EBAY INC
Form 10-Q/A
April 26, 2006

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

Form 10-Q/A
(Amendment No. 1)

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

For the quarterly period ended March 31, 2006

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	**74-0430924**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification Number)*
2145 Hamilton Avenue **San Jose, California**	**95125**
(Address of principal executive offices)	*(Zip Code)*

(408) 376-7400
(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

As of April 21, 2006, there were 1,410,109,123 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.

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EXPLANATORY NOTE

eBay Inc. is filing this Amendment No. 1 to its Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2006, as filed with the Securities and Exchange Commission on April 24, 2006, to correct an error in our narrative description of the impact of foreign currency exchange rates on net revenues and operating expenses during the first quarter of 2006, as compared to the same period of the prior year, on pages 25, 26, 31, and 42 of the Quarterly Report. eBay Inc. s previously filed financial statements remain unchanged.

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PART I: FINANCIAL INFORMATION

Item 1: *Financial Statements*

eBay Inc.
CONDENSED CONSOLIDATED BALANCE SHEET

	December 31, 2005	March 31, 2006
	(In thousands, except par value amounts) (Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,313,580	$ 1,876,434
Short-term investments	774,650	828,049
Accounts receivable, net	322,788	318,878
Funds receivable from customers	255,282	225,295
Restricted cash and investments	29,702	30,755
Other current assets	487,235	620,832
Total current assets	3,183,237	3,900,243
Long-term investments	825,667	793,497
Property and equipment, net	801,602	860,493
Goodwill	6,120,079	6,205,075
Intangible assets, net	823,280	781,988
Other assets	35,121	27,239
Total assets	$ 11,788,986	$ 12,568,535
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 55,692	$ 101,157
Funds payable and amounts due to customers	586,651	660,838
Accrued expenses and other current liabilities	578,557	589,665
Deferred revenue and customer advances	81,940	90,965
Income taxes payable	182,095	238,883
Total current liabilities	1,484,935	1,681,508
Deferred tax liabilities, net	215,682	220,430
Other liabilities	40,388	39,797
Total liabilities	1,741,005	1,941,735
Stockholders equity:		
Common Stock, $0.001 par value; 3,580,000 shares authorized; 1,404,183 and 1,409,069 shares issued and outstanding	1,404	1,409
Additional paid-in capital	7,272,476	7,429,377
Unearned stock-based compensation	(45,540)	

Retained earnings	2,716,511	2,964,793
Accumulated other comprehensive income	103,130	231,221
Total stockholders equity	10,047,981	10,626,800
Total liabilities and stockholders equity	$ 11,788,986	$ 12,568,535

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

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eBay Inc.
CONDENSED CONSOLIDATED STATEMENT OF INCOME

	Three Months Ended March 31, 2005	Three Months Ended March 31, 2006
	(In thousands, except per share amounts) (Unaudited)	
Net revenues	$ 1,031,724	$ 1,390,419
Cost of net revenues(1)	186,369	278,568
Gross profit	845,355	1,111,851
Operating expenses(1):		
Sales and marketing	271,349	400,562
Product development	73,789	119,070
General and administrative	136,389	215,350
Payroll tax on employee stock options	5,731	2,324
Amortization of acquired intangible assets	22,523	51,921
Total operating expenses	509,781	789,227
Income from operations	335,574	322,624
Interest and other income, net	22,403	25,760
Interest expense	(1,720)	(747)
Income before income taxes and minority interests	356,257	347,637
Provision for income taxes	(99,948)	(99,354)
Minority interests	(18)	(1)
Net income	$ 256,291	$ 248,282
Net income per share:		
Basic	$ 0.19	$ 0.18
Diluted	$ 0.19	$ 0.17
Weighted average shares:		
Basic	1,343,442	1,406,309
Diluted	1,382,150	1,437,581
(1) Includes stock-based compensation as follows (2006 increases are due primarily to the adoption of FAS 123(R)):		
Cost of net revenues	$ 78	$ 9,476
Sales and marketing		24,721

Product development		322		20,701
General and administrative		3,196		28,920
Total stock-based compensation	$	3,596	$	83,818

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

eBay Inc.
CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Three Months Ended March 31,	
	2005	**2006**
	(In thousands) (Unaudited)	
Net income	$ 256,291	$ 248,282
Other comprehensive income (loss):		
Foreign currency translation	(13,687)	127,533
Unrealized gains (losses) on investments, net	(4,818)	2,592
Unrealized gains (losses) on cash flow hedges	1,414	(1,564)
Estimated tax benefit (provision)	1,314	(470)
Net change in accumulated other comprehensive income (loss)	(15,777)	128,091
Comprehensive income	$ 240,514	$ 376,373

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

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eBay Inc.
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

	Three Months Ended March 31,	
	2005	**2006**
	(In thousands) (Unaudited)	
Cash flows from operating activities:		
Net income	$ 256,291	$ 248,282
Adjustments:		
Provision for doubtful accounts and authorized credits	22,024	27,047
Provision for transaction losses	18,579	25,627
Depreciation and amortization	79,660	123,286
Stock based compensation expense related to stock options and employee stock purchases	3,596	83,818
Tax benefit on the exercise of employee stock options	84,992	37,442
Excess tax benefits from stock-based compensation		(23,372)
Minority interests	18	1
Changes in assets and liabilities, net of acquisition effects:		
Accounts receivable	(54,162)	(22,901)
Funds receivable from customers	(77,333)	29,748
Other current assets	1,203	(117,726)
Other non-current assets	(8,361)	7,263
Deferred tax liabilities, net	2,240	(7,500)
Accounts payable	20,909	51,956
Funds payable and amounts due to customers	168,928	74,331
Accrued expenses and other liabilities	(21,838)	(18,761)
Deferred revenue and customer advances	(6,975)	9,023
Income taxes payable	5,648	56,640
Net cash provided by operating activities	495,419	584,204
Cash flows from investing activities:		
Purchases of property and equipment, net	(79,584)	(133,576)
Purchases of investments	(368,094)	(378,087)
Maturities and sales of investments	245,665	365,777
Acquisitions, net of cash acquired	(445,008)	
Net cash used in investing activities	(647,021)	(145,886)
Cash flows from financing activities:		
Proceeds from issuance of common stock, net	179,279	80,606
Excess tax benefits from stock-based compensation		23,372
Payment of headquarters lease facility obligation	(126,390)	
Principal payments on long-term obligations	(1,849)	

Net cash provided by financing activities	51,040	103,978
Effect of exchange rate changes on cash and cash equivalents	(12,711)	20,558
Net increase (decrease) in cash and cash equivalents	(113,273)	562,854
Cash and cash equivalents at beginning of period	1,330,045	1,313,580
Cash and cash equivalents at end of period	$ 1,216,772	$ 1,876,434

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

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, together with its subsidiaries, pioneers new communities around the world, built on commerce, sustained by trust, and inspired by opportunity. eBay brings together millions of buyers and sellers every day on a local, national and international basis through an array of websites. eBay provides online marketplaces for the sale of goods and services, online payment services and online communication offerings to a diverse community of individuals and businesses.

eBay currently has three primary businesses: the eBay Marketplaces, Payments and Communications. The eBay Marketplaces segments provide the infrastructure to enable online commerce in a variety of formats, including the traditional auction platform, along with our other online platforms, such as Rent.com, Shopping.com, Kijiji, mobile.de, and Marktplaats.nl. The Payments segment, which consists of our PayPal, Inc. (PayPal) business, enables individuals or 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) calls between Skype users, as well as 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.) its California predecessor, as well as all of our consolidated subsidiaries.

Use of estimates

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. On an ongoing basis, we evaluate our estimates, including those related to provisions for doubtful accounts and authorized credits, the provision for transaction losses, legal contingencies, income taxes, advertising and other non-transaction revenues, stock-based compensation expense and goodwill and intangible assets. We base our estimates on historical experience and on various other assumptions that are believed 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.

The consolidated financial statements include 100% of the assets and liabilities of these majority-owned subsidiaries and the ownership interests of minority investors are recorded as minority interests. Investments in entities where we hold more than a 20% but less than a 50% ownership interest and have the ability to significantly influence the operations of the investee are accounted for using the equity method of accounting and the investment balance is included in long-term investments, while our share of the investees results of operations is included in interest and other income, net. For the three month period ended March 31, 2006 and 2005, the equity method income recorded in interest and other income, net were not material to the Company s operating results. Investments in entities where we hold less than a 20% ownership interest and where we do not have the ability to significantly influence the operations of the investee are accounted for using the cost method of accounting and are included in long-term investments.

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eBay Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

These unaudited interim financial statements reflect our condensed consolidated financial position as of December 31, 2005 and March 31, 2006. These statements also show our condensed consolidated statement of income for the three months ended March 31, 2005 and 2006 and our condensed consolidated statement of cash flows for the three months ended March 31, 2005 and 2006. 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 generally accepted accounting principles in the United States of America 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, 2005, included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 23, 2006. The condensed consolidated statements of 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.

Stock-based compensation

On January 1, 2006, we adopted Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (FAS 123(R)), that addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for either equity instruments of the enterprise or liabilities that are based on the fair value of the enterprise s equity instruments or that may be settled by the issuance of such equity instruments. The statement eliminates the ability to account for share-based compensation transactions, as we formerly did, using the intrinsic value method as prescribed by Accounting Principles Board, or APB, Opinion No. 25, Accounting for Stock Issued to Employees, and generally requires that such transactions be accounted for using a fair-value-based method and recognized as expenses in our consolidated statement of income.

We adopted FAS 123(R) using the modified prospective method which requires the application of the accounting standard as of January 1, 2006. Our consolidated financial statements as of and for the first quarter of 2006 reflect the impact of adopting FAS 123(R). In accordance with the modified prospective method, the consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of FAS 123(R). See Note 7 Stock-based Benefit Plans for further details.

Stock-based compensation expense recognized during the period is based on the value of the portion of stock-based payment awards that is ultimately expected to vest. Stock-based compensation expense recognized in the condensed consolidated statement of operations during the first quarter of 2006 included compensation expense for stock-based payment awards granted prior to, but not yet vested, as of December 31, 2005 based on the grant date fair value estimated in accordance with the pro forma provisions of FAS 148 and compensation expense for the stock-based payment awards granted subsequent to December 31, 2005, based on the grant date fair value estimated in accordance with FAS 123(R). As stock-based compensation expense recognized in the statement of income for the first quarter of 2006 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. FAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In the pro forma information required under FAS 148 for the periods prior to 2006, we accounted for forfeitures as they occurred.

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eBay Inc.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2 Net Income Per Share

Basic net income per share is computed by dividing the net income for the period by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing the net income for the period by the weighted average number of 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, which in the current period includes consideration of stock-based compensation required by FAS 123(R). The following table sets forth the computation of basic and diluted net income per share for the periods indicated (in thousands, except per share amounts):

	Three Months Ended March 31,	
	2005	**2006**
Numerator:		
Net income	$ 256,291	$ 248,282
Denominator:		
Weighted average common shares	1,343,582	1,406,449
Weighted average unvested restricted common stock subject to repurchase	(140)	(140)
Denominator for basic calculation	1,343,442	1,406,309
Weighted average effect of dilutive securities:		
Weighted average unvested restricted common stock subject to repurchase	140	140
Employee stock options	38,568	31,132
Denominator for diluted calculation	1,382,150	1,437,581
Net income per share:		
Basic	$ 0.19	$ 0.18
Diluted	$ 0.19	$ 0.17

The calculation of diluted net income per share excludes all anti-dilutive shares. For the three months ended March 31, 2005 and 2006, the number of anti-dilutive shares, as calculated based on the weighted average closing price of our common stock for the period, amounted to approximately 15.8 million and 36.8 million shares, respectively.

Note 3 Business Combinations, Goodwill and Intangible Assets

The following table presents goodwill balances and the movements for each of our reportable segments during the three months ended March 31, 2006 (in thousands):

	December 31, 2005	Goodwill Acquired	Adjustments	March 31, 2006
Reportable segments:				
U.S. Marketplaces	$ 961,081	$	$ (6,849)	$ 954,232

International Marketplaces		1,525,789				35,876	1,561,665
Payments		1,348,385				53	1,348,438
Communications		2,312,184				55,916	2,368,100
	$	6,147,439	$		$	84,996	$ 6,232,435

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eBay Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Adjustments to goodwill during the three months ended March 31, 2006, resulted primarily from foreign currency translation adjustments and purchase price adjustments related to deferred tax assets.

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 of December 31, 2005 and March 31, 2006, the goodwill related to our equity investment totaled approximately $27.4 million.

In accordance with Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (FAS 142), goodwill is subject to at least an annual assessment for impairment, applying a fair-value based test. We conduct our annual impairment test as of August 31 of each year. Based on our last impairment test as of August 31, 2005 we determined there was no impairment. There were no events or circumstances from that date through March 31, 2006 indicating that a further assessment was necessary.

Intangible Assets

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

	December 31, 2005				**March 31, 2006**			
	Gross Carrying Amount	**Accumulated Amortization**	**Net Carrying Amount**	**Weighted Average Useful Economic Life (Years)**	**Gross Carrying Amount**	**Accumulated Amortization**	**Net Carrying Amount**	**Weighted Average Useful Economic Life (Years)**
Intangible assets:								
Customer lists and user base	$ 526,657	$ (145,397)	$ 381,260	6	$ 530,264	$ (170,417)	$ 359,847	6
Trademarks and trade names	443,565	(75,571)	367,994	5	451,354	(98,629)	352,725	5
Developed technologies	101,971	(45,882)	56,089	4	100,931	(49,706)	51,225	4
All other	36,450	(14,761)	21,689	4	38,325	(16,671)	21,654	4
	$ 1,108,643	$ (281,611)	$ 827,032		$ 1,120,874	$ (335,423)	$ 785,451	

All of our acquired identifiable intangible assets are subject to amortization. As of December 31, 2005 and March 31, 2006, the net carrying amount of intangible assets related to our equity investment totaled approximately $3.8 million and $3.5 million respectively. Aggregate amortization expense for intangible assets totaled $23.9 million and $53.4 million for the three months ended March 31, 2005 and 2006, respectively.

As of March 31, 2006, expected future intangible asset amortization is as follows (in thousands):

Fiscal Years:	
2006 (remaining nine months)	$ 147,301
2007	188,257
2008	180,600
2009	162,128

2010	90,212
Thereafter	16,953
	$ 785,451

On April 24, 2006, we acquired all equity securities of Tradera.com, the leading online auction-style marketplace in Sweden for approximately 365 million Swedish Kronor, plus acquisition costs and an adjustment for net cash acquired. Based on an April 21, 2006 exchange rate of SEK 7.56 to US$1.00, the net purchase amount approximates $48 million.

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eBay Inc.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 4 Segments

Reporting segments are based upon our internal organization structure, the manner in which our operations are managed, the criteria used by our chief operating decision-maker to evaluate segment performance, the availability of separate financial information, and overall materiality considerations.

The U.S. Marketplaces segment includes our U.S. online marketplaces commerce platforms. The International Marketplaces segment includes our international online marketplaces commerce platforms. The Payments segment includes our global payments platform, consisting of our PayPal subsidiary. The Communications segment includes the VoIP offerings provided by our Skype subsidiary. Results from our Communications segment reflect Skype operations for the post-acquisition period from October 15, 2005.

Direct contribution consists of revenues less direct costs. Direct costs include specific costs of net revenues, sales and marketing expenses, and general and administrative expenses over which segment managers have direct discretionary control, such as advertising and marketing programs, customer support expenses, bank charges, transaction expenses, provisions for doubtful accounts, authorized credits and transaction losses. Expenses over which segment managers do not currently have discretionary control, such as certain general and administrative costs, amortization of acquired intangible assets and stock-based compensation expenses, are monitored by management through shared cost centers and are not evaluated in the measurement of segment performance. Prior period amounts have been reclassified to reflect the current management of site operations cost and product development expenses as direct costs.

The following table summarizes our financial performance (in thousands):

	Three Months Ended March 31, 2005			
	U.S. Marketplaces	**International Marketplaces**	**Payments**	**Consolidated**
Net revenues from external customers	$ 404,848	$ 393,792	$ 233,084	$ 1,031,724
Direct costs	244,592	194,324	159,969	598,885
Direct contribution	$ 160,256	$ 199,468	$ 73,115	$ 432,839
Operating expenses and indirect costs of net revenues				97,265
Income from operations				335,574
Interest and other income, net				22,403
Interest expense				(1,720)
Income before income taxes and minority interests				$ 356,257

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eBay Inc.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Three Months Ended March 31, 2006				
	U.S. Marketplaces	International Marketplaces	Payments	Communications	Consolidated
Net revenues from external customers	$ 527,220	$ 492,973	$ 335,066	$ 35,160	$ 1,390,419
Direct costs	317,516	254,870	248,412	44,008	864,806
Direct contribution	$ 209,704	$ 238,103	$ 86,654	$ (8,848)	$ 525,613
Operating expenses and indirect costs of net revenues					202,989
Income from operations					322,624
Interest and other income, net					25,760
Interest expense					(747)
Income before income taxes and minority interests					$ 347,637

Note 5 Balance Sheet Components

At December 31, 2005 and March 31, 2006, short and long-term investments were classified as available-for-sale securities, except for restricted cash and investments, and were reported at fair value as follows (in thousands):

	December 31, 2005			
	Gross Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Short-term investments:				
Restricted cash and investments	$ 29,670	$ 32	$	$ 29,702
Corporate debt securities	362,438	4	(2,679)	359,763
Government and agency securities	371,537		(3,198)	368,339
Time deposits and other	46,548			46,548
	$ 810,193	$ 36	$ (5,877)	$ 804,352
Long-term investments:				
Restricted cash and investments	$ 1,065	$	$	$ 1,065
Corporate debt securities	665,418	115	(1,921)	663,612
Government and agency securities	110,450		(1,409)	109,041
Equity instruments and equity method investments	51,949			51,949

$ 828,882	$	115	$	(3,330)	$	825,667

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eBay Inc.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	March 31, 2006			
	Gross Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Short-term investments:				
Restricted cash and investments	$ 30,717	$ 38	$	$ 30,755
Corporate debt securities	370,018	16	(2,669)	367,365
Government and agency securities	420,367		(2,733)	417,634
Time deposits and other	43,050			43,050
	$ 864,152	$ 54	$ (5,402)	$ 858,804
Long-term investments:				
Restricted cash and investments	$ 1,071	$	$	$ 1,071
Corporate debt securities	699,686	136	(999)	698,823
Government and agency securities	34,985	6	(45)	34,946
Equity instruments and equity method investments	58,657			58,657
	$ 794,399	$ 142	$ (1,044)	$ 793,497

Other Current Assets

	December 31, 2005	March 31, 2006
	(In thousands)	
Customer accounts	$ 324,595	$ 429,266
Prepaid expenses	44,610	54,698
Deferred tax asset, net	59,274	75,543
Other	58,756	61,325
	$ 487,235	$ 620,832

Customer accounts include liquid assets set aside for certain customer liabilities as required in conjunction with PayPal s Electronic Money Institution license from the United Kingdom s Financial Services Authority. The customer liabilities represent claims on PayPal s U.K. subsidiary and may be invested only in specified types of liquid assets. These assets are included on our balance sheet as current assets with an offsetting current liability in funds payable and amounts due to customers. All customer funds held by PayPal as an agent or custodian, for the benefit of its customers and, accordingly, are not reflected in our consolidated balance sheet. These balances include funds held in the U.S. which are deposited in accounts insured by the Federal Deposit Insurance Corporation.

Note 6 Litigation and Other 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 in the regional court of Cologne, Germany. The suit subsequently was transferred to the regional court in Düsseldorf, Germany. Rolex alleged that our subsidiaries were infringing Rolex s trademarks as a result of users selling counterfeit Rolex watches through our German website. The suit also alleged unfair competition. Rolex sought an order enjoining the sale of Rolex-branded watches on the website as well as damages. In December 2002, a trial was held in the matter and the court ruled in favor of eBay on all causes of action. Rolex appealed the ruling to the Higher Regional Court of

eBay Inc.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Düsseldorf, and the appeal was heard in October 2003. In February 2004, the court rejected Rolex s appeal and ruled in our favor. Rolex has appealed the ruling to the German Federal Supreme Court, and a hearing is expected in December 2006. In September 2004, the German Federal Supreme Court issued its written opinion in favor of Rolex in a case involving an unrelated company, ricardo.de AG, but somewhat comparable legal theories. Although it is not yet clear what the ultimate effect of the reasoning of the German Federal Supreme Court s ricardo.de decision will have when applied to eBay, we believe the Court s decision has resulted in an increase in similar litigation against us in Germany, although we do not currently believe that it will require a significant change in our business practices.

In September 2001, MercExchange LLC filed a complaint against us, our Half.com subsidiary and ReturnBuy, Inc. in the U.S. District Court for the Eastern District of Virginia (No. 2:01-CV-736) alleging infringement of three patents (relating to online consignment auction technology, multiple database searching and electronic consignment systems) and seeking a permanent injunction and damages (including treble damages for willful infringement). In October 2002, the court granted in part our summary judgment motion, effectively invalidating the patent related to online auction technology and rendering it unenforceable. This ruling left only two patents in the case. Trial of the matter began in April 2003. In May 2003, the jury returned a verdict finding that eBay had willfully infringed one and Half.com had willfully infringed both of the patents in the suit, awarding $35 million in compensatory damages. Both parties filed post-trial motions, and in August 2003, the court entered judgment for MercExchange in the amount of approximately $30 million plus pre-judgment interest and post-judgment interest in an amount to be determined, while denying MercExchange s request for an injunction and attorneys fees. We appealed the verdict and judgment in favor of MercExchange and MercExchange filed a cross-appeal of the granting in part of our summary judgment motion and the denial of its request for an injunction and attorneys fees.

In March 2005, the U.S. Court of Appeals for the Federal Circuit issued a ruling in the appeal of the MercExchange patent litigation suit which, among other things (1) invalidated all claims asserted against eBay and Half.com arising out of the multiple database search patent and reduced the verdict amount by $4.5 million; (2) upheld the electronic consignment system patent; (3) affirmed the district court s refusal to award attorneys fees or enhanced damages against us; (4) reversed the district court s order granting summary judgment in our favor regarding the auction patent; and (5) reversed the district court s refusal to grant an injunction and remanded that issue to the district court for further proceedings. In May 2005, the Court of Appeals for the Federal Circuit granted our petition to stay the mandate in the case in order to allow us to petition the U.S. Supreme Court for review on certain issues. We filed our petition for review with the U.S. Supreme Court in July 2005, and in November 2005, the Court granted our petition for review. Oral arguments in the case were heard by the Court in March 2006, and the Court s decision is expected in the second quarter of 2006. In parallel with the federal court proceedings, at our request, the U.S. Patent and Trademark Office is actively reexamining each of the patents in suit, having found that substantial questions exist regarding the validity of the claims contained in them. In January 2005, the Patent and Trademark Office issued an initial ruling rejecting all of the claims contained in the patent that related to online auctions; in March 2005, the Patent and Trademark Office issued an initial ruling rejecting all of the claims contained in the patent that related to electronic consignment systems; and in May 2005, the Patent and Trademark Office issued an initial ruling rejecting all of the claims contained in the patent that related to multiple database searching. In March 2006, the Patent and Trademark Office affirmed its earlier ruling rejecting the claims contained in the patent that related to electronic consignment systems. Even if successful, our litigation of these matters will continue to be costly. In addition, as a precautionary measure, we have modified certain functionality of our websites and business practices in a manner which we believe would avoid any further infringement. For this reason, we believe that any injunction that might be issued by the district court will not have any impact on our business. We also believe we have appropriate reserves for this litigation. Nonetheless, if we are not successful in appealing or modifying the court s ruling, and if the modifications to the functionality of our websites and business practices are not sufficient to make them non-infringing, we would

eBay Inc.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

likely be forced to pay significant additional damages and licensing fees and/or modify our business practices in an adverse manner.

In August 2002, Charles E. Hill & Associates, Inc. filed a lawsuit in the U.S. District Court for the Eastern District of Texas (No. 2:02-CV-186) alleging that we and 17 other companies, primarily large retailers, infringed three patents owned by Hill generally relating to electronic catalog systems and methods for transmitting and updating data at a remote computer. The suit seeks an injunction against continuing infringement, unspecified damages, including treble damages for willful infringement, and interest, costs, expenses, and fees. The case was transferred to the U.S. District Court for the Southern District of Indiana in January 2003, but was transferred back to the U.S. District Court for the Eastern District of Texas in December 2003. A claim construction hearing was held in August 2005. In February 2006, we entered into and paid for a settlement agreement with the plaintiffs in the case under which we will be licensed under all of the patents at issue.

In February 2002, PayPal was sued in California state court (No. CV-805433) in a purported class action alleging that its limiting access to customer accounts and failure to promptly restore access to legitimate accounts violates California state consumer protection laws and is an unfair business practice and a breach of PayPal s User Agreement. This action was re-filed with a different named plaintiff in June 2002 (No. CV-808441), and a similar action was also filed in the U.S. District Court for the Northern District of California in June 2002 (No. C-02-2777). In March 2002, PayPal was sued in the U.S. District Court for the Northern District of California (No. C-02-1227) in a purported class action alleging that its limiting access to customer accounts and failure to promptly restore access to legitimate accounts violates federal and state consumer protection and unfair business practice laws. The two federal court actions were consolidated into a single case, and the state court action was stayed pending developments in the federal case. In June 2004, the parties announced that they had reached a proposed settlement. The settlement received approval from the federal court on November 2, 2004, and the state court action was dismissed with prejudice in March 2005. In the settlement, PayPal does not acknowledge that any of the allegations in the case are true. Under the terms of the settlement, certain PayPal account holders are eligible to receive payment from a settlement fund of $9.25 million, less administrative costs and the amount awarded to plaintiffs counsel by the court. That sum is being distributed to class members who have submitted timely claims in accordance with the settlement s plan of allocation. The plan of allocation for the portion of the settlement fund that remains undistributed was approved by the District Court in March 2006. Substantially all of the cost associated with the settlement was recognized in 2003.

In July 2004, a purported class action lawsuit was filed by two eBay users in Superior Court of the State of California, County of Santa Clara (No. 104CV022708) alleging that eBay engaged in improper billing practices as the result of problems with the rollout of a new billing software system in the second and third quarters of 2004. The lawsuit sought damages and injunctive relief. An amended complaint was filed in January 2005, dropping one plaintiff, changing the capacity of the other plaintiff to that of representative plaintiff, and adding seven additional eBay users as plaintiffs. The amended complaint expanded its claim to include numerous alleged improper billing practices from September 2003 until the present. In February 2005, eBay filed a motion to strike and a demurrer seeking to dismiss the complaint. In April 2005, the court sustained portions of the demurrer, but granted the plaintiffs leave to amend their complaint. The plaintiffs filed a second amended complaint, dropping the last original plaintiff and again adding new plaintiffs. We filed a motion to strike and a demurrer regarding the plaintiffs second amended complaint. In July 2005, the court again sustained a portion of the demurrer and again granted the plaintiffs leave to amend their complaint, and the plaintiffs filed a third amended complaint. In December 2005, the plaintiffs filed a fourth amended complaint, dropping several plaintiffs. In April 2006, the court approved a settlement agreement entered into by the parties. Under the terms of the settlement, the plaintiffs agreed to dismiss the lawsuit and release eBay from all claims, and eBay agreed to make a $250,000 payment primarily directed to charity. The estimated settlement was accrued in our consolidated income statement for the three months ended March 31, 2006.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In February 2005, eBay was sued in Superior Court of the State of California, County of Santa Clara (No. 105CV035930) in a purported class action alleging that certain bidding features of our site constitute shill bidding for the purpose of artificially inflating bids placed by buyers on the site. The complaint alleges violations of California s Auction Act, California s Consumer Remedies Act, and unfair competition. The complaint seeks injunctive relief, damages, and a constructive trust. In April 2005, we filed a demurrer seeking to dismiss the complaint, and a hearing on the demurrer was held in February 2006. In March 2006, the parties reached tentative agreement on the terms of a settlement. The court must approve the terms of the settlement in order for it to become final. The estimated settlement was accrued in our consolidated income statement for the year ended December 31, 2005.

In March 2005, eBay, PayPal, and an eBay seller were sued in Supreme Court of the State of New York, County of Kings (No. 6125/05) in a purported class action alleging that certain disclosures regarding PayPal s Buyer Protection Policy, users chargeback rights, and the effects of users choice of funding mechanism are deceptive and/or misleading. The complaint alleged misrepresentation on the part of eBay and PayPal, breach of contract and deceptive trade practices by PayPal, and that PayPal and eBay have jointly violated the civil RICO statute (18 U.S.C. Section 1961(4)). In April 2005, eBay and PayPal removed the case to the U.S. District Court for the Eastern District of New York and the plaintiffs filed an amended complaint in the U.S. District Court (No. 05-CV-01720) repeating the allegations of the initial complaint but dropping the civil RICO allegations. The complaint seeks injunctive relief, compensatory damages, and punitive damages. Following several mediation sessions, the parties reached a tentative settlement in December 2005 and executed a Memorandum of Understanding in March 2006. The parties are engaged in the process of finalizing the settlement documentation. The court must approve the terms of the settlement in order for it to become final. The estimated settlement was accrued in our consolidated income statement for the year ended December 31, 2005.

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 have been notified of several 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 to face additional patent infringement claims involving services we provide, including various aspects of our 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 expand geographically into jurisdictions where the underlying laws with respect to the potential liability of online intermediaries like ourselves are either unclear or less favorable. These claims, whether meritorious or not, could be time consuming and costly to resolve, cause service upgrade delays, require expensive changes in our methods of doing business, or could require us to enter into costly royalty or licensing agreements.

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.

Indemnification Provisions

In the ordinary course of business, we have included limited indemnification provisions in certain of our agreements with parties with whom 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 any third party with respect to our domain names, trademarks,

eBay Inc.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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, including agreements under which we have developed technology for certain commercial parties, we have provided an indemnity for other types of third-party claims, substantially all of which are indemnities related to our copyrights, trademarks, and patents. In our PayPal business, we have provided an indemnity to our payments processors in the event of certain third-party claims or card association fines against the processor arising out of conduct by PayPal. To date, no significant costs have been incurred, either individually or collectively, in connection with our indemnification provisions.

Note 7 Stock-based Benefit Plans

Employee Stock Purchase Plan

We have an employee stock purchase plan for all eligible employees. Under the plan, shares of our common stock may be purchased over an offering period with a maximum duration of two years at 85% of the lower of the fair market value on the first day of the applicable offering period or on the last day of the six-month purchase period. Employees may purchase shares having a value not exceeding 10% of their gross compensation during an offering period. No shares were purchased during the three months ended March 31, 2005 or 2006. At March 31, 2006, approximately 7.2 million shares were authorized. Our employee stock purchase plan contains an evergreen provision that automatically increases, on each January 1, the number of shares reserved for issuance under the employee stock purchase plan by the number of shares purchased under this plan in the preceding calendar year.

Stock Unit Plan

We have a deferred stock unit plan under which deferred stock units have been granted to new non-employee directors elected to our Board of Directors after December 31, 2002. Under this plan, each new director receives a one-time grant of deferred stock units equal to the result of dividing $150,000 by the fair market value of our common stock on the date of grant. Each deferred stock unit constitutes an unfunded and unsecured promise by us to deliver one share of our common stock (or the equivalent value thereof in cash or property at our election). Each deferred stock unit award granted to a new non-employee director upon election to the Board vests 25% one year from the date of grant, and at a rate of 2.08% per month thereafter. If the services of the director are terminated at any time, all rights to the unvested deferred stock units shall also terminate. In addition, directors may elect to receive, in lieu of annual retainer and committee chair fees and at the time these fees would otherwise be payable (i.e., on a quarterly basis in arrears for services provided), fully vested deferred stock units with an initial value equal to the amount of these fees. Deferred stock units are payable following the termination of a director s tenure as a director. All eBay officers, directors and employees are eligible to receive awards under the plan, although, to date, awards have been made only to new non-employee directors. As of March 31, 2006, 29,224 units have been awarded under this plan.

Other Equity Incentive Plans

We have equity incentive plans for directors, officers, employees and non-employees. Stock options granted under these plans generally vest 25% one year from the date of grant (or 12.5% six months from the date of grant for grants to existing employees) and the remainder vest at a rate of 2.08% per month thereafter, and generally expire 7 to 10 years from the date of grant. Stock options issued prior to June 1998, were exercisable immediately, subject to repurchase rights held by us, which lapsed over the vesting period. At March 31, 2006, 584.8 million shares were authorized under our stock option plans. Shares of restricted stock issued under these plans are subject to repurchase rights which lapse over the vesting period, typically five years. At March 31, 2006, 74.2 million shares were available for future grant.

eBay Inc.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Impact of the Adoption of FAS 123(R)

We adopted FAS 123(R) using the modified prospective transition method beginning January 1, 2006. Accordingly, during the three-month period ended March 31, 2006, we recorded stock-based compensation expense for awards granted prior to, but not yet vested, as of January 1, 2006, as if the fair value method required for pro forma disclosure under FAS 123 were in effect for expense recognition purposes, adjusted for estimated forfeitures. For these awards, we have continued to recognize compensation expense using the accelerated amortization method under FIN 28. For stock-based awards granted after January 1, 2006, we have recognized compensation expense based on the estimated grant date fair value method using the Black-Scholes valuation model. For these awards, we have recognized compensation expense using a straight-line amortization method. As FAS 123(R) requires that stock-based compensation expense be based on awards that are ultimately expected to vest, stock-based compensation for the three-month period ended March 31, 2006 has been reduced for estimated forfeitures. When estimating forfeitures, we consider voluntary termination behaviors as well as trends of actual option forfeitures. The impact on our results of operations of recording stock-based compensation for the three-month period ended March 31, 2006 was as follows (in thousands):

Cost of net revenues	$	9,476
Sales and marketing		24,721
Product development		20,701
General and administrative		28,920
	$	83,818

Prior to adopting FAS 123(R), we presented all tax benefits resulting from the exercise of stock options as operating cash flows in the Statement of Cash Flows. FAS 123(R) requires cash flows resulting from excess tax benefits to be classified as a part of cash flows from financing activities. Excess tax benefits are realized tax benefits from tax deductions for exercised options in excess of the deferred tax asset attributable to stock compensation costs for such options. As a result of adopting FAS 123(R), $23.4 million of excess tax benefits for the three months ended March 31, 2006 have been classified as a financing cash inflow. Cash received from option exercises under all share-based payment arrangements for the three-month periods ended March 31, 2005 and 2006, was $179.3 million and $80.6 million, respectively. The total income tax benefit recognized in the income statement for stock-based compensation costs was $0 and $25.5 million for the three-month periods ended March 31, 2005 and 2006, respectively. Total stock-based compensation costs capitalized as part of an asset was $0 and $2.2 million for the three-month periods ended March 31, 2005 and 2006, respectively.

Prior to the adoption of FAS 123(R), the intrinsic value of Skype s and Shopping.com s unvested common stock options assumed in the acquisition were recorded as unearned stock-based compensation as of December 31, 2005. Upon the adoption of FAS 123(R) in January 2006, the unearned stock-based compensation balance of approximately $45.5 million was reclassified to additional-paid-in-capital.

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 assumptions were used for each respective period:

	Three Months Ended March 31,	
	2005	**2006**
Risk-free interest rates	3.5%	4.6%-4.7%
Expected lives (in years)	3	3.1-4.9
Dividend yield	0%	0%
Expected volatility	36%	34%-38%
Weighted-average volatility		35%

Our computation of expected volatility for the first quarter of 2006 is based on a combination of historical and market-based implied volatility from traded options on our stock. Prior to 2006, our computation of expected volatility was based on historical volatility. Our computation of expected life in 2006, 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 range provided above results from the behavior patterns of separate groups of employees that have similar historical experience. 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.

Stock-based Payment Award Activity

The following table summarizes activity under our equity incentive plans for the three months ended March 31, 2006 (in thousands, except per share amounts):

	Shares	**Weighted Average Exercise Price**	**Weighted Average Remaining Contractual Term (in years)**	**Aggregate Intrinsic Value**
Outstanding at January 1, 2006	129,109	$ 28.19		
Granted and assumed	21,064	40.14		
Exercised	(4,686)	17.20		
Forfeited/expired/cancelled	(1,983)	36.61		
Outstanding at March 31, 2006	143,504	$ 30.19	7.32	$ 1,445,051
Vested and expected to vest at March 31, 2006	132,341	$ 29.49	7.27	$ 1,414,756
Options exercisable at March 31, 2006	64,848	$ 22.96	6.60	$ 1,081,657

The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the quoted price of our common stock for the 90.4 million options that were in-the-money at March 31, 2006. During the three months ended March 31, 2006 and 2005, the aggregate intrinsic value of options exercised under our stock option plans was $112.4 million and $238.6 million, respectively, determined as of the date of option exercise. As of March 31, 2006, there was approximately $419 million of total unrecognized compensation cost related to unvested share-based compensation arrangements granted under our stock awards plans. That cost is expected to be recognized over a weighted-average period of two years.

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eBay Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The weighted average grant-date fair value of options granted in three-month period ended March 31, 2005 and 2006 was $12.28 and $12.31, respectively.

A summary of the status and changes of our nonvested shares related to our equity incentive plans as of and during the three months ended March 31, 2006 is presented below (in thousands, except per share amounts):

	Shares		Weighted Average Grant-Date Fair Value
Nonvested at January 1, 2006	40	$	43.82
Granted	200		39.68
Nonvested at March 31, 2006	240	$	40.37

Pro forma Information for Periods Prior to the Adoption of FAS 123R

Prior to the adoption of FAS No. 123(R), we provided the disclosures required under FAS No. 123, as amended by FAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosures. Employee stock-based compensation expense recognized under FAS 123(R) was not reflected in our results of operations for the three-month period ended March 31, 2005 for employee stock option awards as all options were granted with an exercise price equal to the market value of the underlying common stock on the date of grant. Our ESPP was deemed non-compensatory under the provisions of APB No. 25. Forfeitures of awards were recognized as they occurred. Previously reported amounts have not been restated.

The pro forma information for the three months ended March 31, 2005 was as follows (in thousands, except per share amounts):

Net income, as reported	$	256,291
Add: Amortization of stock-based compensation expense determined under the intrinsic value method (net of cancellations)		282
Deduct: Total stock-based compensation expense determined under fair value based method, net of tax		(63,441)
Pro forma net income	$	193,132
Earnings per share:		
Basic Reported	$	0.19
Pro forma	$	0.14
Diluted Reported	$	0.19
Pro forma	$	0.14

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

FORWARD LOOKING STATEMENTS

This report contains statements that involve expectations, plans or intentions (such as those relating to future business or financial results, new features or services, or management strategies). These statements are forward-looking and are subject to risks and uncertainties, so actual results may vary materially. You can identify these forward-looking statements by words such as may, should, expect, anticipate, believe, estimate, intend other similar expressions. You should consider our forward- looking statements in light of the risks discussed under the heading Risk Factors That May Affect Results of Operations and Financial Condition below, 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. We assume no obligation to update any 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 document.

Overview

About eBay

Our purpose is to pioneer new communities around the world built on commerce, sustained by trust, and inspired by opportunity. We bring together millions of buyers and sellers every day on a local, national and international basis through an array of websites. We provide online marketplaces for the sale of goods and services, online payments services and online communication offerings to a diverse community of individuals and businesses. We currently have three primary businesses: eBay Marketplaces, Payments and Communications. Our eBay Marketplaces provide the infrastructure to enable online commerce in a variety of formats, including the traditional auction platform, along with our other online platforms, such as Rent.com, Shopping.com, Kijiji, mobile.de, and Marktplaats.nl. Our Payments business, which consists of our PayPal business, enables individuals or businesses to securely, easily and quickly send and receive payments online. Our Communications business, which consists of our Skype business, enables VoIP calls between Skype users, as well as provides low-cost connectivity to traditional fixed-line and mobile telephones.

Executive Operating and Financial Summary

Our focus is on understanding our key operating and financial metrics

Members of our senior management team regularly review key operating metrics such as new users, new user accounts, active users, listings and gross merchandise volume, as well as total payment volume processed by our wholly owned PayPal subsidiary and number of users registered with our Skype subsidiary. Members of our senior management also regularly review key financial information including net revenues, operating income margins, earnings per share, cash flows from operations and free cash flows, which we define as operating cash flows less purchases of property and equipment, net. These operating and financial measures allow us to monitor the health and vibrancy of our Marketplaces, Payments, and Communications platforms and the profitability of our business and to evaluate the effectiveness of investments that we have made and continue to make in the areas of international expansion, customer support, product development, marketing 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

Consolidated net revenues for the three-month period ended March 31, 2006 was $1.390 billion, representing a growth rate of 35% year over year. Operating income was $322.6 million and was 23% of net revenues. Net income for the three-month period ended March 31, 2006 was $248.3 million, or $0.17 earnings per diluted share, which includes the impact of FAS 123(R) stock-based compensation expense of $0.04 earnings per diluted share.

Our expectations for growth

We expect that our growth in net revenues during 2006 will result primarily from increased net transaction revenues across our U.S. Marketplaces, International Marketplaces, Payments and Communications segments. We continue to make investments in our business and infrastructure to help us achieve our long-term growth objectives. We expect to continue our investments in the areas of international expansion for our eBay Marketplaces, our Payments and Communications businesses, customer support, site operations, marketing and various corporate infrastructure areas. We believe these investments are necessary to support the long-term demands of our growing business as well as to build the infrastructure necessary to support long- term growth. In addition, to the extent that the U.S. dollar strengthens against foreign currencies, and, in particular, the Euro, British pound and Korean won, the remeasurement of these foreign currency denominated transactions into U.S. dollars will negatively impact our consolidated net revenues and, to the extent that they are not hedged, our net income.

The discussion of our consolidated financial results contained herein is intended to assist investors, analysts and other parties reading this report to better understand the key operating and financial measures summarized above as well as the changes in our consolidated results of operations from year to year, and the primary factors that accounted for those changes.

Stock-based Compensation

During the first quarter of 2006, we implemented the following new critical accounting policy related to our stock-based compensation. Beginning on January 1, 2006, we began accounting for stock options and ESPP shares under the provisions of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (FAS 123(R)), which requires the recognition of the fair value of stock-based compensation. Under the fair value recognition provisions for FAS 123(R), stock-based compensation cost is estimated at the grant date based on the fair value of the awards expected to vest and recognized as expense ratably over the requisite service period of the award. We have used the Black-Scholes valuation model, or BSM, to estimate fair value of our stock-based awards which requires various judgmental assumptions including estimating stock price volatility, forfeiture rates, and expected life. Our computation of expected volatility is based on a combination of historical and market-based implied volatility. In addition, we consider many factors when estimating expected forfeitures and expected life, including types of awards, employee class, and historical experience. If any of the assumptions used in the BSM model change significantly, stock-based compensation expense may differ materially in the future from that recorded in the current period.

We adopted FAS 123(R) using the modified prospective method which requires the application of the accounting standard as of January 1, 2006. Our consolidated financial statements as of and for the first quarter of 2006 reflect the impact of FAS 123(R). In accordance with the modified prospective method, the consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of FAS 123(R).

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Seasonality

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

	Three Months Ended			
	March 31	**June 30**	**September 30**	**December 31**
	(In thousands, except percentages)			
2004				
Net revenues	$ 756,239	$ 773,412	$ 805,876	$ 935,782
Current quarter vs prior quarter	17%	2%	4%	16%
2005				
Net revenues	$ 1,031,724	$ 1,086,303	$ 1,105,515	$ 1,328,859
Current quarter vs prior quarter	10%	5%	2%	20%
2006				
Net revenues	$ 1,390,419	N/A	N/A	N/A
Current quarter vs prior quarter	5%			

We have historically experienced our strongest quarters of sequential growth in the first and fourth fiscal quarters. We expect transaction activity patterns on our websites to increasingly mirror general consumer buying patterns, both online and offline as our business matures. Our expectation is that Skype s business will experience seasonally slower growth during holiday periods.

Results of Operations

The following table sets forth, for the periods presented, certain data from our condensed consolidated statement of income as a percentage of net revenues. This information should be read in conjunction with our condensed consolidated financial statements and notes thereto included elsewhere in this report.

	Three Months Ended				
	March 31, 2005	**June 30, 2005**	**September 30, 2005**	**December 31, 2005**	**March 31, 2006**
Net revenues	100.0%	100.0%	100.0%	100.0%	100%
Cost of net revenues(1)	18.1	17.7	18.1	18.0	20.0
Gross profit	81.9	82.3	81.9	82.0	80.0
Operating expenses(1):					
Sales and marketing	26.3	26.4	26.6	28.5	28.8
Product development	7.2	6.6	7.1	7.8	8.6
General and administrative	13.2	11.9	13.1	13.7	15.5
Payroll tax on employee stock options	0.6	0.1	0.2	0.3	0.2
Amortization of acquired intangible assets	2.2	2.4	2.6	3.9	3.7
Total operating expenses	49.4	47.5	49.6	54.1	56.8

Income from operations	32.5	34.9	32.3	27.9	23.2
Interest and other income, net	2.2	3.0	2.8	1.9	1.9
Interest expense	(0.2)	(0.0)	(0.0)	(0.1)	(0.1)
Income before income taxes and minority interests	34.5	37.8	35.0	29.7	25.0
Provision for income taxes	(9.7)	(11.0)	(11.9)	(8.7)	(7.1)
Minority interests	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)
Net income	24.8%	26.8%	23.1%	21.0%	17.9%

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(1) Includes stock-based compensation as follows (2006 increases are due primarily to the adoption of FAS 123(R)):

Cost of net revenues	0.0%	0.0%	0.0%	0.1%	0.7%
Sales and marketing	0.0	0.0	0.1	0.6	1.8
Product development	0.0	0.1	0.1	0.4	1.5
General and administrative	0.3	(0.1)	0.3	0.6	2.0
Total stock-based compensation	0.3%	0.0%	0.5%	1.7%	6.0%

Net Revenues Summary

	Three Months Ended March 31, 2005	Percent Change	Three Months Ended March 31, 2006
	(In thousands, except percent changes)		
Net Revenues by Type:			
Transaction net revenues			
U.S. Marketplaces	$ 388,759	30%	$ 507,312
International Marketplaces	387,187	25%	483,215
Payments	227,097	44%	328,150
Communications		n/a	35,160
Total net transaction revenues	1,003,043	35%	1,353,837
Advertising and other non-transaction net revenues	28,681	28%	36,582
Total net revenues	$ 1,031,724	35%	$ 1,390,419
Net Revenues by Segment:			
U.S. Marketplaces	$ 404,848	30%	$ 527,220
International Marketplaces	393,792	25%	492,973
Payments	233,084	44%	335,066
Communications		n/a	35,160
Total net revenues	$ 1,031,724	35%	$ 1,390,419
Net Revenues by Geography:			
U.S.	$ 556,246	35%	$ 748,136
International	475,478	35%	642,283
Total net revenues	$ 1,031,724	35%	$ 1,390,419

Our net revenues are derived primarily from listing, feature and final value fees paid by sellers on our eBay Marketplaces and fees from payment processing services on our PayPal platform. Our net revenues have continued to grow each year, primarily as a result of increased auction and fixed-price transaction activity, reflected in the growth in the number of our confirmed registered users, user activity, listings, user gross merchandise volume on our eBay Marketplaces platforms and payment transactions both on and off the eBay Marketplaces processed by PayPal. We believe these increases are largely the result of our promotional efforts and our emphasis on enhancing the online commerce experience of our user community, both domestically and internationally, through the introduction of new site features and functionality and expanded trust and safety programs.

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Net Marketplaces revenues are attributed to U.S. and International geographies based upon the country in which the seller, payment recipient, advertiser or end-to-end service provider is located. Our Payments and Communications segments net revenues include amounts earned internationally.

	Three Months Ended March 31, 2005	Percent Change	Three Months Ended March 31, 2006
	(In millions, except percentages)		
Supplemental Operating Data:			
U.S. and International Marketplaces			
Segments(1):			
Confirmed registered users(2)	147.1	31%	192.9
Active users(3)	60.5	25%	75.4
Number of non-stores listings(4)	399.8	23%	490.8
Number of stores listings(4)	32.0	164%	84.6
Gross merchandise volume(5)	$ 10,602	18%	$ 12,504
Payments Segment:			
Total accounts(6)	71.6	47%	105.0
Active accounts(7)	22.1	32%	29.2
Number of payments(8)	110.4	35%	149.2
Total payment volume(9)	$ 6,233	41%	$ 8,769
Communications Segment:			
Registered users(10)			94.6

(1) Rent.com, Shopping.com, and our classifieds websites are not included in these metrics.

(2) Cumulative total of all users who have completed the registration process on one of eBay s trading platforms.

(3) All users, excluding users of Half.com, Internet Auction, Rent.com, Shopping.com, and our classifieds websites, who bid on, bought, or listed an item within the previous 12-month period. Includes users of eBay India since the migration to the eBay platform in April 2005.

(4) All listings on eBay s trading platforms during the quarter, regardless of whether the listing subsequently closed successfully.

(5) Total value of all successfully closed items between users on eBay s trading platforms during the quarter, regardless of whether the buyer and seller actually consummated the transaction.

(6) Cumulative total of all accounts opened, including users who made payments using PayPal but have not registered and excluding accounts that have been closed or locked and the payment gateway business accounts.

(7) All accounts, and users whether registered or not, that sent or received at least one payment through the PayPal system during the quarter.

(8) Total number of payments initiated through the PayPal system during the quarter, excluding the payment gateway business, regardless of whether the payment was actually sent successfully, or was reversed, rejected,

or pending at the end of the quarter.

(9) Total dollar volume of payments initiated through the PayPal system during the quarter, excluding the payment gateway business, regardless of whether the payment was actually sent successfully, or was reversed, rejected, or was pending at the end of the quarter.

(10) Communications registered users represent the cumulative total of all users who have completed the Skype registration process.

The U.S. Marketplaces segment includes our U.S. marketplaces commerce platforms, other than our PayPal subsidiary. The International Marketplaces segment includes our international marketplaces commerce platforms excluding our PayPal and Skype subsidiaries. The Payments segment consists of our global payments platform operated by our PayPal subsidiary. The Communications segment consists of our VoIP offerings from our Skype subsidiary subsequent to our acquisition of Skype on October 14, 2005.

Our net revenues result from fees associated with our transaction, referral fees, advertising and other services in our U.S. Marketplaces, International Marketplaces, Payments, and Communications segments. Net transaction revenues are derived primarily from listing, feature and final value fees paid by sellers and fees from payment processing services. Net revenues from advertising are derived principally from the sale of banner and sponsorship advertisements for cash and through barter arrangements. Other non-transaction net revenues are derived principally from contractual arrangements with third parties that provide transaction services to eBay and PayPal users.

Marketplaces Net Transaction Revenues

Total net transaction revenues from our Marketplaces segment increased 35% in the aggregate during the first quarter of 2006, compared to the same period in the prior year. The growth in both domestic and international net transaction revenues was primarily the result of increased transaction activity, reflected in the growth of the number of registered users, active users, listings and gross merchandise volume. Gross merchandise volume from Marketplaces increased 18% during the first quarter of 2006, compared to the same period of the prior year. During the first quarter of 2006, there was gross merchandise volume growth across all major categories, with our motors, consumer electronics, computers, sports, clothing & accessories, home & garden and business and industrial categories contributing most of such year-over-year growth.

U.S. Marketplaces

U.S. Marketplaces net transaction revenues increased 30% during the first quarter of 2006, compared to the same period in the prior year. Net transaction revenues derived from the U.S. Marketplaces represented 37% of the total net transaction revenues in the first quarter of 2006, compared to 39% in the same period of the prior year. Gross merchandise volume from the U.S. Marketplaces increased 18% during the first quarter of 2006, compared to the same period of the prior year. The U.S. Marketplaces is our largest and most developed business. We expect net transaction revenues from our U.S. Marketplaces segment to increase in the remainder of 2006, but to decrease as a percentage of total eBay Marketplaces net transaction revenues as the International Marketplaces segment grows in significance. In addition, even as the U.S. Marketplaces segment continues to grow in absolute terms, we expect its growth rate in 2006 to be lower than that of 2005. These expectations are subject to additional uncertainties related to the possible impact of changes to the store inventory format search initiative, planned trust and safety initiatives and the upcoming launch of eBay Express.

International Marketplaces

International Marketplaces net transaction revenues increased 25% during the first quarter of 2006 compared to the same period of the prior year. International Marketplaces net transaction revenues as a percentage of total net transaction revenues was 36% during the first quarter of 2006, compared to 39% in the same period of the prior year. Gross merchandise volume from the International Marketplaces increased 18% during the first quarter of 2006, compared to the same period of the prior year. The growth in our International Marketplaces net transaction revenues was primarily the result of strong performances in the United Kingdom and Germany as well as significant increases in certain of our less established markets, particularly Australia, France and Italy, partially offset by slower growth in Korea due to increased competition. The relative strength of the U.S. dollar against certain foreign currencies, primarily the Euro, decreased net revenues by approximately $42.6 million during the first quarter of 2006, compared to the same period of the prior year. Changes in foreign currency rates will impact our operating results, and to the extent that the U.S. dollar strengthens, our foreign currency denominated transaction net revenues will be negatively impacted. We expect that the growth rates of our International Marketplaces segment transaction net revenues will continue to decline in the remainder of 2006, although we expect such revenues to grow in significance relative to our total eBay Marketplaces as we continue to develop and deploy our global online commerce platform during the remainder of 2006.

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Payments Segment Net Transaction Revenues

Payments segment net transaction revenues increased 44% during the first quarter of 2006 compared to the same period of the prior year. Payments segment net transaction revenues as a percentage of total net transaction revenues was 24% during the first quarter of 2006, compared to 23% in the same period of the prior year. The growth in Payments segment net transaction revenues was positively affected by PayPal s continued penetration of eBay Marketplaces transactions, particularly in the United States and the United Kingdom. Further, Payments segment net transaction revenues have grown in connection with the increase in our eBay Marketplaces gross merchandise volume during the first quarter of 2006 as compared to the same period of the prior year.

In addition, revenues increased as a result of an increase in total payment volume for our PayPal merchant services transactions and the inclusion of the payment gateway business. The total payment volume for our PayPal merchant services transactions was approximately $2.9 billion in the first quarter of 2006, which represents 33% of PayPal s total payment volume. The total payment volume for our PayPal merchant services transactions was approximately $1.8 billion in the same period of the prior year, which represents 29% of PayPal s total payment volume. Our Payments segment net transaction revenues as a percentage of total payment volume increased slightly to 3.7% during the first quarter of 2006, compared to 3.6% in the same period of the prior year.

Net transaction revenues from the Payments segment earned internationally totaled $118.6 million during the first quarter of 2006, representing 36% of total Payments segment net transaction revenue during that period. This is compared to net transaction revenues from the Payments segment earned internationally of $81.7 million during the first quarter of 2005, representing 36% of total Payments segment net transaction revenue. The relative strength of the U.S. dollar against certain foreign currencies, primarily the Euro, decreased net revenues by approximately $7.6 million during the first quarter of 2006, as compared to the same period of the prior year. 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 the Payments segment net transaction revenues to increase in total during 2006 and for net transaction revenues earned internationally to increase in total and as a percentage of Payments net transaction revenues. We also expect that the Payments segment net transaction revenues will increase as a percentage of total net transaction revenues in the remainder of 2006.

Communications Segment Net Transaction Revenues

Communications net transaction revenues were $35.2 million in the first quarter of 2006. This segment revenue represents the revenue generated from VoIP offerings from our recent acquisition of Skype on October 14, 2005. We expect the Communications segment net transaction revenues to increase in total and as a percentage of total net transactions revenues during the remainder of 2006.

Advertising and Other Non-Transaction Net Revenues

Advertising and other non-transaction net revenues increased during the first quarter of 2006 as compared to the same period in 2005. Advertising and other non-transaction net revenues represented 3% of total net revenues during the first quarter of 2006 and of 2005. We continue to view our business as primarily transaction-revenue driven and we expect advertising and other net revenues to continue to represent a relatively small proportion of total net revenues during the remainder of 2006.

Cost of Net Revenues

	Three Months Ended March 31, 2005	Percent Change	Three Months Ended March 31, 2006
	(In thousands, except percentages)		
Cost of net revenues	$ 186,369	49%	$ 278,568
As a percentage of net revenues	18.1%		20.0%

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Cost of net revenues consists primarily of costs associated with payment processing, site operations, and certain types of customer support. Significant cost components include bank charges, credit card interchange and assessments, other payment processing costs, employee compensation and facilities costs for our customer support and site operations, depreciation of equipment and amortization of required capitalization of major site product development costs and telecommunication costs.

The increase in cost of net revenues during the first quarter of 2006, compared to the same period in the prior year, was primarily due to an increase in payment processing costs, the volume of transactions on our Marketplaces and Payments websites, development and expansion of our customer support and site operations infrastructure, telecommunication costs and stock-based compensation. Payment processing costs increased $25.5 million during the first quarter of 2006 compared to the same period of the prior year. This increase reflects the increase in PayPal s total payment volume and increased payment processing costs offset by reduced contractual payment processing rates. Aggregate customer support and site operations costs increased approximately $30.0 million during the first quarter of 2006, compared to the same period of the prior year. Telecommunications costs increased $26.5 million during the first quarter of 2006, compared to the same period of the prior year, due to the inclusion of such costs since our acquisition of Skype in October 2005. Stock-based compensation expense included in cost of net revenues in the first quarter of 2006 was $9.5 million. Cost of net revenues prior to fiscal 2006 did not include FAS 123(R) stock-based compensation expense. Cost of net revenues are expected to increase in total and as a percentage of net revenues during the remainder of 2006 resulting from the expected growth of our lower gross margin Payments and Communications businesses, and increased stock-based compensation expense offset by our expected operational efficiency in our site operations and transaction costs.

Operating Expenses

Sales and Marketing

	Three Months Ended March 31, 2005	Percent Change	Three Months Ended March 31, 2006
	(In thousands, except percentages)		
Sales and marketing	$ 271,349	48%	$ 400,562
As a percentage of net revenues	26.3%		28.8%

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

The increase in sales and marketing expenses in the first quarter of 2006, compared to the same period in the prior year was primarily due to a $24.7 million increase in stock-based compensation expense recognized as sales and marketing expenses from the adoption of FAS 123(R) and our continued investment in growing our global user base. Advertising and marketing costs increased by $68.1 million due to our integrated marketing campaigns globally and search engine marketing expenses in our Shopping.com business. Employee-related costs, not including stock-based compensation expense, increased by approximately $27.4 million during the first quarter of 2006 as compared to the same period of the prior year. Sales and marketing expenses are expected to increase in total however, remain consistent as a percentage of net revenues during the remainder of 2006 as we recognize additional stock-based compensation expense and as Shopping.com has higher sales and marketing expenses as a percentage of net revenues than our other businesses. In addition, our online marketing expenses are expected to increase because of increases in the volume of online advertising that we expect to purchase in order to attract new customers and increased user activity on our websites, including growth initiatives in sales and marketing activities in our Marketplaces segments.

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Product Development

	Three Months Ended March 31, 2005	Percent Change	Three Months Ended March 31, 2006
	(In thousands, except percentages)		
Product development	$ 73,789	61%	$ 119,070
As a percentage of net revenues	7.2%		8.6%

Product development expenses consist primarily of employee compensation, stock-based compensation, consultant costs, facilities costs and depreciation on equipment used for development. Product development expenses are net of required capitalization of major site and other product development efforts. These capitalized costs totaled $18.0 million in the first quarter of 2006 and are reflected as a cost of net revenues when amortized in future periods. During the first quarter of 2005, capitalized costs for major site and other product development efforts totaled $9.7 million. We anticipate that we will continue to devote significant resources to product development in the future as we add new features and functionality to our Marketplaces and Payments businesses.

The increase in product development expenses in the first quarter of 2006, compared to the same period in the prior year was primarily due to a $20.7 million increase in stock-based compensation expense recognized as product development expenses from the adoption of FAS 123(R) and increased headcount to support various platform development initiatives in our Marketplaces and Payments segments, domestically and internationally. Employee-related costs, not including stock-based compensation expense, increased by approximately $14.9 million during the first quarter of 2006, compared to the same period in the prior year. Product development expenses are expected to increase both in total and as a percentage of net revenues, in the remainder of 2006, as we recognize additional stock-based compensation expense, develop new site features and functionality and continue to improve and expand operations across all platforms.

General and Administrative

	Three Months Ended March 31, 2005	Percent Change	Three Months Ended March 31, 2006
	(In thousands, except percentages)		
General and administrative	$ 136,389	58%	$ 215,350
As a percentage of net revenues	13.2%		15.5%

General and administrative expenses consist primarily of employee compensation, provisions for transaction losses associated with our Payments segment, depreciation of equipment, provision for doubtful accounts, insurance, professional fees and certain trust and safety programs.

The increase in general and administrative expenses in the first quarter of 2006, compared to the same period of the prior year was primarily due to a $28.9 million increase in stock-based compensation expense recognized as general and administrative expenses from the adoption of FAS 123(R), employee-related costs, and facilities costs. While PayPal transaction loss expenses as a percentage of net payment revenues declined from both the year ago period and last quarter, these savings were partially offset by increased investment in our infrastructure to support an increasingly complex and global business. Employee-related costs, not including stock-based compensation expense increased by approximately $24.3 million during the first quarter of 2006, compared to the same period of the prior year. The increases in employee related costs resulted from continued headcount growth primarily in trust and safety programs and corporate functions. Facilities costs increased by approximately $3.3 million during the first quarter of 2006 compared to the same period of the prior year. PayPal s payment transaction loss expense increased approximately $6.9 million during the first quarter of 2006 as compared to same period of the prior year. PayPal s payment transaction loss rate, which is the transaction loss expense as a percentage of PayPal s total payment volume, remained consistent at 0.29% during the first quarter of 2006, compared to 0.30% during the same period of the prior year. General and administrative expenses are expected to increase both in total and as a percentage of revenue during the remainder of 2006 as we recognize additional stock-based compensation expense, continue to invest across all areas of our business and related corporate functions. However, the increase of general expenses as a percentage of revenue is partially offset by the increase in our revenue base at a higher rate.

Payroll Tax on Employee Stock Options

	Three Months Ended March 31, 2005	Percent Change	Three Months Ended March 31, 2006
	(In thousands, except percentages)		
Payroll tax expense from employee stock options	$ 5,731	(59)%	$ 2,324
As a percentage of net revenues	0.6%		0.2%

We are subject to employer payroll taxes on employee gains from the exercise of non-qualified stock options. These employer payroll taxes are recorded as a charge to operations in the period in which such options are exercised and sold based on actual gains realized by employees. The fluctuation in each respective year was primarily the result of the extent of employee gains recognized on stock option exercises. Our results of operations and cash flows could vary significantly depending on the actual period that stock options are exercised by employees and, consequently, the amount of employer payroll taxes assessed. In general, we expect payroll taxes on employee stock option gains to increase during periods in which our stock price is high relative to historic levels.

Amortization of Acquired Intangible Assets

	Three Months Ended March 31, 2005	Percent Change	Three Months Ended March 31, 2006
	(In thousands, except percentages)		
Amortization of acquired intangible assets	$ 22,523	131%	$ 51,921
As a percentage of net revenues	2.2%		3.7%

From time to time we have purchased, and we expect to continue purchasing, assets or businesses to accelerate category and geographic expansion, increase the features, functions, and formats available to our users and maintain a leading role in online e-commerce. These purchase transactions generally result in the creation of acquired intangible assets and lead to a corresponding increase in the amortization expense in future periods. The increase in amortization of acquired intangibles during the first quarter of 2006 compared to the same period of the prior year is due primarily to the business acquisitions consummated during the second half of 2005.

Intangible assets include purchased customer lists and user base, trademarks and trade names, developed technologies, and other intangible assets. We amortize intangible assets, excluding goodwill, using the straight-line method over estimated useful lives ranging from one to eight years. We believe the straight-line method of amortization best approximates the distribution of the economic value of the identifiable intangible assets.

Goodwill represents the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired in a business combination. We evaluate goodwill, at a minimum, on an annual basis and whenever events and changes in circumstances suggest that the carrying amount may not be recoverable. Impairment of goodwill is tested at the reporting unit level by comparing the reporting unit s carrying amount, including goodwill, to the fair value of the reporting unit. The fair values of the reporting units are estimated using a combination of the income, or discounted cash flows, approach and the market approach, which utilizes comparable companies data. If the carrying amount of the reporting unit exceeds its fair value, goodwill is considered impaired and a second step is performed to measure the amount of impairment loss, if any. We conduct our annual impairment test as of August 31 of each year. Based on our last impairment test as of August 31, 2005 we determined there was no impairment. There were no events or circumstances from that date through March 31, 2006 indicating that a further assessment was necessary.

We expect amortization of acquired intangible assets to remain consistent in the remainder of 2006 as a result of the intangible assets associated with our 2005 acquisitions. Amortization of acquired intangible assets may increase should we make additional acquisitions in the future.

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Non-Operating Items

Interest and Other Income, Net

	Three Months Ended March 31, 2005	Percent Change	Three Months Ended March 31, 2006
	(In thousands, except percentages)		
Interest and other income, net	$ 22,403	15%	$ 25,760
As a percentage of net revenues	2.2%		1.9%

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

Our interest and other income, net, increased during the first quarter of 2006 as compared to the same period of the prior year, primarily as a result of increased interest income due to increased cash, cash equivalents and investments balances and higher interest rates. The weighted-average interest rate of our portfolio was approximately 3.5% in the first quarter of 2006 compared to 2.5% in the same period of the prior year. We expect that interest and other income, net, will remain consistent as a percentage of net revenues during 2006 compared to 2005, excluding the potential effects from our recent and future acquisitions.

Interest Expense

	Three Months Ended March 31, 2005	Percent Change	Three Months Ended March 31, 2006
	(In thousands, except percentages)		
Interest expense	$ 1,720	(57)%	$ 747
As a percentage of net revenues	0.2%		0.1%

Interest expense in 2005 consisted of interest charges related to our San Jose headquarters lease facilities, capital leases, and mortgage notes.

Interest expense decreased during the first quarter of 2006, compared to the same period of the prior year, primarily due to the payment of the lease obligation for our San Jose headquarters facility on March 1, 2005. We expect our interest expense will decrease both in total and as a percentage of net revenue during 2006.

Provision for Income Taxes

	Three Months Ended March 31, 2005	Percent Change	Three Months Ended March 31, 2006
	(In thousands, except percentages)		
Provision for income taxes	$ 99,948	(1)%	$ 99,354
As a percentage of net revenues	9.7%		7.1%
Effective tax rate	28%		29%

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

The higher effective tax rates for the first quarter of 2006, compared to the first quarter of 2005, primarily reflect changes in the company s geographic mix of business.

We received tax deductions from the gains realized by employees on the exercise of certain non-qualified stock options for which the benefit was recognized in prior periods as additional paid-in-capital. These tax deductions from prior periods were fully utilized in 2005. Beginning in January 2006, due to the adoption of FAS 123(R), the estimated tax benefit expected from stock-based compensation is recognized when the released expense is reflected in our financial statements.

Impact of Foreign Currency Translation

During the first quarter of 2006, our international net revenues, based upon the country in which the seller, payment recipient, advertiser or other service provider is located, accounted for approximately 46% of our consolidated net revenues consistent with the same period of 2005. The growth in our international operations has increased our exposure to foreign currency fluctuations. Net revenues and related expenses generated from international locations are denominated in the functional currencies of the local countries, and primarily include Euros, British pounds, Korean won, Canadian dollars, Taiwanese dollars, Australian dollars, Chinese renminbi, and Indian rupee. The results of operations and certain of our inter-company balances associated with our international locations are exposed to foreign exchange rate fluctuations. The statements of income of our international operations are translated into U.S. dollars at the average exchange rates in each applicable period. To the extent the U.S. dollar weakens against foreign currencies, the translation of these foreign currency denominated transactions results in increased consolidated net revenues, operating expenses and net income.

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 decrease if the U.S. dollar strengthens against foreign currencies. The change in weighted average foreign currency exchange rates in the first quarter of 2006 relative to 2005 resulted in lower net revenues of approximately $50.2 million and lower aggregate cost of revenues and operating expenses of approximately $25.1 million.

We expect our international operations will continue to grow in significance as we develop and deploy our global marketplaces and global payments platform. As a result, the impact of foreign currency fluctuations in future periods could become more significant and may have a negative impact on our consolidated net revenues and net income in the event the U.S. dollar strengthens relative to other currencies. See the information in Item 3 under Foreign Currency Risk for additional discussion of the impact of foreign currency translation and related hedging activities.

Foreign Exchange Hedging Policy

We are a rapidly growing company, with an increasing proportion of our operations outside the United States. Accordingly, our foreign currency exposures have increased substantially and are expected to continue to grow. The objective of our foreign exchange exposure management program is to identify material foreign currency exposures and to manage these exposures to minimize the potential effects of currency fluctuations on our reported consolidated cash flow, and results of operations.

Our primary foreign currency exposures are transaction, economic and translation:

Transaction Exposure: Around the world, we have certain assets and liabilities, primarily receivables, investments and accounts payable (including inter-company transactions) that are denominated in currencies other than the relevant entity s functional currency. In certain circumstances, changes in the functional currency value of these assets and liabilities create fluctuations in our reported consolidated financial position, results of operations and cash flows. We may enter into foreign exchange forward contracts or other instruments to minimize the short-term foreign currency fluctuations on such assets and liabilities. The gains and losses on the foreign exchange forward contracts offset the transaction gains and losses on certain foreign currency receivables, investments and payables recognized in earnings.

Economic Exposure: We also have anticipated and unrecognized future cash flows, including revenues and expenses, denominated in currencies other than the relevant entity s functional currency. Our primary economic exposures include future royalty receivables, customer collections, and vendor payments. Changes in the relevant entity s functional currency value will cause fluctuations in the cash flows we expect to receive when these cash flows are realized or settled. We may enter into foreign exchange forward contracts or other derivatives to hedge the value of a portion of these cash flows. We account for these foreign exchange contracts as cash flow hedges. The effective portion of the derivative s gain or loss is initially reported as a component of accumulated other comprehensive income (loss) and subsequently reclassified into earnings when the transaction is settled.

Earnings Translation Exposure: As our international operations grow, fluctuations in the foreign currencies create volatility in our reported results of operations because we are required to consolidate the results of operations of our foreign denominated subsidiaries. We may decide to purchase forward exchange contracts or other instruments to offset the earnings impact of currency fluctuations. Such contracts will be marked-to-market on a monthly basis and any unrealized gain or loss will be recorded in interest and other income, net.

Employees

As of March 31, 2006, eBay Inc. and its consolidated subsidiaries employed approximately 12,500 people (including approximately 800 temporary employees), of whom approximately 7,200 were located in the United States (including approximately 300 temporary employees). Our future success is substantially dependent on the performance of our executive and senior management and key technical personnel, and on our continuing ability to find and retain highly qualified technical and managerial personnel.

Liquidity and Capital Resources

Cash Flows

	Three Months Ended March 31,	
	2005	**2006**
	(In thousands)	
Net cash provided by (used in):		
Operating activities	$ 495,419	$ 584,204
Investing activities	(647,021)	(145,886)
Financing activities	51,040	103,978
Effect of exchange rates on cash and cash equivalents	(12,711)	20,558
Net increase in cash and cash equivalents	$ (113,273)	$ 562,854

We generated cash from operating activities in amounts greater than net income in the three months ended March 31, 2006 and 2005, mainly due to non-cash charges to earnings. Non-cash charges to earnings included depreciation and amortization on our long-term assets, stock-based compensation expense related to employee stock options and purchases, tax benefits on the exercise of employee stock options resulting from personal gains recognized by our employees, provision for doubtful accounts and authorized credits resulting from increasing revenues and the provision for transaction losses resulting from increased total payment volumes processed by our PayPal subsidiary.

Prior to adopting FAS 123(R), the Company presented all tax benefits resulting from the exercise of stock options as operating cash flows in the Statement of Cash Flows. FAS 123(R) requires cash flows resulting from excess tax benefits to be classified as a part of cash flows from financing activities. Excess tax benefits represent tax benefits related to exercised options in excess of the associated deferred tax asset for such options. As a result of adopting FAS 123(R), $23.4 million of excess tax benefits for the three months ended March 31, 2006 have been classified as an operating cash outflow and a financing cash inflow. In addition, as prior period tax benefits from stock options were fully utilized, cash outflows will be required for estimated tax payments. These payments will be dependent on the amount of current period tax benefits generated from exercised options.

Net cash used in investing activities during the first three months of 2006 consisted primarily of net purchases of property and equipment totaled $133.6 million during the first three months of 2006 related mainly to purchases of computer equipment and software to support our site operations, customer support and international expansion. Net cash used in investing activities during the first three months of 2005 consisted primarily of the cash payment for the acquisition of Rent.com of approximately $435.4 million and the net purchase of investments of approximately $122.4 million.

The net cash flows provided by financing activities during the first three months of 2006 consisted primarily of proceeds from stock option exercises of $80.6 million and excess tax benefits from stock-based compensation of $23.4 million. Our future cash flows from stock options are difficult to project as such amounts are a function of our stock price, the number of options outstanding, and the decisions by employees to exercise stock options. In general, we expect proceeds from stock option exercises to increase during periods in which our stock price is high relative to historic levels.

The positive effect of exchange rates on cash and cash equivalents during the three months ended March 31, 2006 was due to the weakening of the U.S. dollar during the quarter against other foreign currencies, primarily the Euro. The negative effect of exchange rates on cash and cash equivalents during the three months ended March 31, 2005 was due to the strengthening of the U.S. dollar during the quarter against other foreign currencies, primarily the Euro.

On April 24, 2006, we acquired all equity securities of Tradera.com, the leading online auction-style marketplace in Sweden for approximately 365 million Swedish Kronor, plus acquisition costs and an adjustment for net cash acquired. Based on an April 21, 2006 exchange rate of SEK 7.56 to US$1.00, the net purchase amount approximates $48 million.

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

Other Financial Arrangements

As of March 31, 2006, we had no off-balance sheet arrangements that are reasonably likely to have a future material effect on our consolidated financial condition, results of operations, liquidity, capital expenditures or capital resources.

Indemnification Provisions

In the ordinary course of business, we have included limited indemnification provisions in certain of our agreements with parties with whom 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 any 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, including agreements under which we have developed technology for certain commercial parties, we have provided an indemnity for other types of third-party claims, substantially all of which are indemnities related to our copyrights, trademarks, and patents. In our PayPal business, we have provided an indemnity to our payments processors in the event of certain third-party claims or card association fines against the processor arising out of conduct by PayPal. To date, no significant costs have been incurred, either individually or collectively, in connection with our indemnification provisions.

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

Interest Rate Risk

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

Investments in both fixed-rate and floating-rate interest-earning instruments carry varying degrees of interest rate risk. The fair market value of our fixed-rate securities may be adversely impacted due to a rise in interest rates. In general, securities with longer maturities are subject to greater interest-rate risk than those with shorter maturities. While floating rate securities generally are subject to less interest-rate risk than fixed-rate securities, floating-rate securities may produce less income than expected if interest rates decrease. Due in part to these factors, our investment income may fall short of expectations or we may suffer losses in principal if securities are sold that have declined in market value due to changes in interest rates. As of March 31, 2006, our fixed-income investments earned a pretax yield of approximately 3.5%, with a weighted average maturity of two months. If interest rates were to instantaneously increase (decrease) by 100 basis points, the fair market value of our total investment portfolio could decrease (increase) by approximately $5.1 million.

Equity Price Risk

We are exposed to equity price risk on the marketable portion of equity instruments and equity method investments we hold, typically as the result of strategic investments in third parties that are subject to considerable market risk due to their volatility. We typically do not attempt to reduce or eliminate our market exposure in these equity investments. We did not record an impairment charge during either of the three months ended March 31, 2006 or 2005 relating to the other-than-temporary impairment in the fair value of equity investments. At March 31, 2006, the total carrying value of our equity instruments and equity method investments was $58.7 million.

Foreign Currency Risk

International net revenues result from transactions by our foreign operations and are typically denominated in the local currency of each country. These operations also incur most of their expenses in the local currency. Accordingly, our foreign operations use the local currency, which is primarily the Euro, and to a lesser extent, the British pound, as their functional currency. Our international operations are subject to risks typical of international operations, including, but not limited to, differing economic conditions, changes in political climate, differing tax structures, other regulations and restrictions, and foreign exchange rate volatility. Accordingly, our future results could be materially adversely impacted by changes in these or other factors. In addition, at March 31, 2006, we held balances in cash, cash equivalents and investments outside the U.S. totaling approximately $1.1 billion.

Transaction Exposure:

As of March 31, 2006, we had outstanding forward foreign exchange hedge contracts with notional values equivalent to approximately $124.6 million with maturity dates within 15 days. The hedge contracts are used to offset changes in the functional currency value of assets and liabilities denominated in foreign currencies as a result of currency fluctuations. Transaction gains and losses on the contracts and the assets and liabilities are recognized each period in our consolidated statement of income.

Translation Exposure:

Foreign exchange rate fluctuations may adversely impact our consolidated financial position as well as our consolidated results of operations. Foreign exchange rate fluctuations may adversely impact our financial position as the assets and liabilities of our foreign operations are translated into U.S. dollars in preparing our consolidated balance sheet. The effect of foreign exchange rate fluctuations on our consolidated financial position for the three months ended March 31, 2006, was a net translation gain of approximately $127.5 million. This gain is recognized as an adjustment to stockholders equity through accumulated other comprehensive income. Additionally, foreign exchange rate fluctuations may adversely impact our consolidated results of operations as exchange rate fluctuations on transactions denominated in currencies other than our functional currencies result in gains and losses that are reflected in our consolidated statement of income.

We consolidate our international subsidiaries by converting them into U.S. dollars in accordance with Statement of Financial Accounting Standards No. 52 Foreign Currency Translation (FAS 52). The results of operations and our financial position will fluctuate when there is a change in foreign currency exchange rates. From time to time, we enter into transactions to hedge portions of our foreign currency denominated earnings translation exposure using both foreign currency options and forward contracts. All contracts that hedge translation exposure mature ratably over the quarter in which they are executed. During the three months ended March 31, 2006, the realized gains and losses related to these hedges were not significant.

Economic Exposure:

We currently charge our international subsidiaries on a monthly basis for their use of intellectual property and technology and for certain corporate services provided by eBay and PayPal. These charges are denominated in Euros and these forecasted inter-company transactions represent a foreign currency cash flow exposure. To reduce foreign exchange risk relating to these forecasted inter-company transactions, we entered into forward foreign exchange contracts during the three months ended March 31, 2006. The objective of the forward contracts is to ensure that the U.S. dollar-equivalent cash flows are not adversely affected by changes in the U.S. dollar/Euro exchange rate. Pursuant to Statement of Financial Accounting Standards No. 133 Accounting for Derivative Instruments and Hedging Activities (FAS 133), we expect the hedge of certain of these forecasted transactions using the forward contracts to be highly effective in offsetting potential changes in cash flows attributed to a change in the U.S. dollar/Euro exchange rate. Accordingly, we record as a component of other comprehensive income all unrealized gains and losses related to the forward contracts that receive hedge accounting treatment. We record all unrealized gains and losses in interest and accumulated other income, net, related to the forward contracts that do not receive hedge accounting treatment pursuant to FAS 133. During the three months ended March 31, 2005 and 2006, the realized gains and losses related to these hedges were not significant. The notional amount of our economic hedges receiving hedge accounting treatment and the loss, net of gains, recorded to accumulated other comprehensive income as of March 31, 2006 were $122.5 million and $0.8 million, respectively.

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.

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 in the regional court of Cologne, Germany. The suit subsequently was transferred to the regional court in Düsseldorf, Germany. Rolex alleged that our subsidiaries were infringing Rolex s trademarks as a result of users selling counterfeit Rolex watches through our German website. The suit also alleged unfair competition. Rolex sought an order enjoining the sale of Rolex-branded watches on the website as well as damages. In December 2002, a trial was held in the matter and the court ruled in favor of eBay on all causes of action. Rolex appealed the ruling to the Higher Regional Court of Düsseldorf, and the appeal was heard in October 2003. In February 2004, the court rejected Rolex s appeal and ruled in our favor. Rolex has appealed the ruling to the German Federal Supreme Court, and a hearing is expected in December 2006. In September 2004, the German Federal Supreme Court issued its written opinion in favor of Rolex in a case involving an unrelated company, ricardo.de AG, but somewhat comparable legal theories. Although it is not yet clear what the ultimate effect of the reasoning of the German Federal Supreme Court s ricardo.de decision will have when applied to eBay, we believe the Court s decision has resulted in an increase in similar litigation against us in Germany, although we do not currently believe that it will require a significant change in our business practices.

In September 2001, MercExchange LLC filed a complaint against us, our Half.com subsidiary and ReturnBuy, Inc. in the U.S. District Court for the Eastern District of Virginia (No. 2:01-CV-736) alleging infringement of three patents (relating to online consignment auction technology, multiple database searching and electronic consignment systems) and seeking a permanent injunction and damages (including treble damages for willful infringement). In October 2002, the court granted in part our summary judgment motion, effectively invalidating the patent related to online auction technology and rendering it unenforceable. This ruling left only two patents in the case. Trial of the matter began in April 2003. In May 2003, the jury returned a verdict finding that eBay had willfully infringed one and Half.com had willfully infringed both of the patents in the suit, awarding $35 million in compensatory damages. Both parties filed post-trial motions, and in August 2003, the court entered judgment for MercExchange in the amount of approximately $30 million plus pre-judgment interest and post-judgment interest in an amount to be determined, while denying MercExchange s request for an injunction and attorneys fees. We appealed the verdict and judgment in favor of MercExchange and MercExchange filed a cross-appeal of the granting in part of our summary judgment motion and the denial of its request for an injunction and attorneys fees.

In March 2005, the U.S. Court of Appeals for the Federal Circuit issued a ruling in the appeal of the MercExchange patent litigation suit which, among other things (1) invalidated all claims asserted against eBay and Half.com arising out of the multiple database search patent and reduced the verdict amount by $4.5 million; (2) upheld the electronic consignment system patent; (3) affirmed the district court s refusal to award attorneys fees or enhanced damages against us; (4) reversed the district court s order granting summary judgment in our favor regarding the auction patent; and (5) reversed the district court s refusal to grant an injunction and remanded that issue to the district court for further proceedings. In May 2005, the Court of Appeals for the Federal Circuit granted our petition to stay the mandate in the case in order to allow us to petition the U.S. Supreme Court for review on certain issues. We filed our petition for review with the U.S. Supreme Court in July 2005, and in November 2005, the Court granted our petition for review. Oral arguments in the case were heard by the Court in March 2006, and the Court s decision is expected in the second quarter of 2006. In parallel with the federal court proceedings, at our request, the U.S. Patent and Trademark Office is actively reexamining each of the patents in suit, having found that substantial questions exist regarding the validity of the claims contained in them. In January 2005, the Patent and Trademark Office issued an initial ruling rejecting all of the claims contained in the patent that related to online auctions; in March 2005, the Patent and Trademark Office issued an initial ruling rejecting all of the claims contained in the patent that related to electronic consignment systems; and in May 2005, the Patent and Trademark Office issued an initial ruling rejecting all of the claims contained in the patent that related to multiple database searching. In March 2006, the Patent and Trademark Office affirmed its earlier ruling rejecting the claims contained in the patent that related to electronic consignment systems. Even if successful, our litigation of these matters will continue to be costly. In addition, as a precautionary measure, we have modified certain functionality of our websites and business practices in a manner which we believe would avoid any further infringement. For this reason, we believe that any injunction that might be issued by the district court will not have any impact on our business. We also believe we have appropriate reserves for this litigation. Nonetheless, if we are not successful in appealing or modifying the court s ruling, and if the modifications to the functionality of our websites and business practices are not sufficient to make them non-infringing, we would likely be forced to pay significant additional damages and licensing fees and/or modify our business practices in an adverse manner.

In August 2002, Charles E. Hill & Associates, Inc. filed a lawsuit in the U.S. District Court for the Eastern District of Texas (No. 2:02-CV-186) alleging that we and 17 other companies, primarily large

retailers, infringed three patents owned by Hill generally relating to electronic catalog systems and methods for transmitting and updating data at a remote computer. The suit seeks an injunction against continuing infringement, unspecified damages, including treble damages for willful infringement, and interest, costs, expenses, and fees. The case was transferred to the U.S. District Court for the Southern District of Indiana in January 2003, but was transferred back to the U.S. District Court for the Eastern District of Texas in December 2003. A claim construction hearing was held in August 2005. In February 2006, we entered into and paid for a settlement agreement with the plaintiffs in the case under which we will be licensed under all of the patents at issue.

In February 2002, PayPal was sued in California state court (No. CV-805433) in a purported class action alleging that its limiting access to customer accounts and failure to promptly restore access to legitimate accounts violates California state consumer protection laws and is an unfair business practice and a breach of PayPal s User Agreement. This action was re-filed with a different named plaintiff in June 2002 (No. CV-808441), and a similar action was also filed in the U.S. District Court for the Northern District of California in June 2002 (No. C-02-2777). In March 2002, PayPal was sued in the U.S. District Court for the Northern District of California (No. C-02-1227) in a purported class action alleging that its limiting access to customer accounts and failure to promptly restore access to legitimate accounts violates federal and state consumer protection and unfair business practice laws. The two federal court actions were consolidated into a single case, and the state court action was stayed pending developments in the federal case. In June 2004, the parties announced that they had reached a proposed settlement. The settlement received approval from the federal court on November 2, 2004, and the state court action was dismissed with prejudice in March 2005. In the settlement, PayPal does not acknowledge that any of the allegations in the case are true. Under the terms of the settlement, certain PayPal account holders are eligible to receive payment from a settlement fund of $9.25 million, less administrative costs and the amount awarded to plaintiffs counsel by the court. That sum is being distributed to class members who have submitted timely claims in accordance with the settlement s plan of allocation. The plan of allocation for the portion of the settlement fund that remains undistributed was approved by the District Court in March 2006. Substantially all of the cost associated with the settlement was reserved in 2003.

In July 2004, a purported class action lawsuit was filed by two eBay users in Superior Court of the State of California, County of Santa Clara (No. 104CV022708) alleging that eBay engaged in improper billing practices as the result of problems with the rollout of a new billing software system in the second and third quarters of 2004. The lawsuit sought damages and injunctive relief. An amended complaint was filed in January 2005, dropping one plaintiff, changing the capacity of the other plaintiff to that of representative plaintiff, and adding seven additional eBay users as plaintiffs. The amended complaint expanded its claim to include numerous alleged improper billing practices from September 2003 until the present. In February 2005, eBay filed a motion to strike and a demurrer seeking to dismiss the complaint. In April 2005, the court sustained portions of the demurrer, but granted the plaintiffs leave to amend their complaint. The plaintiffs filed a second amended complaint, dropping the last original plaintiff and again adding new plaintiffs. We filed a motion to strike and a demurrer regarding the plaintiffs second amended complaint. In July 2005, the court again sustained a portion of the demurrer and again granted the plaintiffs leave to amend their complaint, and the plaintiffs filed a third amended complaint. In December 2005, the plaintiffs filed a fourth amended complaint, dropping several plaintiffs. In April 2006, the court approved a settlement agreement entered into by the parties. Under the terms of the settlement, the plaintiffs agreed to dismiss the lawsuit and release eBay from all claims, and eBay agreed to make a $250,000 payment primarily directed to charity. The estimated settlement was accrued in our consolidated income statement for the three months ended March 31, 2006.

In February 2005, eBay was sued in Superior Court of the State of California, County of Santa Clara (No. 105CV035930) in a purported class action alleging that certain bidding features of our site constitute shill bidding for the purpose of artificially inflating bids placed by buyers on the site. The complaint alleges violations of California s Auction Act, California s Consumer Remedies Act, and unfair competition. The complaint seeks injunctive relief, damages, and a constructive trust. In April 2005, we filed a demurrer seeking to dismiss the complaint, and a hearing on the demurrer was held in February 2006. In March 2006, the parties reached tentative agreement on the terms of a settlement. The court must approve the terms of the

settlement in order for it to become final. The estimated settlement was accrued in our consolidated income statement for the year ended December 31, 2005.

In March 2005, eBay, PayPal, and an eBay seller were sued in Supreme Court of the State of New York, County of Kings (No. 6125/05) in a purported class action alleging that certain disclosures regarding PayPal s Buyer Protection Policy, users chargeback rights, and the effects of users choice of funding mechanism are deceptive and/or misleading. The complaint alleged misrepresentation on the part of eBay and PayPal, breach of contract and deceptive trade practices by PayPal, and that PayPal and eBay have jointly violated the civil RICO statute (18 U.S.C. Section 1961(4)). In April 2005, eBay and PayPal removed the case to the U.S. District Court for the Eastern District of New York and the plaintiffs filed an amended complaint in the U.S. District Court (No. 05-CV-01720) repeating the allegations of the initial complaint but dropping the civil RICO allegations. The complaint seeks injunctive relief, compensatory damages, and punitive damages. Following several mediation sessions, the parties reached a tentative settlement in December 2005 and executed a Memorandum of Understanding in March 2006. The parties are engaged in the process of finalizing the settlement documentation. The court must approve the terms of the settlement in order for it to become final. The estimated settlement was accrued in our consolidated income statement for the year ended December 31, 2005.

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 have been notified of several 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 to face additional patent infringement claims involving services we provide, including various aspects of our 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 expand geographically into jurisdictions where the underlying laws with respect to the potential liability of online intermediaries like ourselves are either unclear or less favorable. These claims, whether meritorious or not, could be time consuming and costly to resolve, cause service upgrade delays, require expensive changes in our methods of doing business, or could require us to enter into costly royalty or licensing agreements.

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.

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 fluctuate.

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

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

- the volume, size, timing, and completion rate of transactions using our websites or technology;

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

our ability to integrate, manage, and profitably expand our newly-acquired Skype business;

our ability to successfully integrate and manage other recent and prospective acquisitions;

regulatory actions imposing obligations on our businesses (including Skype) or our users;

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;

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

new laws or regulations, or interpretations of existing laws or regulations, that harm the Internet, electronic commerce, online payments or communications, or our business models;

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

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;

the costs and results of litigation that involves us;

our ability to expand PayPal s product offerings outside of the U.S. (including our ability to obtain any necessary regulatory approvals);

our ability to increase the acceptance of PayPal by online merchants outside of the eBay marketplaces;

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

our ability to manage PayPal s transaction loss and credit card chargeback rates and payment funding mix;

the success of our geographic and product expansions;

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

the continued financial strength of our technology suppliers and other parties with whom 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, viruses, and other dangers of the Internet;

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

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

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 and our limited operating history, 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

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expenses as a percentage of net revenues may be significantly different from historical or projected rates. Our operating results in one or more future quarters may fall below the expectations of securities analysts and investors. In that event, the trading price of our common stock would almost certainly decline.

We may not maintain our level of profitability or rates of growth.

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

- attract new users, keep existing users active on our websites, and increase the activity levels of our active users;
- react to changes in consumer use of the Internet and develop new sources of monetization for some of our services;
- manage the costs of our business, including the costs associated with maintaining and developing our websites, customer support, transaction and chargeback rates, and international and product expansion;
- maintain sufficient transaction volume to attract buyers and sellers;
- increase the awareness of our brands; and
- provide our customers with superior community, customer support, and trading and payment experiences.

We invest heavily in marketing and promotion, customer support, and further development of the operating infrastructure for our core and recently acquired 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. In addition, we are spending in advance of anticipated growth, which may also harm our profitability. Growth rates in our most established markets, such as Germany and the U.S., have declined over time and may continue to do so as the existing base of users and transactions becomes larger. The expected future growth of our PayPal, Skype and Shopping.com businesses may also cause downward pressure on our profit margin because those businesses have lower gross margins than our eBay trading platforms.

There are many risks associated with our international operations.

Our international expansion has been rapid and we have only limited experience in many of the countries in which we now do business. Our international business, especially in Germany, the U.K., and South Korea, has also become critical to our revenues and profits. Net revenues outside the United States accounted for approximately 46% of our net revenues in the first quarter of 2005 and 2006. Expansion into international markets requires management attention and resources and requires us to localize our service to conform to local cultures, standards, and policies. The commercial, Internet, and transportation infrastructure in lesser-developed countries may make it difficult for us to replicate our business model. In many countries, we compete with local companies who 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. Even if we are successful, we 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, and Shopping.com, we are subject to risks of doing business internationally, including the following:

- regulatory requirements, including regulation of Internet services, auctioneering, professional selling, distance selling, communications, 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 special taxes, or limit the transfer of information between eBay and our affiliates;

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- legal uncertainty regarding our liability for the listings and other content provided by our users, including uncertainty as a result of less Internet-friendly legal systems, unique local laws, and lack of clear precedent or applicable law;
- difficulties in integrating with local payment providers, including banks, credit and debit card associations, and electronic fund transfer systems;
- differing levels of retail distribution, shipping, and communications infrastructures;
- different employee/employer relationships and the existence of workers councils and labor unions;
- difficulties in staffing and managing foreign operations;
- longer payment cycles, different accounting practices, and greater problems in collecting accounts receivable;
- potentially adverse tax consequences, including local taxation of our fees or of transactions on our websites;
- higher telecommunications and Internet service provider costs;
- strong local competitors;
- different and more stringent consumer protection, data protection, and other laws;
- cultural ambivalence towards, or non-acceptance of, online trading;
- seasonal reductions in business activity;
- expenses associated with localizing our products, including offering customers the ability to transact business in the local currency;
- laws and business practices that favor local competitors or prohibit foreign ownership of certain businesses;
- profit repatriation restrictions, foreign currency exchange restrictions, and exchange rate fluctuations;
- volatility in a specific country s or region s political or economic conditions; and
- differing intellectual property laws.

Some of these factors may cause our international costs 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 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, below.

We are continuing to expand PayPal s services internationally. We have limited experience with the payments business outside of the U.S. In some countries, expansion of PayPal s business may require a close commercial relationship with one or more local banks or a shared ownership interest with a local entity. We do not know if these or other factors may prevent, delay, or limit PayPal s expansion or reduce its profitability. Any limitation on our ability to expand PayPal internationally could harm our business.

We maintain a portion of Shopping.com s research and development facilities and personnel in Israel, and as a result, political, economic and military conditions in Israel affect those operations. 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 Shopping.com s employees in Israel could be required to serve in the military for extended periods of time under emergency circumstances. Shopping.com s Israeli operations could be disrupted by the absence of employees due to military service, which could adversely affect its business.

Our operations in China are subject to risks and uncertainties relating to the laws and regulations of the People s Republic of China.

Our operations in the People s Republic of China, or PRC, are conducted through our EachNet subsidiary and through a PayPal subsidiary. EachNet and PayPal are Delaware corporations and foreign persons under the laws of the PRC and are subject to many of the risks of doing business internationally described above in There are many risks associated with our international operations. The PRC currently regulates its Internet sector through regulations restricting the scope of foreign investment and through the enforcement of content restrictions on the Internet. While many aspects of these regulations remain unclear, they purport to limit and require licensing of various aspects of the provision of Internet information services. These regulations have created substantial uncertainties regarding the legality of foreign investments in PRC Internet companies, including EachNet and PayPal, and the business operations of such companies. In order to meet local ownership and regulatory licensing requirements, the eBay EachNet website is operated through a foreign-owned enterprise indirectly owned by eBay s European operating entity, which acts in cooperation with a local PRC company owned by certain local employees. The PayPal China website is operated through a foreign-owned enterprise owned by PayPal s International headquarters entity, which acts in cooperation with a local PRC company owned by certain local employees. We believe EachNet s and PayPal s current ownership structures comply with all existing PRC laws, rules, and regulations. There are, however, substantial uncertainties regarding the interpretation of current PRC laws and regulations, and it is possible that the PRC government will ultimately take a view contrary to ours. The People s Bank of China, or PBOC, has recently proposed guidelines for payment settlement organizations which, may require PayPal to act in cooperation with a different local PRC entity and obtain approval from the PBOC. There are also uncertainties regarding EachNet s and PayPal s ability to enforce contractual relationships they have entered into with respect to management and control of the company s business. If EachNet or PayPal were found to be in violation of any existing or future PRC laws or regulations, it could be subject to fines and other financial penalties, have its business and Internet content provider licenses revoked, or be forced to discontinue its business entirely. In addition, any finding of a violation by EachNet or PayPal of PRC laws or regulations could make it more difficult for us to launch new or expanded services in the PRC.

Although Skype does not conduct operations in the PRC directly, it makes its product available through a joint venture and its product is used by residents of the PRC. PRC regulations surrounding VoIP telephony are unclear or non-existent, and the PRC or one of more of its provinces may adopt regulations that restrict or prohibit the use of Skype s product.

We are exposed to fluctuations in currency exchange 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 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 decrease if the U.S. dollar strengthens against foreign currencies. The change in weighted average foreign currency exchange rates in the first quarter of 2006 relative to 2005 resulted in lower net revenues of approximately $50.2 million and lower aggregate cost of revenues and operating expenses of approximately $25.1 million. 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 and British Pound, our European revenues and profits will be reduced as a result of these translation adjustments. In addition, to the extent the U.S. dollar strengthens against the Euro and the British Pound, cross-border trade related to purchases of dollar-denominated goods by non-U.S. purchasers may decrease, and that decrease may not be offset by a corresponding increase in cross-border trade involving purchases by U.S. buyers of goods denominated in other currencies. While we from time to time 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.

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

Skype licenses technology underlying certain 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 audio and video compression/decompression used to provide high sound and video quality. Both of these technologies are key to the software Skype provides. In addition, various other technologies used by Skype are licensed from third parties. 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 delays, a decrease in service quality, or a complete failure of Skype s product 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 to license or develop alternative technologies would harm Skype s business.

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

We have acquired a number of businesses in the past, and completed eight acquisitions in 2005. We expect to continue to evaluate and consider a wide array of potential strategic transactions, including business combinations, acquisitions and dispositions of businesses, technologies, services, products and other assets, including interests in our existing subsidiaries. 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, and, in the case of Skype, the complex earn-out structure associated with the transaction;

- declining employee morale and retention issues resulting from changes in, or acceleration of, compensation, or changes in reporting relationships, future prospects, or the direction of the business;

- the need to integrate each company s accounting, management, information, human resource and other administrative systems to permit effective management, and the lack of control if such integration is delayed or not implemented;

- the need to implement controls, procedures and policies appropriate for a larger public company at companies that prior to acquisition had lacked such controls, procedures and policies; and

- in some cases, including in connection with PayPal s recent acquisition of VeriSign s payment gateway business, the need to transition operations, users, and/or customers onto our existing platforms.

Foreign acquisitions involve special risks, including those related to integration of operations across different cultures and languages, currency risks, and the particular economic, political, and regulatory risks associated with specific countries. Moreover, we may not realize the anticipated benefits of any or all of our acquisitions. Future acquisitions or mergers may result in a need to issue additional equity securities, spend our cash, or incur debt, liabilities, or amortization expenses related to intangible assets, any of which could reduce our profitability and harm our business.

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. eBay s primary website has been interrupted for periods of up to 22 hours, and our PayPal site suffered intermittent unavailability over a five-day period in October 2004. 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. These interruptions increase the burden on our engineering staff, which, in turn, could delay our introduction of new features and services on our sites. Because PayPal is a regulated financial entity, frequent or persistent site interruptions could lead to regulatory inquiries. These inquiries could result in 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 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.

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

Our historical growth has been largely attributable to word of mouth, and to frequent and high visibility national and local media coverage. We believe that continuing to strengthen our brands will be critical to achieving widespread acceptance of our services, and will require an increased focus on active marketing efforts. The demand for and cost of online and traditional advertising have been increasing, and may continue to increase. Accordingly, we will need to spend increasing amounts of money on, and devote greater resources to, advertising, marketing, and other efforts to create and maintain brand loyalty among users. During 2004 and 2005, we significantly increased the number of brands we are supporting, adding Rent.com, Shopping.com, Kijiji, 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. 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.

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 e-commerce businesses such as eBay and 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 e-commerce. In many cases, it is not clear how existing statutes apply to the Internet or e-commerce. In addition, some jurisdictions have implemented or may implement laws

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specifically addressing the Internet or some aspect of e-commerce. The application of existing, new, 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 through the Internet. These proposals, if adopted, could substantially impair the growth of e-commerce, and could diminish our opportunity to derive financial benefit from our activities. The U.S. federal government s moratorium on states and other local authorities imposing access or discriminatory taxes on the Internet is scheduled to expire in November 2007. This moratorium does not prohibit federal, state, or local authorities from collecting taxes on our income or from collecting taxes that are due under existing tax rules.

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 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 foreign countries may seek to impose a tax collection or reporting or record-keeping obligation on companies such as eBay that engage in or facilitate e-commerce. Such an obligation could be imposed if eBay were ever deemed to be the legal agent of eBay sellers by a jurisdiction in which eBay operates. A successful assertion by one or more states or foreign countries that we should collect taxes on the exchange of merchandise or services on our websites would harm our business.

In July 2003, in compliance with the changes brought about by the European Union (EU) VAT directive on electronically supplied services, eBay began collecting VAT on the fees charged to EU sellers on eBay sites catering to EU residents. eBay also pays input VAT to suppliers within the various countries the company operates. In most cases, eBay is entitled to reclaim input VAT from the various countries with regard to our own payments to suppliers or vendors. However, because of our unique business model, the application of the laws and rules that allow such reclamation is sometimes uncertain. A successful assertion by one or more countries that eBay is not entitled to reclaim VAT would 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 requirements could harm eBay sellers 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.

Fraudulent activities on our websites and disputes between users of our services may harm our business.

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

- non-delivery of, or disputes over the quality of, goods and services due to merchant fraud or inadequate merchant business practices;
- reversal of payment by buyers both for legitimate reasons and in cases of buyer fraud;
- unauthorized use of credit card and bank account information and identity theft;
- the need to provide effective customer support to process disputes between senders and recipients;
- potential breaches of system security;
- potential employee fraud; and
- use of PayPal s system by customers to make or accept payment for illegal or improper purposes.

For the year ended December 31, 2005 and the first quarter of 2006, PayPal s transaction loss totaled $73.8 million and $25.6 million, representing 0.27% and 0.29% of PayPal s total payment volume, respectively.

Failure to deal effectively with fraudulent transactions and customer disputes would increase PayPal s loss rate and harm its business.

PayPal s highly automated and liquid payment service makes PayPal an attractive target for fraud. In configuring its service, PayPal faces an inherent trade-off between customer convenience and security. Identity thieves and those committing fraud using stolen credit card or bank account numbers 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 would be required to reimburse customers for any funds stolen as a result of 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 has been assessed substantial fines for excess charge-backs in the past, and excessive charge-backs may arise in the future. PayPal has taken measures to detect and reduce the risk of fraud, but these measures may not be effective against new forms of fraud. If these measures do not succeed, our business will suffer.

PayPal offers a buyer protection program that refunds to buyers up to $1,000 in certain eBay transactions if they do not receive the goods they purchased or if the goods differ significantly from what was described by the seller. If PayPal makes such a refund, it seeks to collect reimbursement from the seller, but may not be able to receive any funds from the seller. The PayPal buyer protection program has increased PayPal s loss rate and could cause future fluctuations in PayPal s loss rate.

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 jurisdictions, buyers may also have the right to withdraw from a sale made by a professional seller within a specified time period.

While 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 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.

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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.

Changes to credit card association fees, rules, or practices could harm PayPal s business.

Because PayPal is not a bank, it cannot belong to or directly access credit card associations, such as Visa and MasterCard. As a result, PayPal must rely on banks or payment processors to process transactions, and must pay a fee for this service. From time to time, credit card associations may increase the interchange fees that they charge for each transaction using one of their cards. MasterCard and Visa each implemented increases in their interchange fees for credit cards in April 2005. PayPal s credit card processors have the right to pass any increases in interchange fees 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 association operating rules, and PayPal has agreed to reimburse its processors for any fines they are assessed by credit card associations as a result of any rule violations by PayPal. The credit card associations and their member banks set and interpret the credit card rules. Some of those member banks compete with PayPal. Visa, MasterCard, American Express, or Discover 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 associations 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 Visa s and MasterCard s discretion. PayPal also could be subject to fines from MasterCard and Visa if it fails to detect that merchants are engaging in activities that are illegal or activities 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 MasterCard and Visa 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.

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. Senders funded 53% of PayPal s payment volume using credit cards during both 2005 and the first quarter of 2006, 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 if merchandise is not delivered or is not as described, the ability to earn frequent flier miles or other incentives offered by credit cards, the ability to defer payment, or a reluctance to provide bank account information to PayPal. PayPal has received inquiries regarding its disclosure practices with regard to funding mechanisms from the attorneys general of a number of states, and in March 2005, a complaint seeking class action status was filed alleging, among other things, that PayPal s disclosure regarding the effects of users choice of funding mechanism is deceptive. While we believe PayPal s disclosure is legal and accurate, any required change to our disclosure practices could result in increased use of credit card funding, damaging PayPal s business.

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.

A number of U.S. states have enacted legislation regulating money transmitters. To date, PayPal has obtained licenses in 33 of these jurisdictions and interpretations in nine states that licensing is not required under their existing statutes. 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. In July 2005, PayPal entered into a settlement agreement and agreed to pay $225,000 to the California Department of Financial Institutions in connection with alleged violations of the California Financial Code relating to the use of a receipt form for international payments that had not been pre-approved by the Department, and incomplete reporting to the Department. If PayPal were found to be in violation of other 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.

We believe that the licensing or approval requirements of the U.S. Office of the Comptroller of the Currency, the Federal Reserve Board, and other federal or state agencies that regulate banks, bank holding companies, or other types of providers of e-commerce services do not apply to PayPal, except for certain money transmitter licenses mentioned above. However, PayPal has received written communications in the past from state regulatory authorities expressing the view that its service might constitute an unauthorized banking business. PayPal has taken steps to address these states concerns. However, we cannot guarantee that the steps PayPal has taken to address these regulatory concerns will be effective in all states, and one or more states may conclude that PayPal is engaged in an unauthorized banking business. If PayPal is found to be engaged in an unauthorized banking business in one or more states, it might be subject to monetary penalties and adverse publicity and might be required to cease doing business with residents of those states. Even if the steps it has taken to resolve these states concerns are deemed sufficient by the state regulatory authorities, PayPal could be subject to fines and penalties for its prior activities. The need to comply with state laws prohibiting unauthorized banking activities could also limit PayPal s ability to enhance its services in the future. Any change to PayPal s business practices that makes the service less attractive to customers or prohibits its use by residents of a particular jurisdiction could decrease the velocity of trade on eBay, which would further harm our business.

Although there have been no definitive interpretations to date, PayPal has assumed that its service is subject to the Electronic Fund Transfer Act and Regulation E of the Federal Reserve Board. As a result, among other things, PayPal must provide advance disclosure of changes to its service, follow specified error resolution procedures and absorb losses above $50 from transactions not authorized by the consumer. 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, and PayPal does not have extensive experience in complying with them. 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 1.66 million transactions per day during the first quarter of 2006, and any violations could expose PayPal to significant liability.

PayPal s 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 55 markets, and to receive payments in 42 of those markets. In 25 of these 42 markets, customers can withdraw funds to local bank accounts, and in eight of these markets customers can withdraw funds by receiving a bank draft in the mail.

PayPal offers customers the ability to send or receive payments denominated in U.S. dollars, British pounds, Euros, Canadian dollars, Japanese yen, and Australian dollars. We act in cooperation with a local company in the People s Republic of China, or PRC, which offers PRC residents the ability to send or receive payments denominated in renminbi. 25 of the 55 markets whose residents can use the PayPal service are members of the European Union, and PayPal provides localized versions of its service to customers in the EU through PayPal (Europe) Ltd., a wholly-owned subsidiary of PayPal that is licensed in the United Kingdom to operate as an Electronic Money Institution. PayPal (Europe) implements its localized services in EU countries through an expedited passport notification process through the UK regulator to regulators in other EU member states, pursuant to EU Directives. PayPal (Europe) 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 UK consumer protection law. Any such responses from these regulators could increase the cost of, or delay, PayPal s plans for expanding its business. PayPal (Europe) is subject to significant fines or other enforcement action if it violates the disclosure, reporting, anti-money laundering, capitalization, funds management or other requirements imposed on electronic money institutions.

In many markets outside of the U.S. and the European Union, it is not clear whether PayPal s U.S.-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 and other laws of those countries (such as data protection and anti-money laundering laws) may apply. 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. Alternatively, PayPal could be required to obtain licenses or regulatory approvals that could impose a substantial cost on it and involve considerable delay to the provision or development of its product. 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.

The current regulatory environment for Voice over Internet Protocol (VoIP) is unclear, 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 unclear. Skype s VoIP communications products are not currently subject to all of the same regulations that apply to traditional telephony. VoIP companies are generally subject to different regulatory regimes in different countries, and in some cases are subject to lower regulatory fees and lesser regulatory requirements. Governments may impose increased fees, taxes, and administrative burdens on VoIP companies. Increased fees could include interconnection fees and access charges payable to local exchange carriers to carry and terminate traffic, contributions to the Universal Service Fund in the United States and elsewhere, and other charges. New laws and regulations may require Skype to meet various emergency service requirements, disability access requirements, consumer protection requirements, number assignment and portability requirements, and interception or wiretapping requirements, such as the Communications Assistance for Law Enforcement Act. 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 of the VoIP telephony market and popularity of VoIP telephony products heighten the risk that governments will seek to regulate VoIP telephony and the Internet. 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 are considering legislation to impose their own requirements and taxes on VoIP. Increased regulatory requirements on VoIP would increase Skype s costs, and, as a result, our business would suffer.

Regulatory agencies may require Skype to conform to rules that are unsuitable for VoIP communications technologies, that are difficult or impossible to comply with due to the nature of IP routing, or that are unnecessary or unreasonable in light of the manner in which Skype s products are offered to customers. For example, while suitable alternatives may be developed in the future, the current IP network does not enable Skype to identify the 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. If Skype were subject to regulations that are costly or impossible for it to comply with given its technology, its business would be adversely affected.

In many countries in which Skype operates or provides VoIP products, 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, that Skype or its customers will be able to comply with existing or future requirements, or that Skype or its customers will continue in full compliance with any requirements. 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.

New rules and regulations with respect to VoIP are being considered in various countries around the world. Such new rules and regulations could increase our costs of doing business or prevent us from delivering our products and offerings over the Internet, which could adversely affect Skype s customer base, and thus its revenue.

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 Skype and possibly our other offerings by restricting or prohibiting the use of their lines for our offerings, by filtering, blocking or delaying 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. These activities are technically feasible and may be permitted in the U.S. after recent regulatory changes, including recent decisions by the U.S. Supreme Court and Federal Communications Commission. In addition, Internet service providers could attempt to charge us each time our customers use our offerings, or could charge us for delivery of email to our customers. 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.

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. Today, there are still relatively few laws specifically directed towards online services. However, due to the increasing popularity and use of the Internet and online services, many laws relating to the Internet are being debated at all levels of government around the world and it is possible that such laws and regulations will be adopted. These laws and regulations could cover issues such as user privacy, freedom of expression, pricing, fraud, content and quality of products and services, taxation, advertising, intellectual property rights, and information security. It is not clear how existing laws governing issues such as property ownership, copyrights and other intellectual property issues, taxation, libel and defamation, obscenity, and personal privacy apply to online businesses. The vast majority of these laws were adopted prior to the advent of the Internet and related technologies and, as a result, do not contemplate or address the unique issues of the Internet and related technologies. Those laws that do reference the Internet, such as the U.S. Digital Millennium Copyright Act and the European Union s Directive on Distance Selling and Electronic Commerce have begun to be interpreted by the courts and implemented by the EU Member States, but their applicability and scope remain somewhat uncertain. As our activities and the types of goods listed on our website expand, 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 in order to allow the sale of certain items, such as real estate, event tickets, cultural goods, boats, and automobiles.

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. No final legal determination has been made as to whether the California regulations apply to our business (or that of our users) and little precedent exists in this area. Several states and some foreign jurisdictions 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 2002, Illinois amended its auction law to provide for a special regulatory regime for Internet auction listing services, and we have registered as an Internet auction listing service in Illinois. Although this registration has not had a negative impact on our business to date, other regulatory and licensure claims could result in costly litigation or could require us to change the way we or our users do business in ways that increase costs or reduce revenues or force 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.

In addition, because our services are accessible worldwide, and we facilitate sales of goods to users worldwide, foreign jurisdictions may claim that we are required to comply with their laws. For example, the Australian high court has ruled that a U.S. website in certain circumstances must comply with Australian laws regarding libel. As we expand and localize our international activities, we become obligated to comply with the laws of the countries in which we operate. Laws regulating Internet companies outside of the U.S. may be less favorable than those in the U.S., giving greater rights to consumers, content owners, and users. Compliance may be more costly or may require us to change our business practices or restrict our service offerings relative to those in the U.S. Our failure to comply with foreign laws could subject us to penalties ranging from criminal prosecution to bans on our services.

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 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. In addition, a party who is able to circumvent our security measures could misappropriate proprietary information, or cause interruptions in our operations, damage our computers or those of our users, or otherwise damage our reputation and business.

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 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 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. We actively pursue the parties responsible for these attempts at misappropriation, and we have developed tools to detect, and help users detect, fake websites and unauthorized access to customer accounts and we encourage our users to divulge sensitive information only after they have verified that they are on our legitimate websites, but we cannot entirely eliminate these types of activities.

Some businesses and security consultants have expressed concern over the potential for Skype s software to create security vulnerabilities on its users computers. While we believe Skype s software is safe and does not pose a security risk to its users, the perception that Skype s software is unsafe could hamper its adoption, and any actual security breach could damage Skype s reputation and expose us to a risk of loss or litigation and possible liability.

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

Our failure to manage growth could harm our business.

We are currently expanding our headcount, facilities, and infrastructure in the U.S. and internationally. We 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:

Our Websites. We must constantly add new hardware, update software and add new engineering personnel to accommodate the increased use of our and our subsidiaries websites and the new products and features we 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 developed or purchased technologies or businesses with our existing systems, and any failure to do so could result in problems on our sites. For example, in October 2004, we experienced unscheduled downtime on the PayPal website over a period of five days related to system upgrades. Despite our efforts to increase site scalability and reliability, our infrastructure could prove unable to handle a larger volume of customer transactions. Some of our more recently acquired businesses may be particularly subject to this risk given their shorter histories and, in some cases, higher growth rates. Any failure to accommodate transaction growth could impair customer satisfaction, lead to a loss of customers, impair our ability to add customers, or increase our costs, all of which would harm our business. 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. In 2004, we completed a significant project to enhance our billing software. Problems with the conversion to the new billing system during the second and third quarters of 2004 caused incorrect account balance totals to be displayed for some users. While these problems have been corrected and we believe that no users were overcharged, 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 trust and safety activity we provide worldwide. If we are unable to provide these operations in a cost-effective manner, users of our websites may have negative experiences, current and future revenues could suffer, and our operating margins may decrease.

We must continue to hire, train, and manage new employees at a rapid rate. 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 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.

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

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.

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. 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.

The success of Skype depends on continued growth in its number of users, which in turn depends on wider public acceptance of VoIP. The VoIP communications medium is in its early stages, and it may not develop a broad audience. Potential new users may view VoIP as unattractive relative to traditional telephone services for a number of reasons, including the need to purchase computer headsets, the need to leave a personal computer on in order to communicate with Skype, or the perception that the price advantage for VoIP is insufficient to justify the perceived inconvenience. Potential users may also view more familiar online communication methods, such as e-mail or instant messaging, as sufficient for their communications needs. Managers of some large private branch exchange, or PBX, systems in businesses, universities, government agencies, and other institutions may refuse to allow the use of Skype due to concerns over security, server usage, or for other reasons. If VoIP does not achieve wide public acceptance, our Skype business will be adversely affected.

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 currently unsettled in the United States and internationally. We are aware that certain goods, such as weapons, adult material, tobacco products, alcohol, and other goods that may be subject to regulation, have been listed and traded on our service. We may be unable to prevent our users from selling unlawful goods or selling goods 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 service. We have been subject to several lawsuits based upon such allegations. In December 2004, an executive of Baazee.com, our Indian subsidiary, was arrested in connection with a user s listing of a pornographic video clip on that site. Similarly, our Korean subsidiary and one of its employees were found criminally liable for listings on the Korean subsidiary s website. In order to reduce our exposure to this liability, we have prohibited the listing of certain items and increased the number of personnel reviewing questionable items. In the future, we may implement other protective measures that could require us to spend substantial resources or discontinue certain service offerings. Any costs incurred as a result of potential liability relating to the sale of unlawful goods or the unlawful sale of goods could harm our business. In addition, we have received significant and continuing media attention relating to the listing or sale of unlawful goods using our services. This negative publicity could damage our reputation and diminish the value of our brand names. It also could make users reluctant to continue 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. PayPal s acceptable use policy enables PayPal to fine users in certain jurisdictions up to $500 or take legal action to recover its losses for certain violations of that policy, including online gambling and illegal sales of prescription medications. Despite measures PayPal has taken to detect and lessen the risk of this kind of conduct, illegal activities could still be funded using PayPal.

PayPal is subject to anti-money laundering 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 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 could apply. 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 associations, could raise PayPal s costs significantly and reduce the attractiveness of its product. Failure to comply with federal, state or foreign country money laundering laws could result in significant criminal and civil lawsuits, penalties, and forfeiture of significant assets.

We are subject to intellectual property and other litigation.

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 in the regional court of Cologne, Germany. The suit subsequently was transferred to the regional court in Düsseldorf, Germany. Rolex alleged that our subsidiaries were infringing Rolex s trademarks as a result of users selling counterfeit Rolex watches through our German website. The suit also alleged unfair competition. Rolex sought an order enjoining the sale of Rolex-branded watches on the website as well as damages. In December 2002, a trial was held in the matter and the court ruled in favor of eBay on all causes of action. Rolex appealed the ruling to the Higher Regional Court of Düsseldorf, and the appeal was heard in October 2003. In February 2004, the court rejected Rolex s appeal and ruled in our favor. Rolex has appealed the ruling to the German Federal Supreme Court, and a hearing is expected in December 2006. In September 2004, the German Federal Supreme Court issued its written opinion in favor of Rolex in a case involving an unrelated company, ricardo.de AG, but somewhat comparable legal theories. Although it is not yet clear what the ultimate effect of the reasoning of the German Federal Supreme Court s ricardo.de decision will have when applied to eBay, we believe the Court s decision has resulted in an increase in similar litigation against us in Germany, although we do not currently believe that it will require a significant change in our business practices.

In September 2001, MercExchange LLC filed a complaint against us, our Half.com subsidiary and ReturnBuy, Inc. in the U.S. District Court for the Eastern District of Virginia (No. 2:01-CV-736) alleging infringement of three patents (relating to online consignment auction technology, multiple database searching and electronic consignment systems) and seeking a permanent injunction and damages (including treble damages for willful infringement). In October 2002, the court granted in part our summary judgment motion, effectively invalidating the patent related to online auction technology and rendering it unenforceable. This ruling left only two patents in the case. Trial of the matter began in April 2003. In May 2003, the jury returned a verdict finding that eBay had willfully infringed one and Half.com had willfully infringed both of the patents in the suit, awarding $35 million in compensatory damages. Both parties filed post-trial motions, and in August 2003, the court entered judgment for MercExchange in the amount of approximately $30 million plus pre-judgment interest and post-judgment interest in an amount to be determined, while denying MercExchange s request for an injunction and attorneys fees. We appealed the verdict and judgment in favor of MercExchange and MercExchange filed a cross-appeal of the granting in part of our summary judgment motion and the denial of its request for an injunction and attorneys fees.

In March 2005, the U.S. Court of Appeals for the Federal Circuit issued a ruling in the appeal of the MercExchange patent litigation suit which, among other things (1) invalidated all claims asserted against eBay and Half.com arising out of the multiple database search patent and reduced the verdict amount by $4.5 million; (2) upheld the electronic consignment system patent; (3) affirmed the district court s refusal to award attorneys fees or enhanced damages against us; (4) reversed the district court s order granting summary judgment in our favor regarding the auction patent; and (5) reversed the district court s refusal to grant an injunction and remanded that issue to the district court for further proceedings. In May 2005, the Court of Appeals for the Federal Circuit granted our petition to stay the mandate in the case in order to allow us to petition the U.S. Supreme Court for review on certain issues. We filed our petition for review with the U.S. Supreme Court in July 2005, and in November 2005, the Court granted our petition for review. Oral arguments in the case were heard by the Court in March 2006, and the Court s decision is expected in the second quarter of 2006. In parallel with the federal court proceedings, at our request, the U.S. Patent and Trademark Office is actively reexamining each of the patents in suit, having found that substantial questions exist regarding the validity of the claims contained in them. In January 2005, the Patent and Trademark Office issued an initial ruling rejecting all of the claims contained in the patent that related to online auctions; in March 2005, the Patent and Trademark Office issued an initial ruling rejecting all of the claims contained in the patent that related to electronic consignment systems; and in May 2005, the Patent and Trademark Office issued an initial ruling rejecting all of the claims contained in the patent that related to multiple database searching. In March 2006, the Patent and Trademark Office affirmed its earlier ruling rejecting the claims contained in the patent that related to electronic consignment systems. Even if successful, our litigation of these matters will continue to be costly. In addition, as a precautionary measure, we have modified certain

functionality of our websites and business practices in a manner which we believe would avoid any further infringement. For this reason, we believe that any injunction that might be issued by the district court will not have any impact on our business. We also believe we have appropriate reserves for this litigation. Nonetheless, if we are not successful in appealing or modifying the court s ruling, and if the modifications to the functionality of our websites and business practices are not sufficient to make them non-infringing, we would likely be forced to pay significant additional damages and licensing fees and/or modify our business practices in an adverse manner.

In August 2002, Charles E. Hill & Associates, Inc. filed a lawsuit in the U.S. District Court for the Eastern District of Texas (No. 2:02-CV-186) alleging that we and 17 other companies, primarily large retailers, infringed three patents owned by Hill generally relating to electronic catalog systems and methods for transmitting and updating data at a remote computer. The suit seeks an injunction against continuing infringement, unspecified damages, including treble damages for willful infringement, and interest, costs, expenses, and fees. The case was transferred to the U.S. District Court for the Southern District of Indiana in January 2003, but was transferred back to the U.S. District Court for the Eastern District of Texas in December 2003. A claim construction hearing was held in August 2005. In February 2006, we entered into and paid for a settlement agreement with the plaintiffs in the case under which we will be licensed under all of the patents at issue.

In February 2002, PayPal was sued in California state court (No. CV-805433) in a purported class action alleging that its limiting access to customer accounts and failure to promptly restore access to legitimate accounts violates California state consumer protection laws and is an unfair business practice and a breach of PayPal s User Agreement. This action was re-filed with a different named plaintiff in June 2002 (No. CV-808441), and a similar action was also filed in the U.S. District Court for the Northern District of California in June 2002 (No. C-02-2777). In March 2002, PayPal was sued in the U.S. District Court for the Northern District of California (No. C-02-1227) in a purported class action alleging that its limiting access to customer accounts and failure to promptly restore access to legitimate accounts violates federal and state consumer protection and unfair business practice laws. The two federal court actions were consolidated into a single case, and the state court action was stayed pending developments in the federal case. In June 2004, the parties announced that they had reached a proposed settlement. The settlement received approval from the federal court on November 2, 2004, and the state court action was dismissed with prejudice in March 2005. In the settlement, PayPal does not acknowledge that any of the allegations in the case are true. Under the terms of the settlement, certain PayPal account holders are eligible to receive payment from a settlement fund of $9.25 million, less administrative costs and the amount awarded to plaintiffs counsel by the court. That sum is being distributed to class members who have submitted timely claims in accordance with the settlement s plan of allocation. The plan of allocation for the portion of the settlement fund that remains undistributed was approved by the District Court in March 2006. Substantially all of the cost associated with the settlement was reserved in 2003.

In July 2004, a purported class action lawsuit was filed by two eBay users in Superior Court of the State of California, County of Santa Clara (No. 104CV022708) alleging that eBay engaged in improper billing practices as the result of problems with the rollout of a new billing software system in the second and third quarters of 2004. The lawsuit sought damages and injunctive relief. An amended complaint was filed in January 2005, dropping one plaintiff, changing the capacity of the other plaintiff to that of representative plaintiff, and adding seven additional eBay users as plaintiffs. The amended complaint expanded its claim to include numerous alleged improper billing practices from September 2003 until the present. In February 2005, eBay filed a motion to strike and a demurrer seeking to dismiss the complaint. In April 2005, the court sustained portions of the demurrer, but granted the plaintiffs leave to amend their complaint. The plaintiffs filed a second amended complaint, dropping the last original plaintiff and again adding new plaintiffs. We filed a motion to strike and a demurrer regarding the plaintiffs second amended complaint. In July 2005, the court again sustained a portion of the demurrer and again granted the plaintiffs leave to amend their complaint, and the plaintiffs filed a third amended complaint. In December 2005, the plaintiffs filed a fourth amended complaint, dropping several plaintiffs. In April 2006, the court approved a settlement agreement entered into by the parties. Under the terms of the settlement, the plaintiffs agreed to dismiss the lawsuit and release eBay

from all claims, and eBay agreed to make a $250,000 payment primarily directed to charity. The estimated settlement was accrued in our consolidated income statement for the three months ended March 31, 2006.

In February 2005, eBay was sued in Superior Court of the State of California, County of Santa Clara (No. 105CV035930) in a purported class action alleging that certain bidding features of our site constitute shill bidding for the purpose of artificially inflating bids placed by buyers on the site. The complaint alleges violations of California s Auction Act, California s Consumer Remedies Act, and unfair competition. The complaint seeks injunctive relief, damages, and a constructive trust. In April 2005, we filed a demurrer seeking to dismiss the complaint, and a hearing on the demurrer was held in February 2006. In March 2006, the parties reached tentative agreement on the terms of a settlement. The court must approve the terms of the settlement in order for it to become final. The estimated settlement was accrued in our consolidated income statement for the year ended December 31, 2005.

In March 2005, eBay, PayPal, and an eBay seller were sued in Supreme Court of the State of New York, County of Kings (No. 6125/05) in a purported class action alleging that certain disclosures regarding PayPal s Buyer Protection Policy, users chargeback rights, and the effects of users choice of funding mechanism are deceptive and/or misleading. The complaint alleged misrepresentation on the part of eBay and PayPal, breach of contract and deceptive trade practices by PayPal, and that PayPal and eBay have jointly violated the civil RICO statute (18 U.S.C. Section 1961(4)). In April 2005, eBay and PayPal removed the case to the U.S. District Court for the Eastern District of New York and the plaintiffs filed an amended complaint in the U.S. District Court (No. 05-CV-01720) repeating the allegations of the initial complaint but dropping the civil RICO allegations. The complaint seeks injunctive relief, compensatory damages, and punitive damages. Following several mediation sessions, the parties reached a tentative settlement in December 2005 and executed a Memorandum of Understanding in March 2006. The parties are engaged in the process of finalizing the settlement documentation. The court must approve the terms of the settlement in order for it to become final. The estimated settlement was accrued in our consolidated income statement for the year ended December 31, 2005.

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 have been notified of several 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 to face additional patent infringement claims involving services we provide, including various aspects of our 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 expand geographically into jurisdictions where the underlying laws with respect to the potential liability of online intermediaries like ourselves are either unclear or less favorable. These claims, whether meritorious or not, could be time consuming and costly to resolve, cause service upgrade delays, require expensive changes in our methods of doing business, or could require us to enter into costly royalty or licensing agreements.

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.

Government inquiries may lead to charges or penalties.

A large number of transactions occur on our websites. We believe that government regulators have received a substantial number of consumer complaints about both eBay and PayPal, which, while small as a percentage of our total transactions, are large in aggregate numbers. As a result, we have from time to time been contacted by various foreign 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 these and other business practices from the attorneys general of a number of states. If PayPal s processes are found to violate federal or state law on consumer protection and unfair business practices, it could be subject to an enforcement action or fines. If PayPal becomes subject to an enforcement action, it could be required to restructure its business processes in ways that would harm its business, and to pay substantial fines. Even if PayPal is able to defend itself successfully, an enforcement action could cause damage to its reputation, could consume substantial amounts of its management s time and attention, and could require PayPal to change its customer service and operations in ways that could increase its costs and decrease the effectiveness of its anti-fraud program. Both eBay and PayPal are likely to receive additional inquiries from regulatory agencies in the future, which may lead to action against either company. 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 fines or other penalties, or forced to change our operating practices in ways that could harm our business.

We are subject to laws relating to the use and transfer of personally identifiable information about our users, especially for financial information and for users located outside of the U.S. New laws in this area have been passed by several jurisdictions, and other jurisdictions are considering imposing additional restrictions. Violation of these laws, which in many cases 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 relations, could subject us to significant penalties and negative publicity and could adversely affect us.

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 defending their rights against online companies, including eBay. Allegations of infringement of intellectual property rights have resulted in litigation against us from time to time, including litigation brought by Tiffany & Co. and Robespierre, Inc. (doing business as Nanette Lepore) in the U.S., Rolex S.A. in Germany, and a number of other owners of intellectual property rights. In both the Tiffany and Nanette Lepore cases, the plaintiffs seek to hold eBay liable for counterfeit items listed on our sites by third parties. Tiffany seeks, among other things, an injunction that would require eBay to prevent sellers from listing 5 or more Tiffany items, as well as damages. Nanette Lepore seeks, among other things, to require eBay to block all listings offering Nanette Lepore items, as well as damages. eBay anticipates that a trial in the Tiffany case will be scheduled before the end of 2006. Recently, eBay successfully prevented Nanette Lepore from obtaining a preliminary injunction. In the ruling, the court found that eBay s process for addressing the listing of counterfeit items by third parties on its site was both reasonable and adequate. While we have been largely successful to date 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 our defense. In addition, a public perception that counterfeit or pirated items are commonplace on our site could damage our reputation and our business. Litigation and negative publicity may increase as our sites 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 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.

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

The law relating to the liability of online services companies for information carried on or disseminated through their services is currently unsettled. Claims could be made against online services companies under both U.S. and foreign law for defamation, libel, invasion of privacy, negligence, copyright or trademark infringement, or other theories based on the nature and content of the materials disseminated through their services. Several private lawsuits seeking to impose liability upon us under a number of these theories have been brought against us. In addition, 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 recent court decisions have narrowed the scope of the immunity provided to Internet service providers like us under the Communications Decency Act. This trend, if continued, may increase our potential liability to third parties for the user-provided content on our site. 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.

Customer complaints or negative publicity about our customer service could diminish use of our services.

Customer complaints or negative publicity about our customer service 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 can damage relations with our customers. These measures heighten the need for prompt and accurate customer service to resolve irregularities and disputes. Effective customer service requires significant personnel expense, and this expense, if not managed properly, could significantly impact our profitability. Failure to manage or train our customer service representatives properly could compromise our ability to handle customer complaints effectively. If we do not handle customer complaints effectively, our reputation may suffer and we may lose our customers confidence.

Because it is providing a financial service and operating in a more regulated environment, PayPal, unlike eBay, must provide telephone as well as email customer service and must resolve certain customer contacts within shorter time frames. As part of PayPal s program to reduce fraud losses, it may temporarily restrict the ability of customers to withdraw their funds if those funds or the customer s account activity are identified by PayPal s anti-fraud models as suspicious. PayPal has in the past received negative publicity with respect to its customer service 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. Current and future revenues could suffer, or its operating margins may decrease. In addition, negative publicity about or experiences with PayPal s customer support could cause eBay s reputation to suffer or affect consumer confidence in the eBay brands as a whole.

Problems with 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, and caching services that make our sites load faster, 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. In either circumstance, 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 on our websites more difficult, and thereby harm our business. Any security breach at one of these companies could also affect our customers

and harm our business. Although we generally have been able to renew or extend the terms of contractual arrangements with these third party service providers on acceptable terms, there can be no assurance that we will continue to be able to do so in the future.

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. The loss of the services of any of our executive officers or other key employees could harm our business. We do not have long-term employment agreements with any of our key personnel, we do not maintain any key person life insurance policies, and our Chief Executive Officer and many other members of our senior management team have fully vested the vast majority of their equity incentives. 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 stock options they are to receive in connection with their employment. Fluctuations in our stock price may make it more difficult to retain and motivate employees whose stock option strike prices are substantially above current market prices. Similarly, decreases in the number of unvested stock options held by existing employees, either because their options have vested or because the size of follow-on option grants has declined, may make it more difficult to retain and motivate employees.

Skype s future success depends substantially upon the continued services of its senior management and key personnel, and the loss of their services could harm our business. Several key members of Skype s engineering team are consultants, not full time employees, who provide services to us and third parties. Many of Skype s employees had equity in Skype prior to its acquisition by eBay. Skype equity holders were given the option of receiving their portion of the acquisition consideration in the form of a lump-sum up-front payment or receiving a lower up-front payment in exchange for the possibility of receiving additional consideration in the form of potential earn-out payments tied to the achievement of certain performance targets prior to June 30, 2009. Several key members of Skype s senior management and key employees chose to receive less up-front consideration in exchange for the possibility of receiving the performance-based earn-out payments. Although eligible Skype employees have also been granted eBay stock options, the earn-out payments are not tied to continued employment with Skype or eBay, and key Skype employees may choose to depart because of differences in corporate culture, because they believe the earn-out targets will be achieved without their contributions, or because they believe the earn-out targets are not achievable. The loss of the services of any of Skype s senior management or key personnel could delay the development and introduction of new features and products, and could harm our ability to grow Skype s business.

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

Marketplaces

eBay s 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 can easily launch online sites at a nominal cost using commercially available software or partnering with any one of a number of successful e-commerce 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. These include most prominently: 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 have launched a variety of services that provide new channels for buyers to find and buy items from sellers of all sizes. We recently acquired Shopping.com Ltd., an online shopping comparison site. Shopping.com competes with sites such as Buy.com, Google s Froogle, In-Store.com, MySimon.com, Nextag.com, Pricegrabber.com, Shopzilla, and Yahoo! Product Search, which offer shopping search engines that allow consumers to search the Internet for specified products. Similarly, 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 site. For example, category-specific competitors to offerings in our Business & Industrial category include Alibaba, Ariba, Bid4Assets, BidFreight.com, Buyer Zone, Commerce One, DotMed, DoveBid, Go Industry, Grainger, IronPlanet, labx.com, Liquidation.com, Machinetools.com, Oracle, Partsforindustry.com, PurchasePro.com, Ritchie Brothers Auctioneers, Testmart, Tractor Supply Company, and VerticalNet. In addition, many competitors have been successful at establishing online marketplaces that cater to a particular retail category, such as vehicles, tickets, or sporting goods.

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 e-commerce sites, such as Quelle and Otto in Germany, Yahoo-Kimo in Taiwan, Daum and Gmarket in South Korea, TaoBao and 1pai, a partnership between Sina.com and Yahoo! in China, and Amazon in the U.K. and other countries. In some of these countries, there are online sites that have much larger customer bases and greater brand recognition than we do, and in 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 eBay Marketplaces include the following:

- ability to attract 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;
- system reliability;
- reliability of delivery and payment;
- website convenience and accessibility;
- level of service fees; and
- quality of search tools.

Some current and potential competitors have longer 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 larger, well-established and well-financed companies. As a result, some of our competitors with other revenue sources may be able to devote more resources to marketing and promotional campaigns, adopt more aggressive pricing policies and devote substantially more resources to website and systems development than we can. 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

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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-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, we have implemented a buyer protection program that generally insures items up to a value of $200, with a $25 deductible, for users with a non-negative feedback rating at no cost to the user. PayPal has implemented a similar buyer protection program covering losses from selected eBay sellers up to $1,000, with no deductible. Depending on the amount and size of claims we receive under these programs, these product offerings could harm our 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 users to match. New technologies may increase the competitive pressures by enabling our competitors to offer a lower cost service.

Although we have established Internet traffic arrangements with several large online services and search engine companies, these arrangements may not be renewed on commercially reasonable terms 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.

PayPal

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

- credit card merchant processors that offer their services to online merchants, including Cardservice International, Chase Paymentech, First Data, iPayment and Wells Fargo; and payment gateways, including CyberSource and Authorize.net;

- Money remitters such as MoneyGram and Western Union, a subsidiary of First Data;

- Bill payment services, including CheckFree;

- processors that provide online merchants the ability to offer their customers the option of paying for purchases from their bank account, including Certegy, PayByTouch and TeleCheck, a subsidiary of First Data, or to pay on credit, including Bill Me Later;

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

- issuers of stored value targeted at online payments, including VisaBuxx, NetSpend and Next Estate.

In addition, Google has stated it is developing a new payment service.

Some of these competitors have longer operating histories, significantly greater financial, technical, marketing, customer service and other resources, greater name recognition, or a larger base of customers in affiliated businesses than PayPal. PayPal s competitors may respond to new or emerging technologies and changes in customer requirements faster and more effectively than PayPal. They may devote greater resources to the development, promotion, and sale of products and services than PayPal, and they may offer lower prices. PayPal may be forced to lower its prices in response. Competing services tied to established banks and other financial institutions may offer greater liquidity and engender greater consumer confidence in the safety and efficacy of their services than PayPal.

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, and Royal Bank of Scotland s World Pay and Webpay International s Click & Buy in the European Community, NOCHEX, Moneybookers, NETeller and FirePay in the U.K., CertaPay and HyperWallet in Canada, Paymate in Australia, Alipay 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.

Skype

The market for Skype s products is also emerging, intensely competitive, and characterized by rapid technological change. Many traditional telecommunications carriers and cable providers offer, or have indicated that they plan to offer, VoIP products or services that compete with the software Skype provides. In addition, many Internet companies, including AOL, Google, Microsoft, and Yahoo! offer, or have indicated that they plan to offer in the near future, VoIP products that are similar to Skype s. We expect VoIP competitors 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. For example, Skype s competitors may integrate more traditional methods of online communication that do not involve VoIP technology, such as instant messaging, with content and functionality that Skype does not have, or that is superior to Skype s, 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. In addition, some of Skype s competitors, such as telecommunications carriers and cable television providers, may be able to bundle services and products that Skype does not offer. These could include various forms of wireless communications, voice and data services, Internet access, and cable television. This form of bundling would put Skype at a competitive disadvantage if these providers can combine a variety of service offerings at a single attractive price. Furthermore, competitors may choose to make their services interoperable with one another, rather than proprietary, which could increase the attractiveness of their services relative to Skype and decrease the value of Skype s network of users.

Many 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. As a result of their greater resources, many current and potential competitors may be able to lower their prices substantially, thereby eroding some or all of Skype s cost advantage.

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 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 combination of trademark, copyright, patent, trade dress and trade secret laws, and through the domain name dispute resolution system. We also rely on contractual restrictions to protect our proprietary rights in products and services. We have entered into confidentiality and invention assignment agreements with our employees and contractors, and 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 this opposition to Skype s application were to be successful, Skype might be forced to apply for trademark registration in each individual EU country, resulting in increased expenditures and damage to its business if its application were rejected in individual countries. 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.

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

None

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

Not applicable.

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

None.

Item 5: ***Other Information***

Audit Committee Pre-Approvals of Non-Audit Engagements

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, diligence or other permitted services not related to the services 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 March 31, 2006, our Audit Committee approved the non-audit engagement of PwC to perform due diligence services related to certain potential acquisitions.

Item 6: ***Exhibits***

Exhibit 10.01	2003 Deferred Stock Unit Plan, as amended+*
Exhibit 10.02	Form of 2003 Deferred Stock Unit Plan Electing Director Award Agreement, as amended+*
Exhibit 10.03	Form of 2003 Deferred Stock Unit Plan New Director Award Agreement as amended+*
Exhibit 10.04	Summary of Compensation Payable to Named Executive Officers+*
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.

\+ Indicates a management contract or compensatory plan or arrangement.

* Previously filed with the company s Quarterly Report on Form 10-Q filed on April 25, 2006.

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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/ Margaret C. Whitman

Margaret C. Whitman
President and Chief Executive Officer

Date: April 25, 2006

Principal Financial Officer:
By: /s/ Robert H. Swan

Robert H. Swan
Senior Vice President and Chief Financial Officer

Date: April 25, 2006

Principal Accounting Officer:
By: /s/ Douglas Jeffries

Douglas Jeffries
Vice President, Chief Accounting Officer

Date: April 25, 2006

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