harm our future revenues and profits, and could subject us to regulatory scrutiny. Our eBay.com website has been interrupted for periods of up to 22 hours, and our PayPal website has suffered intermittent unavailability for periods as long as five days. In August 2007, Skype experienced an interruption during which the majority of Skype's users were unable to use its products for approximately two days. Any unscheduled interruption in our services results in an immediate, and possibly substantial, loss of revenues. Frequent or persistent interruptions in our services could cause current or potential users to believe that our systems are unreliable, leading them to switch to our competitors or to avoid our sites, and could permanently harm our reputation and brands. Reliability is particularly critical for PayPal, especially as it seeks to expand its Merchant Services business. Because PayPal is a regulated financial entity, frequent or persistent site interruptions could lead to fines, penalties, or mandatory changes to PayPal's business practices, and ultimately could cause PayPal to lose existing licenses it needs to operate or prevent it from obtaining additional licenses that it needs to expand. Finally, because our customers may use our products for critical transactions, any system failures 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.

Although our systems have been designed around industry-standard architectures to reduce downtime in the event of outages or catastrophic occurrences, they remain 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. Some of our systems, including our Shopping.com and Skype websites, are not

## **Table of Contents**

fully redundant, and our disaster recovery planning is not sufficient for all eventualities. Our systems are also subject to break-ins, sabotage, and intentional acts of vandalism. Despite any precautions we may take, the occurrence of a natural disaster, a decision by any of our third-party hosting providers to close a facility we use without adequate notice for financial or other reasons, or other unanticipated problems at our hosting facilities could result in lengthy interruptions in our services. We do not carry business interruption insurance sufficient to compensate us for losses that may result from interruptions in our service as a result of system failures.

### ***There are many risks associated with our international operations.***

Our international expansion has been rapid and our international business, especially in Germany and the U.K., has also become critical to our revenues and profits. Net revenues outside the U.S. accounted for approximately 51% and 53%, respectively, of our net revenues in fiscal year 2007 and the first nine months of 2008. Expansion into international markets requires management attention and resources and requires us to localize our services to conform to local cultures, standards, and policies. The commercial, Internet, and transportation infrastructure in lesser-developed countries may make it more difficult for us to replicate our traditional Marketplace business model. In many countries, we compete with local companies that understand the local market better than we do, and we may not benefit from first-to-market advantages. We may not be successful in expanding into particular international markets or in generating revenues from foreign operations. For example, in 2002 we withdrew our eBay marketplace offering from the Japanese market, and in 2007 we contributed our business in China to a joint venture with a local Chinese company. Even if we are successful in developing new markets, we often expect the costs of operating new sites to exceed our net revenues for at least 12 months in most countries.

As we continue to expand internationally, including through the expansion of PayPal, Skype, Shopping.com, and our classified businesses, we are increasingly subject to risks of doing business internationally, including the following:

strong local competitors;

regulatory requirements, including regulation of Internet services, communications, auctioneering, professional selling, distance selling, privacy and data protection, banking, and money transmitting, that may limit or prevent the offering of our services in some jurisdictions, prevent enforceable agreements between sellers and buyers, prohibit the listing of certain categories of goods, require product changes, require special licensure, subject us to various taxes, penalties or audits, or limit the transfer of information between us and our affiliates;

greater liability or legal uncertainty regarding our liability for the listings and other content provided by our users, including uncertainty as a result of legal systems that are less developed with respect to the Internet, unique local laws, conflicting court decisions and lack of clear precedent or applicable law;

cultural ambivalence towards, or non-acceptance of, online trading;

laws and business practices that favor local competitors or prohibit foreign ownership of certain businesses;

difficulties in integrating with local payment providers, including banks, credit and debit card networks, and electronic fund transfer systems or with the local telecommunications infrastructure;

differing levels of retail distribution, shipping, communications, and Internet infrastructures;

different employee/employer relationships and the existence of workers' councils and labor unions;

difficulties in staffing and managing foreign operations;



challenges associated with joint venture relationships, including dependence on our joint venture partners;  
difficulties in implementing and maintaining adequate internal controls;  
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;

## **Table of Contents**

higher telecommunications and Internet service provider costs;

different and more stringent user protection, data protection, privacy and other laws;

seasonal reductions in business activity;

expenses associated with localizing our products, including offering customers the ability to transact business in the local currency;

profit repatriation restrictions, foreign currency exchange restrictions, and exchange rate fluctuations;

volatility in a specific country's or region's political, economic or military conditions; and

differing intellectual property laws.

Some of these factors may cause our international costs of doing business to exceed our comparable domestic costs. As 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, repatriating money without adverse tax consequences, and risks relating to foreign currency exchange rate fluctuations. The impact of currency exchange rate fluctuations is discussed in more detail under "We are exposed to fluctuations in currency exchange rates and interest rates," above.

In addition, we conduct certain functions, including product development, customer support and other operations, in regions outside the U.S., particularly in India and China. We are subject to both U.S. and local laws and regulations applicable to our offshore activities, and any factors which reduce the anticipated benefits, including cost efficiencies and productivity improvements, associated with providing these functions outside of the U.S. could adversely affect our business.

We are continuing to expand PayPal's services internationally. In some countries, expansion of PayPal's business may require a close commercial relationship with one or more local banks, a shared ownership interest with a local entity or registration as a bank under local law. Such requirements may reduce our profitability or limit the scope of our activities in particular countries. Any limitation on our ability to expand PayPal internationally could harm our business.

We maintain a portion of Shopping.com's research and development facilities and personnel in Israel, and in January 2008 we acquired Fraud Sciences Ltd., an Israeli company. As a result, political, economic and military conditions in Israel affect those operations. The future of peace efforts between Israel and its neighboring countries remains uncertain. Increased hostilities or terrorism within Israel or armed hostilities between Israel and neighboring states could make it more difficult for us to continue our operations in Israel, which could increase our costs. In addition, many of our employees in Israel could be required to serve in the military for extended periods of time under emergency circumstances. Our Israeli operations could be disrupted by the absence of employees due to military service, which could adversely affect our business.

### ***Acquisitions and joint ventures could result in operating difficulties, dilution, and other harmful consequences.***

We have acquired a number of businesses in the past, including, most recently, Den Blå Avis and Bilbasen, classified businesses in Denmark. We also recently announced that we have agreed to acquire Bill Me Later, 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. At any given time we may be engaged in discussions or negotiations with respect to one or more of these types of transactions. Any of these transactions could be material to our financial condition and results of operations. The process of integrating any acquired business may create unforeseen operating difficulties and expenditures and is itself risky. The areas where we may face difficulties include:

diversion of management time, as well as a shift of focus from operating the businesses to issues related to integration and administration, particularly given the large number and size and varying scope of our recent acquisitions;

**Table of Contents**

declining employee morale and retention issues resulting from changes in, or acceleration of, compensation, or changes in management, 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;

in the case of foreign acquisitions, the need to integrate operations across different cultures and languages and to address the particular economic, currency, political, and regulatory risks associated with specific countries;

in some cases, the need to transition operations, users, and customers onto our existing platforms; and

liability for activities of the acquired company before the acquisition, including violations of laws, rules and regulations, commercial disputes, tax liabilities and other known and unknown liabilities.

Moreover, we may not realize the anticipated benefits of any or all of our acquisitions, or may not realize them in the time frame expected. For example, in connection with the Skype transaction, we recorded a goodwill impairment charge of approximately \$1.4 billion in our financial statements during 2007. Future acquisitions or mergers may require us to issue additional equity securities, spend our cash, or incur debt, liabilities, amortization expenses related to intangible assets or write-offs of goodwill, any of which could reduce our profitability and harm our business.

In addition, we have made investments in certain joint ventures in which we have a minority equity interest and lack management and operational control. These investments in joint ventures may involve risks, including the risk that the controlling joint venture partner may have business interests, strategies or goals that are inconsistent with ours, and the risk that business decisions or other actions or omissions of the controlling joint venture partner or the joint venture company may result in harm to our reputation or adversely affect the value of our investment in the joint venture.

***Our expected acquisition of Bill Me Later will expose us to new risks.***

We have signed an agreement to acquire Bill Me Later, Inc., a company that provides transaction-based credit. The acquisition is expected to close during the fourth quarter of 2008. Upon acquiring Bill Me Later, we will be exposed to new risks, including:

risks of writedowns related to Bill Me Later's loan portfolio (expected to exceed \$500 million at closing);

risks related to the willingness of consumers to borrow in the current economic environment and risks related to Bill Me Later's evaluation of the creditworthiness of such consumers;

risks that the nonpayment rate for Bill Me Later's loans would increase as a result of worsening economic conditions, higher unemployment rates, and other factors, which would lead to increases in loan chargeoffs;

any termination or interruption of services provided by certain third parties to Bill Me Later, including payment processors and gateways that process transactions for Bill Me Later and CIT Bank, which funds the consumer loans at the point of sale, prior to Bill Me Later purchasing the receivables;

risks that top merchants may terminate their agreements with Bill Me Later; and

other risks similar to those faced by PayPal, including the risk of systems failures, security breaches or other loss of customer data, fraud, intellectual property claims, compliance failures, and changes to regulations relating to credit offerings.

**Table of Contents**

***Our business and users may be subject to sales tax and other taxes.***

The application of indirect taxes (such as sales and use tax, value-added tax, or VAT, goods and services tax, business tax, and gross receipt tax) to ecommerce businesses such as eBay and to our users is a complex and evolving issue. Many of the fundamental statutes and regulations that impose these taxes were established before the growth of the Internet and ecommerce. In many cases, it is not clear how existing statutes apply to the Internet or electronic commerce or communications conducted over the Internet. In addition, some jurisdictions have implemented or may implement laws specifically addressing the Internet or some aspect of electronic commerce or communications on the Internet. From time to time, some taxing authorities have notified us that they believe we owe them certain taxes. Most recently, the City of Chicago has notified both eBay and StubHub that they are liable for a city amusement tax on tickets to events in Chicago, irrespective of the location of the buyer or seller, and has filed suit to enforce collection of taxes they claim are due. The application of similar existing or future laws could have adverse effects on our business.

Several proposals have been made at the U.S. state and local level that would impose additional taxes on the sale of goods and services or communications through the Internet. These proposals, if adopted, could substantially impair the growth of ecommerce and our brands, and could diminish our opportunity to derive financial benefit from our activities. The U.S. federal government's moratorium on state and local taxation of Internet access or multiple or discriminatory taxes on ecommerce was extended through November 2014. This moratorium does not prohibit federal, state, or local authorities from collecting taxes on our income or from collecting certain taxes that were in effect prior to the enactment of the moratorium and/or one of its extensions.

In conjunction with the Streamlined Sales Tax Project—an ongoing, multi-year effort by U.S., state, and local governments to require collection and remittance of distant sales tax by out-of-state sellers—bills have been introduced in the U.S. Congress to overturn the Supreme Court's *Quill* decision, which limits the ability of state governments to require sellers outside of their own state to collect and remit sales taxes on goods purchased by in-state residents. An overturning of the *Quill* decision without a robust small business exemption would harm our users and our business.

We do not collect taxes on the goods or services sold by users of our services. One or more states or the federal government or foreign countries may seek to impose a tax collection or reporting or record-keeping obligation on companies that engage in or facilitate ecommerce. Such an obligation could be imposed by legislation intended to improve tax compliance (and legislation to such effect has been discussed in the U.S. Congress, several states, and a number of foreign jurisdictions) or if an eBay company was ever deemed to be the legal agent of the users of our services by a jurisdiction in which eBay operates. In July 2008, the Housing and Economic Recovery Act of 2008 (H.R. 3221) was signed into law. This law contains provisions that require companies like PayPal to report to the IRS information on payments received by some of our customers. The legislation, effective for payments received after December 31, 2010, will require PayPal and similar companies to report to the IRS customers who receive more than \$20,000 in payments and more than 200 payments in a year. This law will require PayPal to request tax ID numbers from users and track payments by tax ID number. This requirement may decrease seller activity and harm our business. One or more other jurisdictions may also seek to impose tax-collection or reporting obligations based on the location of the product or service being sold or provided in an ecommerce transaction, regardless of where the respective users are located. Imposition of a discriminatory record keeping or tax collecting requirement could decrease seller activity on our sites and would harm our business. Foreign authorities may also require eBay to help ensure compliance by our users with local laws regulating professional sellers, including tax requirements. In addition, we have periodically received requests from tax authorities in many jurisdictions for information regarding the transactions of large classes of sellers on our sites, and in some cases we have been legally obligated to provide this data. The imposition of any requirements on us to disclose transaction records for all or a class of sellers to tax or other regulatory authorities or to file tax forms on behalf of any sellers, especially requirements that are imposed on us

but not on alternative means of ecommerce, and any use of those records to investigate, collect taxes from, or prosecute sellers, could decrease seller activity on our sites and harm our business.

We pay input VAT on applicable taxable purchases within the various countries in which we operate. In most cases, we are entitled to reclaim input VAT from the various countries. However, because of our unique business

**Table of Contents**

model, the application of the laws and rules that allow such reclamation is sometimes uncertain. A successful assertion by one or more countries that we are not entitled to reclaim VAT could harm our business.

We continue to work with the relevant tax authorities and legislators to clarify eBay's obligations under new and emerging laws and regulations. Passage of new legislation and the imposition of additional tax or tax-related reporting requirements could harm our users and our business. There have been, and will continue to be, substantial ongoing costs associated with complying with the various indirect tax requirements in the numerous markets in which eBay conducts or will conduct business.

***The current regulatory environment for Voice over Internet Protocol (VoIP) is uncertain, and Skype's business could be harmed by new regulations or the application of existing regulations to its products.***

The current regulatory environment for VoIP is uncertain and rapidly changing. Skype believes that its Internet communications products are currently subject to few, if any, of the same regulations that apply to traditional telephony and VoIP-based telephone replacement services. VoIP companies are generally subject to different regulatory regimes in different countries, and in most cases are subject to lower, or no, regulatory fees and lesser, or no, specific regulatory requirements. However, the status of VoIP providers is uncertain in many jurisdictions and Skype frequently must respond to inquiries about its regulatory status. Regulatory agencies may require Skype to conform to rules that are difficult or impossible for it to comply with due to the nature of its communications technologies, which could adversely affect its business. For example, while suitable alternatives may be developed in the future, Skype is currently unable to identify the exact geographic origin of the traffic traversing the Internet or to provide detailed calling information about computer-to-computer communications, either of which may make complying with future regulatory requirements, such as emergency service requirements, difficult or impossible.

Governments may impose new or increased fees, taxes, and administrative burdens on VoIP companies, or Skype may change its product offerings in a manner that makes it become subject to telecommunications regulations. Increased fees could include access and other charges payable to local exchange carriers to carry and terminate traffic, contributions to federal or state Universal Service Funds in the United States and elsewhere, and other charges. In addition, such fees may be assessed by governments retroactively or prospectively. Skype may be required to meet various emergency service requirements, disability access requirements, user protection requirements, number assignment and portability requirements, and interception or wiretapping requirements, such as the Communications Assistance for Law Enforcement Act in the U.S. and similar laws in other jurisdictions. Such regulations could result in substantial costs depending on the technical changes required to accommodate the requirements, and any increased costs could erode Skype's pricing advantage over competing forms of communication. Regulations that decrease the degree of privacy for users of Skype's products could also slow its adoption. The increasing growth and popularity of Internet communications heightens the risk that governments will seek to regulate VoIP and Internet communications, and Skype has received an increasing number of inquiries from regulators about its products and services.

Competitors, including the incumbent telephone companies, may devote substantial lobbying efforts to seek greater protection for their existing businesses and increased regulation of VoIP. In the United States, various state legislatures and regulatory agencies are beginning to impose their own requirements and taxes on VoIP. Some countries have prohibited Skype. In many countries in which Skype products are available, the laws that may relate to its offerings are unclear. We cannot be certain that Skype or its customers are currently in full compliance with regulatory or other legal requirements in all countries in which Skype is used. Skype's failure or the failure of those with whom Skype transacts business to comply with these requirements could materially adversely affect our business, financial condition and results of operations. In addition, increased regulatory requirements on VoIP would increase Skype's costs, and, as a result, our business would suffer.

New rules and regulations with respect to VoIP are being considered in various countries around the world, and at least some of these rules and regulations are likely to be adopted and to be applicable to Skype. Such new rules and



regulations are likely to increase our costs of doing business and could prevent us from delivering our products and offerings over the Internet, which could adversely affect Skype's customer base, and thus its revenue.

**Table of Contents**

***Skype depends on key technology that is licensed from third parties.***

Skype licenses technology underlying certain key components of its software from third parties it does not control, including the technology underlying its peer-to-peer architecture and firewall traversal technology and the video compression/decompression used to provide high video quality. Although Skype has contracts in place with its third-party technology providers, there can be no assurance that the licensed technology or other technology that we may seek to license in the future will continue to be available on commercially reasonable terms, or at all. The loss of, or inability to maintain, existing licenses could result in a decrease in service quality or loss of service until equivalent technology or suitable alternatives can be developed, identified, licensed and integrated. While we believe Skype has the ability to either extend these licenses on commercially reasonable terms or identify and obtain or develop suitable alternative products, the costs associated with licensing or developing such products could be high. Any failure to maintain these licenses on commercially reasonable terms or license or develop alternative technologies would harm Skype's business. Skype and one of its licensors are currently attempting to resolve a dispute concerning licensed technology. Failure to successfully resolve this dispute would harm Skype's business.

***Our businesses depend on continued and unimpeded access to the Internet. Internet service providers may be able to block, degrade, or charge us or our users additional fees for our offerings.***

Our customers rely on access to the Internet to use our products and services. In many cases that access is provided by companies that compete with at least some of our offerings, including incumbent telephone companies, cable companies, mobile communications companies, and large Internet service providers. Some of these providers have stated that they may take measures that could degrade, disrupt, or increase the cost of customers' use of our offerings by restricting or prohibiting the use of their lines for our offerings, by filtering, blocking, delaying, or degrading the packets containing the data associated with our products, or by charging increased fees to us or our users for use of their lines to provide our offerings. Some of these providers have contractually restricted their customers' access to VoIP offerings (which would include Skype) through their terms of service with their customers. These activities are technically feasible and may be permitted by applicable law. In addition, Internet service providers could attempt to charge us each time our customers use our offerings. Worldwide, a number of companies have announced plans to take such actions or are selling products designed to facilitate such actions. Interference with our offerings or higher charges for access to our offerings, whether paid by us or by our customers, could cause us to lose existing customers, impair our ability to attract new customers, and harm our revenue and growth.

***Our tickets business is subject to regulatory, competitive, and other risks that could harm this business.***

Our tickets business, which includes our StubHub business, is subject to numerous risks. Many jurisdictions have laws and regulations covering the resale of event tickets, and some jurisdictions prohibit the resale of event tickets at prices above the face value of the tickets. In addition, new laws and regulations may be passed that would limit our or our users' ability to continue this business. Regulatory agencies or courts may claim or hold that we are responsible for ensuring that our users comply with these laws and regulations or that we or our users are either subject to licensure or prohibited from reselling event tickets in their jurisdictions.

Some event organizers and professional sports teams have expressed concern about the resale of their event tickets on our sites. In November 2006, the New England Patriots filed suit against StubHub alleging that StubHub's resale activities violate Massachusetts' ticket resale laws and constitute intentional interference with the team's relationship with its season ticket holders. In April 2007, Ticketmaster filed suit against eBay d/b/a StubHub alleging that StubHub had improperly interfered with Ticketmaster's contracts with its clients by wrongfully obtaining tickets for sale in violation of Ticketmaster's exclusive contractual rights to sell such tickets. Such litigation could result in damage awards, could require us to change our business practices in harmful ways, or could otherwise negatively affect our tickets business. Others have threatened litigation. Our tickets business is also subject to seasonal fluctuations and the

general economic and business conditions that impact the sporting events and live entertainment industries. Our tickets business also faces significant competition from a number of sources, including ticketing service companies (such as TicketMaster and Tickets.com), event organizers (such as professional sports teams and leagues), ticket brokers, and other online and offline ticket resellers, such as TicketsNow (which is owned by TicketMaster) and RazorGator. If we are unable to effectively compete with these competitors,

**Table of Contents**

our tickets business could be harmed. In addition, ticketing service companies and event organizers have recently begun to issue event tickets through paperless (electronic) ticketing systems that include restrictions on the transferability of such event tickets. To the extent that event tickets issued in this manner cannot be resold on our websites, our tickets business could be harmed.

***We depend on key personnel.***

Our future performance depends substantially on the continued services of our senior management and other key personnel and our ability to retain and motivate them. We recently changed our Chief Executive Officer and the heads of all three of our business units. These changes may result in increased attrition of our personnel as new reporting relationships are established and as other companies may increasingly target our executives. 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 many members of our senior management team have fully vested the vast majority of their in-the-money equity incentives. The loss of the services of any of our executive officers or other key employees could harm our business. Our new businesses all depend on attracting and retaining key personnel. 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 equity awards 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. Similarly, decreases in the number of unvested in-the-money stock options held by existing employees, whether because our stock price has declined, options have vested, or because the size of follow-on option grants has declined, may make it more difficult to retain and motivate employees.

In October 2008, we announced our plans to reduce our global workforce to simplify and streamline our organization, improve our cost structure and strengthen our overall businesses. These changes will result in the recording of related accounting charges and could harm employee morale and productivity and be disruptive to our business.

***Problems with or price increases by third parties who provide services to us or to our users could harm our business.***

A number of parties provide services to us or to our users that benefit us. Such services include seller tools that automate and manage listings, merchant tools that manage listings and interface with inventory management software, storefronts that help our users list items, caching services that make our sites load faster, and shipping providers that deliver goods sold on our platform, among others. In some cases we have contractual agreements with these companies that give us a direct financial interest in their success, while in other cases we have none. PayPal is dependent on the processing companies and banks that link PayPal to the credit card and bank clearing networks. Financial, regulatory, or other problems that prevent these companies from providing services to us or our users could reduce the number of listings on our websites or make completing transactions or payments on our websites more difficult, and thereby harm our business. Price increases by companies that provide services to our users could also reduce the number of listings on our websites or make it more difficult for our users to complete transactions, thereby harming our business. For example, we believe recent changes in postal rates may have reduced listing volume on our sites in certain categories. Any security breach at one of these companies could also affect our customers and harm our business. In addition, we have outsourced certain functions to third-party outside providers, including customer support and product development functions, which are critical to our operations. If our service providers do not perform satisfactorily, our operations could be disrupted, which could result in user dissatisfaction and adversely affect our business, reputation and operating results. Although we generally have been able to renew or extend the terms of contractual arrangements with third parties who provide services to us on acceptable terms, there can be no

assurance that we will continue to be able to do so in the future, and there can be no assurance that third parties who provide services directly to our users will continue to do so at reasonable rates or at all.

## **Table of Contents**

### ***Customer complaints or negative publicity about our customer support or anti-fraud measures could diminish use of our services.***

Customer complaints or negative publicity about our customer support could severely diminish consumer confidence in and use of our services. Measures we sometimes take to combat risks of fraud and breaches of privacy and security have the potential to damage relations with our customers or decrease activity on our sites by making our sites more difficult to use or restricting the activities of certain users. These measures heighten the need for prompt and accurate customer support to resolve irregularities and disputes. Effective customer support requires significant personnel expense, and this expense, if not managed properly, could significantly impact our profitability. Failure to manage or train our customer support 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.

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 support and must resolve certain customer contacts within shorter time frames. As part of PayPal's program to reduce fraud losses and prevent money laundering, it may temporarily restrict the ability of customers to withdraw their funds if those funds or the customer's account activity are identified by PayPal's risk models as suspicious. PayPal has in the past received negative publicity with respect to its customer support and account restrictions, and has been the subject of purported class action lawsuits and state attorney general inquiries alleging, among other things, failure to resolve account restrictions promptly. If PayPal is unable to provide quality customer support operations in a cost-effective manner, PayPal's users may have negative experiences, PayPal may receive additional negative publicity, its ability to attract new customers may be damaged, and it could become subject to additional litigation. As a result, current and future revenues could suffer, and its operating margins may decrease. In addition, negative publicity about or experiences with customer support for Marketplaces, PayPal or Skype could cause our reputation to suffer or affect consumer confidence in our brands as a whole.

### ***Our industry is intensely competitive, and other companies or governmental agencies may allege that our behavior is anti-competitive.***

#### *Marketplaces*

Marketplaces businesses currently or potentially compete with a number of companies providing both particular categories of goods and 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. The barriers to entry into these channels are relatively low and current offline and new competitors, including small businesses who want to create and promote their own stores, can easily launch online sites at a nominal cost using commercially available software or partnering with any one of a number of successful ecommerce companies.

Our broad-based competitors include the vast majority of traditional department, warehouse, discount, and general merchandise stores (as well as the online operations of these traditional retailers), emerging online retailers, online classified services, and other shopping channels such as offline and online home shopping networks. Among others, these include: Wal-Mart, 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.

A number of companies offer a variety of services that provide channels for buyers to find and buy items from sellers of all sizes, including online aggregation and classifieds websites such as craigslist (in which we own a minority equity stake), Google Base, Microsoft Live Expo, and Oodle.com. Our Kijiji websites offers classifieds listings in a variety of local international markets, and in July 2007, Kijiji launched local classifieds websites in the U.S. In many markets in which it operates, including in the U.S., our classified platforms compete against more established online

and offline classifieds platforms.

In 2005, we acquired Shopping.com Ltd., an online shopping comparison site. Shopping.com competes with sites such as Buy.com, Google's Product Search, Nextag.com, Pricegrabber.com, Shopzilla, and Yahoo! Product Search, which offer shopping search engines that allow consumers to search the Internet for specified products. Recent legal developments may affect the utility of shopping comparison sites if manufacturers begin requiring

**Table of Contents**

more uniformity in product pricing. In addition, sellers are increasingly acquiring new customers by paying for search-related advertisements on search engine sites such as Google and Yahoo!. We use product search engines and paid search advertising to channel users to our sites, but these services also have the potential to divert users to other online shopping destinations.

We also compete with many local, regional, and national specialty retailers and exchanges in each of the major categories of products offered on our websites. For example, category-specific competitors to offerings in our Clothing & Accessories category include, among others, Abercrombie & Fitch, AE.com, Bloomingdale's, Bluefly.com, Coldwater-Creek.com, Delias.com, Dockers.com, DSW, Eddie Bauer, eBags, eLuxury, The Gap, J.C. Penney, J. Crew, Kohl's, Lands End, Lane Bryant, The Limited, LL Bean, Macy's, The Men's Wearhouse, Neiman-Marcus, Nike, Nordstrom, Old Navy, Overstock.com, Payless, Ross, Saks Fifth Avenue, Shoes.com, Urban Outfitters, Victoria's Secret, Yoox.com, and Zappos.com., as well as other online and offline retailers, stores and shopping networks.

Our international Marketplaces websites compete with similar online and offline channels in each of their vertical categories in most countries. In addition, they compete with general online ecommerce sites, such as Quelle and Otto in Germany, Tradus (recently acquired by Naspers) in Poland, Yahoo-Kimo in Taiwan, Lotte and Gmarket in South Korea, OZtion and Aussie Bidder in Australia, and Amazon in the United Kingdom 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 certain of these jurisdictions there are competitors that may have a better understanding of local culture and commerce than we do.

The principal competitive factors for Marketplaces include the following:

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

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

- community cohesion, interaction and size;
- website ease-of-use and accessibility;
- level of trust in the seller;
- system reliability;
- reliability of delivery and payment;
- level of service fees; and
- quality of search tools.



Some current and potential competitors have longer operating histories, larger customer bases and greater brand recognition in other business and Internet sectors than we do. Other online trading services may be acquired by, receive investments from, or enter into other commercial relationships with 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. 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 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, or may attempt to use existing or future government regulation to prohibit or limit online commerce in certain categories of goods or services. The adoption by manufacturers or government authorities of policies or regulations discouraging the sales of goods or services over the Internet could force eBay users to stop selling certain products on our websites. Increased competition or anti-

**Table of Contents**

Internet distribution policies or regulations may result in reduced operating margins, loss of market share and diminished value of our brand.

Conversely, other companies and government agencies have in the past and may in the future allege that our actions violate the antitrust or competition laws of the U.S. or other countries, or otherwise constitute unfair competition. Such claims, even if without foundation, typically are very expensive to defend, involve negative publicity and diversion of management time and effort, and could result in significant judgments against us.

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 profitability. For example, in January 2008, we announced significant changes to our Marketplaces business in three major areas: fee structure, seller incentives and standards, and buyer and seller feedback. In March 2008, we announced that beginning in June 2008, we would require users in the UK to offer PayPal as one option as a method of payment on most transactions on our localized UK website, and in April 2008, we announced that we planned to require users in Australia to offer and use PayPal as the exclusive method of payment on most transactions on our localized Australian website. In June 2008, the Australian Competition and Consumer Commission (ACCC) issued a draft notice precluding us from requiring PayPal to be used as the exclusive payment option for transactions on our localized Australian website. In July 2008, we withdrew our notification to the ACCC. In August 2008, we announced that beginning in late October 2008, we will no longer allow any forms of paper payment, including checks and money orders, to be used on eBay.com in the U.S. for most categories of items. While these initiatives are intended to improve and make safer our users' buying experience and/or increase activity on our sites, certain users may be negatively affected by or react negatively to these changes. We currently face inquiries from government regulators in various jurisdictions related to actions that we have taken that are designed to improve the safety of transactions on our websites, most notably by requiring PayPal to be offered and/or used for certain high-risk transactions and/or by sellers in certain jurisdictions, and we may face similar inquiries from other government regulators in the future. Any negative reaction to these changes by our users or government authorities could, among other things, force us to change our operating practices in ways that could harm our business, operating results and profitability. 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 sellers 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 or these companies may decide to promote competitive services. Even if these arrangements are renewed, they may not result in increased usage of our services. In addition, companies that control user access to transactions through network access, Internet browsers, or search engines, could promote our competitors, channel current or potential users to their vertically integrated electronic commerce sites or their advertisers' sites, attempt to restrict our access, or charge us substantial fees for inclusion. Search engines are increasingly becoming a starting point for online shopping, and as the costs of operating an online store decline, online sellers may increasingly sell goods through multiple channels, which could reduce the number and value of transactions these sellers conduct through our sites.

*PayPal*

The markets for PayPal's product are intensely competitive and are subject to rapid technological change, including but not limited to: mobile payments, electronic funds transfer networks starting to allow Internet access, cross-border access to networks, creation of new networks, expansion of prepaid cards, and bill pay networks. PayPal competes with existing online and offline payment methods, including, among others:

credit card merchant processors that offer their services to online merchants, including American Express, Cardservice International, Chase Paymentech, First Data, and Wells Fargo; and payment gateways, including

CyberSource and Authorize.net (which has merged with CyberSource);

money remitters such as MoneyGram and Western Union;

bill payment services, including CheckFree;

**Table of Contents**

processors that provide online merchants the ability to offer their customers the option of paying for purchases from their bank account, including Certegy, eBillMe, Revolution Money and TeleCheck, a subsidiary of First Data, or to pay on credit, including Bill Me Later (which we have agreed to acquire);

providers of traditional payment methods, particularly credit cards, checks, money orders, and Automated Clearing House transactions;

issuers of stored value targeted at online payments, including VisaBuxx, NetSpend and GreenDot;

mobile payments, including Obopay, TextPayMe (a subsidiary of Amazon), Crandy, LUUP and Payforit;

Amazon Payments, which acts as a credit processor and can be linked to a personal bank account; and

Google Checkout, which enables the online payment of merchants using credit cards.

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. PayPal's competitors may respond to new or emerging technologies and changes in customer requirements faster and more effectively than PayPal. Some of these competitors may also be subject to lesser licensing, anti-money laundering, and other regulatory requirements than PayPal, which is subject to additional regulations based on its licensure as a bank in Luxembourg. They may devote greater resources to the development, promotion, and sale of products and services than PayPal, and they may offer lower prices. For example, Google Checkout provided free payment processing promotion through February 1, 2008, and currently offers free payments processing on transactions in an amount proportionate to certain advertising spending with Google. 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.

Overseas, PayPal faces competition from similar channels and payment methods. In each country, numerous banks provide standard online credit card acquiring and processing services, and these banks typically have leading market share. In addition, PayPal faces competition from Visa's Visa Direct, MasterCard's MoneySend, Royal Bank of Scotland's World Pay and ClickandBuy in the EU, NOCHEX, Moneybookers, NETeller and FirePay in the United Kingdom, CertaPay and HyperWallet in Canada, Paymate and BPay in Australia, Alipay, YeePay, and 99Bill in China and Inicis in South Korea. In addition, in certain countries, such as Germany and Australia, electronic funds transfer 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.

Some of PayPal's competitors, such as Wells Fargo, First Data, American Express, and Royal Bank of Scotland, also provide processing or foreign exchange services to PayPal. If PayPal were to seek to expand the financial products that it offers, either alone or through a commercial alliance or an acquisition, these processing and foreign exchange relationships could be negatively affected, or these competitors and other processors could make it more difficult for PayPal to deliver its services.

*Skype*

The market for Skype's products is also intensely competitive and characterized by rapid technological change. We expect Skype's various communications competitors, including, for example, the providers of online communications products and telecommunications operators, to continue to improve the performance of their current products and introduce new products, software, services and technologies. If Skype's competitors successfully introduce new

products or enhance their existing products, this could reduce the market for Skype's products, increase price competition, or make Skype's products obsolete, which could lower Skype's adoption rates, decrease its ability to attract new users or cause its current users to migrate to a competing company.

Additionally, several of Skype's current and potential competitors have longer operating histories, are substantially larger, and have greater financial, marketing, technical, and other resources. Some also have greater name recognition and a larger installed base of customers than Skype has.

**Table of Contents**

***If we are unable to operate our new in-house global affiliate platform in an effective and efficient manner, our business could suffer.***

Under our affiliate programs, affiliates and website publishers are paid for traffic driven to our websites. Our affiliate programs were previously run externally through a third-party platform. In April 2008, we launched our new global affiliate platform, the eBay Partner Network, which is managed and operated internally. If we are unable to transition our affiliate programs in-house in a timely and effective manner, this could result in dissatisfaction on the part of our affiliates and/or a reduction in traffic to our websites, which could adversely affect our business and operating results. In addition, we may incur substantial costs associated with implementing and operating the eBay Partner Network, including costs associated with implementing appropriate internal controls and procedures with respect to the new platform. If we are unable to operate the eBay Partner Network as planned, our results of operations, business and reputation may be adversely affected. We are also exposed to the risk of fraud by our affiliates (including click fraud or other clicks or conversions) in our affiliates program, which may result in inflated traffic to our websites and/or lower quality traffic. If we are unable to detect and prevent any such fraud by our affiliates in a timely and effective manner, our profitability may be negatively impacted.

***Our business may be adversely affected by factors that cause our users to spend less time on our websites, including seasonal factors, national events and increased usage of other websites.***

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, and natural disasters, such as hurricanes or earthquakes. Similarly, our results of operations historically have been seasonal because many of our users reduce their activities on our websites with the onset of good weather during the summer months, and on and around national holidays. In addition, increased usage of social networking or other entertainment websites may decrease the amount of time users spend on our websites, which could adversely affect our financial results.

***Our failure to cost effectively manage certain aspects of our business could harm us.***

We have expanded our headcount, facilities, and infrastructure in the U.S. and internationally, and anticipate that further expansion will be required as we continue to expand into new lines of business and geographic areas. 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:

*Website Usability.* User activity rates on our websites depend in part on the quality of our users' experiences on those sites. The rapid growth in the number and complexity of products and features on our sites has occasionally caused users to become confused or overwhelmed or has otherwise impaired users' experiences on those sites. We are in the process of making numerous improvements to our eBay websites, including an attempt to improve the user experience on those websites. These attempts at improvement could fail, or could decrease activity among users who had grown used to or preferred the existing experience on our sites. Any impairment of customer satisfaction as a result of site usability issues could lead to a loss of customers or impair our ability to add customers, either of which would harm our business.

*Website Stability.* 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 regularly introduce. This upgrade process is expensive, and the increased complexity of our websites and the need to support multiple platforms as our portfolio of brands grows increases the cost of additional enhancements. Failure to upgrade our technology, features, transaction processing systems, security infrastructure, or network infrastructure to accommodate increased traffic or transaction volume could harm

our business. Adverse consequences could include unanticipated system disruptions, slower response times, degradation in levels of customer support, impaired quality of users' experiences of our services, impaired quality of services for third-party application developers using our externally accessible Application Programming Interface, or API, and delays in reporting accurate financial information. We may be unable to effectively upgrade and expand our systems in a timely manner or smoothly integrate any newly

**Table of Contents**

developed or purchased technologies or businesses with our existing systems, and any failure to do so could result in problems on our sites. Further, steps to increase the reliability and redundancy of our systems are expensive, reduce our margins, and may not be successful in reducing the frequency or duration of unscheduled downtime.

*Customer Account Billing.* Our revenues depend on prompt and accurate billing processes. Our failure to grow our transaction-processing capabilities to accommodate the increasing number of transactions that must be billed on any of our websites would harm our business and our ability to collect revenue.

*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 user protection 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, current and future revenues could suffer, and our operating margins may decrease.

We must continue to effectively hire, train, and manage new employees. If our new hires perform poorly, 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. The additional headcount and capital investments we are adding will increase our cost base, which will make it more difficult for us to offset any future revenue shortfalls by expense reductions in the short term.

*We may have exposure to greater than anticipated tax liabilities.*

The determination of our worldwide provision for income taxes and other tax liabilities requires estimation and significant judgment and there are many transactions and calculations where the ultimate tax determination is uncertain. Our determination of our tax liability is always subject to audit and review by applicable domestic and foreign tax authorities, and we are currently undergoing a number of such audits and reviews by taxing authorities throughout the world. Any adverse outcome of any such audit or review could have a negative effect on our operating results and financial condition. Although we believe our estimates are reasonable, the ultimate tax outcome may differ from the amounts recorded in our financial statements and may materially affect our financial results in the period or periods for which such determination is made.

*We depend on the continued growth of online commerce and communications.*

The business of selling goods over the Internet, particularly through online trading, is dynamic and relatively new. Concerns about fraud, privacy, and other problems may discourage additional consumers from adopting the Internet as a medium of commerce. In countries such as the U.S. and Germany, where our services and online commerce generally have been available for some time and the level of market penetration of our services is high, acquiring new users for our services may be more difficult and costly than it has been in the past. 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 and may prefer Internet analogues to such traditional retail means to our offerings, such as the retailer's own website. If these consumers prove to be less active than our earlier users, and we are unable to gain efficiencies in our operating costs, including our cost of acquiring new customers, our business could be adversely impacted.

*Our business depends on the development and maintenance of the Internet infrastructure.*



The success of our services 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. The Internet infrastructure may be unable to support such demands. In addition, increasing numbers of users, increasing bandwidth requirements, or problems caused by viruses, worms, and

**Table of Contents**

similar programs may harm the performance of the Internet. 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 generally as well as the level of usage of our services.

***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 federal, state and common law rights, as well as a variety of administrative procedures. 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 confidentiality 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 we have taken to protect our intellectual property may not prevent misappropriation of our technology or deter independent development of similar technologies by others. We pursue the registration of our domain names, trademarks, and service marks in the U.S. and internationally. Effective trademark, copyright, patent, domain name, trade dress, and trade secret protection is very expensive to maintain and may require litigation. We must 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. For example, Skype is in the process of applying to register the Skype name as a trademark worldwide. In the EU, Skype's application is being opposed. If these oppositions to Skype's applications were to be successful, Skype's ability to protect its brand against third-party infringers would be compromised. 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 others. These licensees may take actions that 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 and buildings 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, neighboring owners, or others.

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

Our 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 rights granted to 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 potential acquirer 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.

**Table of Contents****Item 2: *Unregistered Sales of Equity Securities and Use of Proceeds***

Stock repurchase activity during the three months ended September 30, 2008 was as follows:

| <b>Period</b>                        | <b>Total Number<br/>of<br/>Shares<br/>Purchased(2)</b> | <b>Average<br/>Price<br/>Paid<br/>per Share</b> | <b>Total Number of<br/>Shares Purchased<br/>as<br/>Part of Publicly<br/>Announced<br/>Programs</b> | <b>Maximum Dollar<br/>Value that May<br/>Yet<br/>be Purchased<br/>Under<br/>the Programs(1)</b> |
|--------------------------------------|--------------------------------------------------------|-------------------------------------------------|----------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------|
| July 1, 2008-July 31, 2008           | 2,683,473                                              | \$ 24.65                                        | 2,682,132                                                                                          | \$ 1,213,090,493                                                                                |
| August 1, 2008-August 30, 2008       | 18,624,369                                             | \$ 25.48                                        | 18,584,437                                                                                         | \$ 738,993,973                                                                                  |
| September 1, 2008-September 30, 2008 | 3,559,000                                              | \$ 23.17                                        | 3,559,000                                                                                          | \$ 656,500,143                                                                                  |
|                                      | 24,866,842                                             |                                                 | 24,825,569                                                                                         |                                                                                                 |

- (1) In July 2006, our Board authorized a stock repurchase program for up to \$2.0 billion of our common stock within two years from the date of authorization. In January 2007, our Board authorized the expansion of this stock repurchase program to provide for the repurchase of up to an additional \$2.0 billion of our common stock by January 2009. In January 2008, our Board authorized another stock repurchase program to provide for the repurchase of up to an additional \$2.0 billion of our common stock with no expiration from the date of authorization. Under these programs, as of September 30, 2008, we had repurchased in the aggregate approximately \$5.3 billion of our common stock at an average price of \$29.74 per share. As of September 30, 2008, \$656.5 million remained available for further repurchases under the stock repurchase program authorized by the Board in January 2008.
- (2) Includes 1,341 and 39,932 shares of stock withheld from employees to satisfy tax obligations in July and August 2008, respectively.

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

Not applicable.

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

None

**Item 5: *Other Information***

The Audit Committee of our Board of Directors has adopted a policy requiring the pre-approval of any non-audit engagement of PricewaterhouseCoopers LLP, or PwC, our independent registered public accounting firm. In the event that we wish to engage PwC to perform accounting, technical or other permitted services not related to the services

## Edgar Filing: EBAY INC - Form 10-Q

performed by PwC as our independent registered public accounting firm, 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.

During the quarter ended September 30, 2008 there were no pre-approvals of any non-audit engagement work to be performed by PwC.

**Table of Contents**

**Item 6: *Exhibits***

|                |                                                                                                                                                                                 |
|----------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Exhibit 3.01*  | Registrant's Amended and Restated Bylaws.                                                                                                                                       |
| Exhibit 10.01+ | Letter Agreement dated September 30, 2008 between Robert Swan and Registrant.                                                                                                   |
| Exhibit 10.02+ | Separation Agreement dated August 21, 2008 between Rajiv Dutta and Registrant.                                                                                                  |
| Exhibit 10.03  | Second Amendment Agreement dated September 5, 2008, by and among Registrant, Bank of America, N.A., as Administrative Agent, and other lenders named from time to time therein. |
| Exhibit 12.01  | Statement regarding computation of ratio of earnings to fixed charges.                                                                                                          |
| Exhibit 31.01  | Certification of eBay's Chief Executive Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002.                                                                  |
| Exhibit 31.02  | Certification of eBay's Chief Financial Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002.                                                                  |
| Exhibit 32.01  | Certification of eBay's Chief Executive Officer, as required by Section 906 of the Sarbanes-Oxley Act of 2002.                                                                  |
| Exhibit 32.02  | Certification of eBay's Chief Financial Officer, as required by Section 906 of the Sarbanes-Oxley Act of 2002.                                                                  |

\* Filed as an exhibit to Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on October 3, 2008, and incorporated herein by reference

+ Indicates a management contract or compensatory plan or arrangement

**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.

eBay Inc.

Principal Executive Officer:

By: /s/ John Donahoe

John Donahoe

*President and Chief Executive Officer*

Date: October 22, 2008

Principal Financial Officer:

By: /s/ Robert H. Swan

Robert H. Swan

*Senior Vice President and Chief Financial Officer*

Date: October 22, 2008

Principal Accounting Officer:

By: /s/ Phillip P. DePaul

Phillip P. DePaul

*Vice President, Chief Accounting Officer*

Date: October 22, 2008

**Table of Contents**

**INDEX TO EXHIBITS**

|                |                                                                                                                                                                                 |
|----------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Exhibit 3.01*  | Registrant's Amended and Restated Bylaws.                                                                                                                                       |
| Exhibit 10.01+ | Letter Agreement dated September 30, 2008 between Robert Swan and Registrant.                                                                                                   |
| Exhibit 10.02+ | Separation Agreement dated August 21, 2008 between Rajiv Dutta and Registrant.                                                                                                  |
| Exhibit 10.03  | Second Amendment Agreement dated September 5, 2008, by and among Registrant, Bank of America, N.A., as Administrative Agent, and other lenders named from time to time therein. |
| Exhibit 12.01  | Statement regarding computation of ratio of earnings to fixed charges.                                                                                                          |
| Exhibit 31.01  | Certification of eBay's Chief Executive Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002.                                                                  |
| Exhibit 31.02  | Certification of eBay's Chief Financial Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002.                                                                  |
| Exhibit 32.01  | Certification of eBay's Chief Executive Officer, as required by Section 906 of the Sarbanes-Oxley Act of 2002.                                                                  |
| Exhibit 32.02  | Certification of eBay's Chief Financial Officer, as required by Section 906 of the Sarbanes-Oxley Act of 2002.                                                                  |

\* Filed as an exhibit to Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on October 3, 2008, and incorporated herein by reference

+ Indicates a management contract or compensatory plan or arrangement