

YAHOO!

1996 Annual Report

Selected Financial Data

Year Ended December 31,

Statements of Operations Data:	1996	1995*
Net revenues	\$19,073,000	\$1,363,000
Gross profit	15,997,000	1,180,000
Sales and marketing expenses	13,825,000	738,000
Product development expenses	4,461,000	242,000
General and administrative expenses	4,516,000	880,000
Net loss	(2,334,000)	(634,000)
Net loss per share	\$(0.09)	\$(0.03)
Shares used in computing net loss per share	25,444,000	22,541,000
Balance Sheets Data:		
Cash, cash equivalents, and short and long-term investments	\$102,302,000	\$5,297,000
Working capital	89,885,000	5,264,000
Total assets	110,255,000	6,298,000
Shareholders' equity	\$102,075,000	\$5,450,000

* Period comprised of only ten months from March 5, 1995 (inception) through December 31, 1995.

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Financial Information by Quarter

(Unaudited)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
1996				
Net revenues	\$1,733,000	\$3,274,000	\$5,515,000	\$8,551,000
Gross profit	1,566,000	2,754,000	4,477,000	7,200,000
Net income (loss)	81,000	(1,366,000)	(1,145,000)	96,000
Net income (loss) per share	\$0.00	\$(0.05)	\$(0.04)	\$0.00
1995				
Net revenues	—	—	\$288,000	\$1,075,000
Gross profit	—	(26,000)	243,000	963,000
Net income (loss)	—	(355,000)	(371,000)	92,000
Net income (loss) per share	—	\$(0.02)	\$(0.02)	\$0.01

The second quarter of 1995 includes the Company's results for the period from March 5, 1995 (inception) through June 30, 1995.

Consolidated Balance Sheets

December 31,

Assets	1996	1995
Current assets:		
Cash and cash equivalents	\$31,865,000	\$5,297,000
Short-term investments in marketable securities	60,689,000	—
Accounts receivable, net of allowance of \$600,000 and \$82,000	4,648,000	815,000
Prepaid expenses	<u>353,000</u>	—
Total current assets	97,555,000	6,112,000
Long-term investments in marketable securities	9,748,000	—
Property and equipment, net	2,223,000	186,000
Investment in unconsolidated joint venture	<u>729,000</u>	—
	<u>\$110,255,000</u>	<u>\$ 6,298,000</u>
Liabilities And Shareholders' Equity		
Current liabilities:		
Accounts payable	\$992,000	\$20,000
Accrued expenses and other current liabilities	4,367,000	520,000
Deferred revenue	1,229,000	174,000
Due to related parties	<u>1,082,000</u>	<u>134,000</u>
Total current liabilities	7,670,000	848,000
Commitments and contingencies (Note 7)		
Minority interests in consolidated subsidiaries	510,000	—
Shareholders' equity:		
Convertible Preferred Stock, \$0.001 par value; none and 7,750,072 shares authorized; none and 7,738,072 issued and outstanding	—	8,000
Preferred Stock, \$0.001 par value; 10,000,000 and no shares authorized; none issued and outstanding	—	—
Common Stock, \$0.001 par value; 150,000,000 and 50,000,000 shares authorized; 26,577,175 and 10,252,726 issued and outstanding	17,000	—
Additional paid-in capital	105,026,000	6,076,000
Accumulated deficit	<u>(2,968,000)</u>	<u>(634,000)</u>
Total shareholders' equity	<u>102,075,000</u>	<u>5,450,000</u>
	<u>\$110,255,000</u>	<u>\$ 6,298,000</u>

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

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Consolidated Statements of Operations

	Year Ended December 31,	March 5, 1995 (Inception) to December 31,
	1996	1995
Net revenues	\$19,073,000	\$1,363,000
Cost of revenues	<u>3,076,000</u>	<u>183,000</u>
Gross profit	<u>15,997,000</u>	<u>1,180,000</u>
Operating expenses:		
Sales and marketing	13,825,000	738,000
Product development	4,461,000	242,000
General and administrative	<u>4,516,000</u>	<u>880,000</u>
Total operating expenses	<u>22,802,000</u>	<u>1,860,000</u>
Loss from operations	(6,805,000)	(680,000)
Investment income, net	3,931,000	46,000
Minority interests in losses from operations of consolidated subsidiaries	<u>540,000</u>	<u>—</u>
Loss before income taxes	(2,334,000)	(634,000)
Provision for income taxes	—	—
Net loss	<u>\$(2,334,000)</u>	<u>\$(634,000)</u>
Net loss per share	<u>(\$0.09)</u>	<u>(\$0.03)</u>
Weighted average common shares and equivalents	25,444,000	22,541,000

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

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Consolidated Statements of Shareholders' Equity

	Convertible Preferred Stock		Common Stock		Additional Paid-In Capital	Accumulated Deficit	Total
	Shares	Amount	Shares	Amount			
Issuance of Common Stock in connection with the formation of the Company	—	\$—	10,000,000	\$—	\$—	\$—	\$—
Issuance of Series A Convertible Preferred Stock at \$0.20 per share	5,200,000	5,000	—	—	1,018,000	—	1,023,000
Issuance of Common Stock	—	—	63,326	—	1,000	—	1,000
Issuance of options to consultants in exchange for services	—	—	—	—	75,000	—	75,000
Issuance of Series B Convertible Preferred Stock at \$1.97 per share	2,538,072	3,000	—	—	4,978,000	—	4,981,000
Issuance of Common Stock pursuant to exercise of options	—	—	189,400	—	4,000	—	4,000
Net loss	—	—	—	—	—	(634,000)	(634,000)
Balance at December 31, 1995	7,738,072	8,000	10,252,726	—	6,076,000	(634,000)	5,450,000
Issuance of Mandatorily Redeemable Convertible Series C Preferred Stock at \$12.50 per share	5,100,000	5,000	—	—	63,745,000	—	63,750,000
Issuance of Common Stock, net of issuance costs of \$1,192,000	—	—	2,990,000	3,000	35,040,000	—	35,043,000
Conversion Convertible Preferred Stock to Common Stock	(12,838,072)	(13,000)	12,838,072	13,000	—	—	—
Issuance of Common Stock pursuant to exercise of options	—	—	496,377	1,000	9,000	—	10,000
Compensation expense on option grants	—	—	—	—	156,000	—	156,000
Net loss	—	—	—	—	—	(2,334,000)	(2,334,000)
Balance at December 31, 1996	—	\$—	26,577,175	\$17,000	\$105,026,000	\$(2,968,000)	\$102,075,000

Consolidated Statements of Cash Flows

	Year Ended December 31,	March 5, 1995 (Inception) to December 31,
	1996	1995
Cash Flows From Operating Activities:		
Net loss	\$(2,334,000)	\$(634,000)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation	390,000	133,000
Compensation expense on stock option grants	156,000	—
Minority interests in losses from operations of consolidated subsidiaries	(540,000)	—
Changes in assets and liabilities:		
Accounts receivable, net	(3,833,000)	(815,000)
Prepaid expenses	(353,000)	—
Accounts payable	972,000	20,000
Accrued expenses and other current liabilities	3,975,000	392,000
Deferred revenue	1,055,000	174,000
Due to related parties	<u>948,000</u>	<u>134,000</u>
Net cash provided by (used in) operating activities	<u>436,000</u>	<u>(596,000)</u>
Cash Flows From Investing Activities:		
Acquisition of property and equipment	(2,427,000)	(107,000)
Purchases of investments in marketable securities	(113,285,000)	—
Proceeds from sales and maturities of investments in marketable securities	42,848,000	—
Investment in unconsolidated joint venture	<u>(729,000)</u>	<u>—</u>
Net cash used by investing activities	<u>(73,593,000)</u>	<u>(107,000)</u>
Cash Flows From Financing Activities:		
Proceeds from issuance of Common Stock, net	35,053,000	5,000
Proceeds from issuance of Convertible Preferred Stock	63,750,000	6,004,000
Proceeds from minority investors	1,050,000	—
Repayment of lease obligations	<u>(128,000)</u>	<u>(9,000)</u>
Net cash provided by financing activities	<u>99,725,000</u>	<u>6,000,000</u>
Net change in cash and cash equivalents	26,568,000	5,297,000
Cash and cash equivalents at beginning of period	<u>5,297,000</u>	<u>—</u>
Cash and cash equivalents at end of period	<u>\$31,865,000</u>	<u>\$5,297,000</u>
Supplemental Disclosures of Cash Flow Information:		
Cash paid for interest	\$ —	<u>\$ 4,000</u>
Supplemental Schedule of Noncash Transactions:		
Acquisition of property and equipment through capital leases	\$ —	<u>\$137,000</u>

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

Notes to Consolidated Financial Statements

Note 1. The Company and Summary of Significant Accounting Policies

The Company. Yahoo! Inc. (the "Company") develops and maintains Yahoo!, a branded Internet navigational service that is among the most widely used guides for information and discovery on the World Wide Web. The Company was incorporated in California on March 5, 1995 and commenced operations on that date. The Company conducts its business within one industry segment.

Principles of Consolidation. The consolidated financial statements include the accounts of Yahoo! Inc. and its majority-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated. The equity and loss from operations attributable to the minority shareholder interests which related to the Company's foreign and domestic subsidiaries, are shown separately in the balance sheets and statements of operations, respectively. Losses in excess of the minority interest equity are charged against the Company. Investments in entities owned 20% or more but less than majority owned and not otherwise controlled by the Company are accounted for under the equity method.

The consolidated financial statements are presented in accordance with the accounting principles generally accepted in the United States.

Revenue Recognition. The Company derives substantially all of its revenues from the sale of advertisements on short-term contracts. The Company's standard rates for advertising currently range from \$0.02 to \$0.06 per impression. To date, the duration of the Company's advertising commitments has ranged from one week to one year. Advertising revenues are recognized ratably over the period in which the advertisement is displayed, provided that no significant Company obligations remain and collection of the resulting receivable is probable. Company obligations typically include guarantees of minimum number of "impressions," or times that an advertisement appears in page views downloaded by users of Yahoo!. To the extent minimum guaranteed impressions are not met, the Company defers recognition of the corresponding revenues until guaranteed impression levels are achieved. Deferred revenue is comprised of billings in excess of recognized revenue relating to advertising contracts. During 1996, SOFTBANK, a 36% shareholder of the Company, and its related companies accounted for approximately 12% of net revenues. During the period from March 5, 1995 (Inception) to December 31, 1995, another company accounted for approximately 11% of net revenues. International revenues were not material in any period presented. License and royalty revenues are recognized as amounts are earned under the terms of applicable agreements, provided no significant Company obligations exist and collection of the resulting receivable is probable.

Revenues from barter transactions are recognized during the period in which the advertisements are displayed in Yahoo!. Barter transactions are recorded at the lower of estimated fair value of the goods or services received or the estimated fair value of the advertisements given. To date, barter transactions have been insignificant.

Product Development. Costs incurred in the classification and organization of listings within Yahoo! and the development of new products and enhancements to existing products are charged to expense as incurred.

Statement of Financial Accounting Standards No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed," requires capitalization of certain software development costs subsequent to the establishment of technological feasibility. Based upon the Company's product development process, technological feasibility is established upon completion of a working model. Costs incurred by the Company between completion of the working model and the point at which the product is ready for general release have been insignificant.

Advertising Costs. Advertising costs are recorded as expense the first time an advertisement appears. Advertising expense totaled \$3,801,000 for 1996 and \$126,000 for the period from March 5, 1995 (Inception) through December 31, 1995.

Cash, Cash Equivalents, Short and Long-Term Investments. The Company invests certain of its excess cash in debt instruments of the U.S. Government, its agencies, and high-quality corporate issuers. All highly liquid instruments with an original maturity of three months or less are considered cash equivalents; those with original maturities greater than three months and current maturities less than twelve months from the balance sheet date are considered short-term investments, and those with maturities greater than twelve months from the balance sheet date are considered long-term investments.

At December 31, 1996, short-and long-term investments were classified as available-for-sale and consisted of 64% corporate debt securities, 26% debt securities of the U.S. Government and its agencies, and 10% foreign debt securities. All long-term investments are due within five years. At December 31, 1996, the fair value of the investments approximated cost. Fair value is determined based upon the quoted market prices of the securities as of the balance sheet date. At December 31, 1995, the Company did not hold any short or long-term investments.

Concentration of Credit Risk. Financial instruments that potentially subject the Company to significant concentration of credit risk consist primarily of cash, cash equivalents, short and long-term investments, and accounts receivable. Substantially all of the Company's cash, cash equivalents, short and long-term investments are managed by two financial institutions. Accounts receivable are typically unsecured and are derived from revenues earned from customers primarily located in the United States. The Company performs ongoing credit evaluations of its customers and maintains reserves for potential credit losses; historically, such losses have been immaterial and within management's expectations. At December 31, 1996, no one customer accounted for 10% or more of the accounts receivable balance. At December 31, 1995, two customers accounted for a total of 21% of the accounts receivable balance.

Property and Equipment. Property and equipment, including leasehold improvements, are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally two to five years.

Income Taxes. Income taxes are computed using the asset and liability method. Under the asset and liability method, deferred income tax assets and liabilities are determined based on the differences between the financial reporting and tax bases of assets and liabilities and are measured using the currently enacted tax rates and laws.

Foreign Currency. The functional currency of the Company's subsidiaries in the United Kingdom, Germany, and France is the local currency. The financial statements of these subsidiaries are translated to United States dollars using year-end rates of exchange for assets and liabilities, and average rates for the year for revenues, costs, and expenses. Translation gains and losses, which were insignificant at December 31, 1996, are deferred and accumulated as a component of shareholders' equity. Net gains and losses resulting from foreign exchange transactions are included in the consolidated statements of operations and were not significant during the periods presented.

Net Loss per Share. Net loss per share is computed using the weighted average number of common and common equivalent shares outstanding during the period. Common equivalent shares consist of the incremental common shares issuable upon conversion of the convertible preferred stock (using the if-converted method) and shares issuable upon the exercise of stock options and warrants (using the treasury stock method or the modified treasury stock method, whichever applies). Common equivalent shares are excluded from the computation if their effect is antidilutive, except that, pursuant to the Securities and Exchange Commission Staff Accounting Bulletin, the convertible preferred stock (using the if-converted method) and common equivalent shares (using the treasury stock method and the assumed public offering price) issued subsequent to March 5, 1995 through April 11, 1996 have been included in the computation as if they were outstanding for all periods presented.

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

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

Benefit Plan. The Company maintains a 401(k) Profit Sharing Plan (the "401(k) Plan") for its full time employees. Each participant in the 401(k) Plan may elect to contribute from 1% to 17% of his or her annual compensation to the 401(k) Plan. The Company matches employee contributions at a rate of 25%. Employee contributions are fully vested, whereas vesting in matching Company contributions occurs at a rate of 33.3% per year of employment. All contributions to the 401(k) Plan are invested at the employee's discretion in eight separate funds. During 1996, the Company's contribution amounted to \$81,000, all of which was expensed.

Note 2. Balance Sheet Components

	December 31,	
	1996	1995
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Property and equipment:		
Computers and equipment	\$1,520,000	\$239,000
Furniture and fixtures	861,000	2,000
Leasehold improvements	<u>290,000</u>	<u>3,000</u>
	2,671,000	244,000
Less: accumulated depreciation	<u>(448,000)</u>	<u>(58,000)</u>
	\$2,223,000	\$186,000
Accrued expenses and other current liabilities:		
Accrued vacation, wages, and other employee benefits	\$894,000	\$110,000
Accrued professional service expenses	706,000	48,000
Accrued contract costs	554,000	—
Other	<u>2,213,000</u>	<u>362,000</u>
	\$4,367,000	\$520,000
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Note 3. Related Party Transactions

During July 1995, the Company entered into an agreement with a holder of approximately 2% of the Company's Common Stock at December 31, 1996 whereby the shareholder granted the Company a license for trademarks and intellectual property rights for inclusion in Yahoo!. The Company agreed to share with the shareholder certain advertising revenue earned from Yahoo! pages where the shareholder's data appears. The amount of advertising revenue allocated to the shareholder varies based upon the location of pages within Yahoo! and the level of customer usage of the supplied data. During 1996, the Company paid approximately \$375,000 to the shareholder under this agreement and the amount due to the shareholder at December 31, 1996 was \$186,000. During the period from March 5, 1995 (Inception) through December 31, 1995, no amount was paid to the shareholder under the agreement and the amount due to the shareholder at December 31, 1995 was \$35,000. The shareholder also pays certain fees for the maintenance of Yahoo! pages where its data appears. During 1996 and the period from March 5, 1995 (Inception) through December 31, 1995, the Company recognized \$20,000 and \$30,000, respectively, of maintenance revenue relating to the agreement.

During 1996, the Company recognized net revenues of approximately \$2,075,000 on advertising contracts placed by SOFTBANK and its related companies, a 36% shareholder of the Company at December 31, 1996. Contracted prices on these orders are comparable to those given to other major customers of the Company. During 1996, the Company also recognized publication revenues from a subsidiary of SOFTBANK of approximately \$200,000 and development and licensing revenues of approximately \$85,000. Additionally, a sales representative firm which is a subsidiary of SOFTBANK has provided services to the Company totaling approximately \$2,300,000 and \$177,000 during 1996 and 1995, respectively. The amount due to the firm for services rendered totaled \$896,000 at December 31, 1996 and \$99,000 at December 31, 1995. Additionally, the Company entered into two separate joint venture agreements with SOFTBANK during 1996 (see Note 4 below).

Note 4. Joint Ventures

Yahoo! Japan. During April 1996, the Company signed a joint venture agreement with SOFTBANK, a 36% shareholder of the Company at December 31, 1996, whereby Yahoo! Japan Corporation was formed to establish and manage in Japan a Japanese version of the Yahoo! Internet Guide, develop related Japanese on-line navigational services, and conduct other related business. The Company's ownership interest in the joint venture is 40% and is being accounted for using the equity method. At December 31, 1996, the Company's investment in the joint venture was \$729,000, which was also the Company's initial investment. There is no commitment on either company's behalf to invest additional cash in the joint venture.

Yahoo! Marketplace. On August 26, 1996, the Company entered into agreements with Visa International Service Association (VISA) and another party to establish a new company, Yahoo! Marketplace, to develop and operate a navigational service focused on information and resources for the purchase of consumer products and services over the Internet. The parties have agreed to invest a total of up to \$3,000,000 in proportion to their respective equity interests, and as of December 31, 1996, had invested \$1,000,000. The Company currently owns approximately 55% of the equity interest in Yahoo! Marketplace, and therefore, has consolidated the financial results. Additionally, the Company holds two options to acquire a further 9% interest in Yahoo! Marketplace for \$3,600,000 and \$7,000,000 which expire in August 1997 and August 1998, respectively. During 1996, Yahoo! Marketplace incurred losses from operations of \$637,000. At December 31, 1996, \$163,000 of the minority interest on the balance sheet represents VISA's interest in the net assets of Yahoo! Marketplace. In connection with this agreement, the Company has issued to VISA for a purchase price of \$50,000 a warrant to purchase 350,000 shares of the Company's Common Stock at an exercise price of \$12.50 per share, which warrant is exercisable during a two year period commencing in March 1997.

Yahoo! Europe. On November 1, 1996, the Company signed a joint venture agreement with a subsidiary of SOFTBANK, a 36% shareholder of the Company at December 31, 1996, whereby separate companies were formed in Germany, the United Kingdom, and France to establish and manage versions of the Yahoo! Internet Guide for Germany, the United Kingdom, and France, develop related on-line navigational services, and conduct other related business. The parties have agreed to invest a total of up to \$4,000,000 in proportion to their respective equity interests, and as of December 31, 1996, had invested \$2,000,000. The Company has a majority share of approximately 70% in each of the Yahoo! Europe entities, and therefore, has consolidated the financial results. During 1996, Yahoo! Europe incurred losses from operations of \$842,000. At December 31, 1996, \$347,000 of the minority interest on the balance sheet represents SOFTBANK's interest in the net assets of Yahoo! Europe.

Note 5. Shareholders' Equity

Stock Split. On March 6, 1996, the Board of Directors authorized a 2-for-1 stock split (the "Stock Split") of the Company's Preferred Stock and Common Stock. All references to the number of shares of Preferred Stock, Common Stock, and per share amounts have been retroactively restated in the accompanying financial statements to reflect the effect of the Stock Split.

Common Stock. On April 11, 1996, the Company completed its initial public offering of 2,990,000 shares of its Common Stock. Net proceeds to the Company aggregated approximately \$35,043,000. As of the closing date of the offering, all of the Convertible Preferred Stock and Mandatorily Redeemable Convertible Preferred Stock outstanding was converted into an aggregate of 12,850,072 shares of Common Stock. The Company has the right to repurchase, at the original issue price, a declining percentage of certain of the common shares issued to employees under written agreements with such employees. The Company's right to repurchase such stock declines on a percentage basis over four years based on the length of the employees' continual employment with the Company. At December 31, 1996, 3,055,555 shares of common stock were subject to repurchase by the Company.

Preferred Stock. At December 31, 1996, the Company has authorized 10,000,000 shares of undesignated preferred stock. At December 31, 1995, the Company had authorized 7,750,072 shares of preferred stock, of which 5,212,000 shares had been designated Series A Convertible Preferred Stock ("Series A") and 2,538,072 shares had been designated Series B Convertible Preferred Stock ("Series B"). At December 31, 1995, 5,200,000 of Series A and 2,538,072 of Series B were issued and outstanding. Holders of Series A and B were entitled to receive noncumulative, preferential dividends of \$0.025 and \$0.24625, respectively, per annum, when and if declared by the Board of Directors. No such dividends were declared. In the event of liquidation or sale of the Company, Series A and B shareholders were entitled to a per share distribution in preference to common shareholders equal to the original issue price per share of \$0.20 and \$1.97, respectively, plus any declared but unpaid dividends. During March 1996, the Company entered into an agreement to sell 5,100,000 shares of Mandatorily Redeemable Convertible Series C Preferred Stock ("Series C") at a price of \$12.50 per share for aggregate proceeds of \$63,750,000. The holder of Series C was entitled to receive cumulative, preferential dividends of \$0.625 per annum, payable on March 31 of each year, commencing March 31, 1997. The holder of Series C was also entitled to receive dividends on Common Stock, when and if declared by the Board of Directors, based on the number of shares of Common Stock held by the holder of Series C, assuming conversion of all Series C into Common Stock. No such dividends on Common Stock have been declared. In the event of liquidation or sale of the Company, the Series C shareholder was entitled to a per share distribution in preference to common shareholders equal to the original issue price of \$12.50 per share plus any accrued and unpaid dividends. On April 11, 1996, the Company completed its initial public offering of its Common Stock. At that time, all issued and outstanding shares of the Company's Convertible Preferred Stock and Mandatorily Redeemable Convertible Preferred Stock were converted into an aggregate of 12,850,072 shares of Common Stock.

Stock Option Plan. In May 1995, the Board of Directors adopted the 1995 Stock Plan (the "Plan") which originally provided for the grant of up to 5,000,000 incentive stock options, non-qualified stock options, and stock purchase rights. On March 6, 1996, the Board of Directors approved an increase in the number of authorized shares in the Plan to 8,000,000. Under the Plan, incentive stock options may be granted to employees, officers, and directors of the Company and non-qualified stock options and stock purchase rights may be granted to consultants, employees, directors, and officers of the Company. Options granted under the Plan are for periods not to exceed ten years, and must be issued at prices not less than 100% and 85%, for incentive and nonqualified stock options, respectively, of the fair market value of the stock on the date of grant as determined by the Board of Directors. Options granted to shareholders who own greater than 10% of the outstanding stock are for periods not to exceed five years and must be issued at prices not less than 110% of the fair market value of the stock on the date of grant as determined by the Board of Directors. Options granted under the Plan generally vest 25% after the first year and ratably each month over the remaining thirty-six month period. Options to purchase 541,831 and 67,500 shares were exercisable at December 31, 1996 and 1995, respectively.

A summary of the Plan's activity is as follows:

	Available For Grant	Options Outstanding	Price Per Share
Shares reserved	5,000,000	—	—
Options granted	(3,454,910)	3,454,910	\$0.02 - \$ 0.20
Options exercised	—	(189,400)	<u>\$ 0.02</u>
Balance at December 31, 1995	1,545,090	3,265,510	\$0.02 - \$ 0.20
Additional shares reserved	3,000,000	—	—
Options granted	(3,716,343)	3,716,343	\$0.20 - \$20.875
Options canceled	281,000	(281,000)	\$0.02 - \$ 18.50
Options exercised	—	(496,377)	<u>\$ 0.02</u>
Balance at December 31, 1996	1,109,747	6,204,476	\$0.02 - \$20.875

During the period from January 1996 through April 1996, the Company granted options to purchase an aggregate of 2,300,468 shares of Common Stock at exercise prices ranging from \$0.20 to \$10.00 per share. Based in part on an independent appraisal obtained by the Company's Board of Directors, \$625,000 of compensation expense relating to certain options is to be recognized over the four-year vesting periods of the options, of which, \$156,000 was recognized in 1996. During the period from March 5, 1995 (Inception) through December 31, 1995, the Company granted options to purchase 294,400 shares of Common Stock to consultants in exchange for services at an exercise price of \$0.02 per share. The Company recorded expense totaling \$75,000 during the period from March 5, 1995 (Inception) through December 31, 1995 based on the estimated fair value of the services received.

Directors' Stock Option Plan. Effective March 6, 1996, the Board of Directors adopted the 1996 Directors' Stock Option Plan (the "Directors' Plan"). The Directors' Plan provides for the issuance of up to 200,000 nonstatutory stock options to nonemployee directors of the Company. Each person who becomes a nonemployee director of the Company after the date of the Company's initial public offering will automatically be granted a nonstatutory option (the "First Option") to purchase 40,000 shares of Common Stock upon the date on which such person first becomes a director. Thereafter, each director of the Company will be granted an annual option (the "Annual Option") to purchase 5,000 shares of Common Stock. Options under the Directors' Plan will be granted at the fair value of the stock and will vest in equal monthly installments over four years, in the case of the First Option, or at the end of four years in the case of the Annual Option. At December 31, 1996, there had been no option grants under the Directors' Plan.

Employee Stock Purchase Plan. Effective March 6, 1996, the Company's Board of Directors adopted the Employee Stock Purchase Plan (the "Purchase Plan"), which provides for the issuance of a maximum of 300,000 shares of Common Stock. Eligible employees can have up to 15% of their earnings withheld, up to certain maximums, to be used to purchase shares of the Company's Common Stock on every January 1st and July 1st. The price of the Common Stock purchased under the Purchase Plan will be equal to 85% of the lower of the fair market value of the Common Stock on the commencement date of each six month offering period or the specified purchase date. There were no shares issued under the Purchase Plan during 1996.

Stock Compensation. The Company accounts for its employee stock option plans in accordance with the provisions of Accounting Principles Board Opinion No. 25. In October 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 (FAS 123), "Accounting for Stock-Based Compensation" which established a fair value based method of accounting for employee stock option plans. The Company has elected to adopt the disclosure method of FAS 123. Had compensation cost for the Company's option plans been determined based on the fair value at the grant dates, as prescribed in FAS 123, the Company's net loss and pro forma net loss per share would have been as follows:

	1996	1995
Net loss:		
As reported	<u>\$(2,334,000)</u>	<u>\$(634,000)</u>
Pro forma	<u>\$(3,158,000)</u>	<u>\$(636,000)</u>
Net loss per share:		
As reported	<u>\$(0.09)</u>	<u>\$(0.03)</u>
Pro forma	<u>\$(0.12)</u>	<u>\$(0.03)</u>

Prior to the Company's initial public offering, the fair value of each option grant was determined on the date of grant using the minimum value method. Subsequent to the offering, the fair value was determined using the Black-Scholes model. Except for the volatility assumption which was only used under the Black-Scholes model, the following range of assumptions was used to perform the calculations:

	1996	1995
Expected life	30 months	30 months
Interest rate	5.1%- 6.5%	5.3%- 6.0%
Volatility	53%	not applicable
Dividend yield	0%	0%

Because additional stock options are expected to be granted each year, the above pro forma disclosures are not representative of pro forma effects on reported financial results for future years.

Note 6. Income Taxes

No provision for federal and state income taxes has been recorded as the Company has incurred net operating losses through December 31, 1996. The following table sets forth the primary components of deferred tax assets:

	December 31,	
	1996	1995
Net operating loss and credit carryforwards	\$2,651,000	\$94,000
Nondeductible reserves and expenses	1,382,000	134,000
Other	<u>86,000</u>	<u>—</u>
Gross deferred tax assets	4,119,000	228,000
Valuation allowance	<u>(4,119,000)</u>	<u>(228,000)</u>
	\$—	\$—

At December 31, 1996 and December 31, 1995, the Company fully reserved its deferred tax assets. The Company believes sufficient uncertainty exists regarding the realizability of the deferred tax assets such that a valuation allowance is required.

Deferred tax assets and related valuation allowances of approximately \$2,400,000 relate to certain U.S. operating loss carryforwards resulting from the exercise of employee stock options, the tax benefit of which, when recognized, will be accounted for as a credit to additional paid-in capital rather than a reduction of the income tax provision.

Additionally, deferred tax assets of \$236,000 relate to operating loss carryforwards in various foreign jurisdictions. Certain of these carryforwards will expire if not utilized.

At December 31, 1996, the Company had approximately \$5,900,000 of federal net operating loss carryforwards for tax reporting purposes available to offset future taxable income; such carryforwards expire in 2010. Additionally, the Company has approximately \$6,400,000 of California net operating loss carryforwards for tax reporting purposes which will expire beginning in 2003.

Under the Tax Reform Act of 1986, the amounts of and benefits from net operating losses carried forward may be impaired or limited in certain circumstances. Events which may cause limitations in the amount of net operating losses that the Company may utilize in any one year include, but are not limited to, a cumulative ownership change of more than 50% over a three year period. At December 31, 1996, the effect of such limitation, if imposed, is not expected to be material.

Note 7. Commitments and Contingencies

The Company leases its facilities under noncancelable operating lease agreements which expire in June 1998 and January 1999. Future minimum lease payments under noncancelable operating leases with initial terms of one year are \$527,000 in 1997, \$482,000 in 1998, and \$36,000 in 1999 aggregating \$1,045,000. Rent expense under operating leases totaled \$350,000 during 1996 and \$20,000 for the period from March 5, 1995 (Inception) through December 31, 1995.

On March 15, 1996, the Company entered into an agreement with Netscape whereby the Company was designated as one of five "Premier Providers." Under the terms of the agreement, the Company is required to make payments of up to \$5,000,000 over the course of the agreement's one year term, which began in mid-April 1996. During 1996, \$3,500,000 had been paid and recognized as expense under the agreement. The remaining \$1,500,000 was paid during January 1997.

From time to time the Company is subject to legal proceedings and claims in the ordinary course of business, including claims of alleged infringement of trademarks and other intellectual property rights. The Company is not currently aware of any legal proceedings or claims that the Company believes will have, individually or in the aggregate, a material adverse effect on the Company's financial position or results of operations.

Report of Independent Accountants

To the Board of Directors and Shareholders of Yahoo! Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of shareholders' equity and of cash flows present fairly, in all material respects, the financial position of Yahoo! Inc. and its subsidiaries at December 31, 1996 and 1995, and the results of their operations and their cash flows for the year ended December 31, 1996 and the period from March 5, 1995 (Inception) through December 31, 1995, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for the opinion expressed above.

Price Waterhouse LLP

San Jose, California
January 14, 1997